

LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

31 August 2020



Dear Lakehouse Investor,

August was a very busy month for the Fund. An eventful reporting season was in full swing and our team held 45 virtual meetings with current and potential portfolio companies during the month. We were pleased with how our portfolio companies have collectively navigated this crisis and expect they will come out stronger on the other side.

The Fund returned 9.3% net of fees and expenses during the month compared to a 7.2% return for the benchmark. Over the past 12 months the Fund has returned 18.6% compared to 2.1% for its benchmark. And, since inception in mid-November 2016, the Fund has produced a net total return of 136.7% compared to 36.8% for the benchmark. In annualised terms, the Fund has returned 25.5% per year since inception compared to 8.6% per year for the benchmark.

	1 Month	3 Month	1 Year	3 Year (p.a.)	Inception (p.a.)
Lakehouse Small Companies Fund	9.3%	12.8%	18.6%	29.0%	25.5%
Benchmark	7.2%	6.6%	2.1%	8.0%	8.6%
Excess Return	2.1%	6.2%	16.5%	21.0%	16.9%

We continue to take a balanced view of the economic backdrop and market opportunity set. The human and economic costs of COVID-19 are real, however, so is the structural pull-forward in adoption of business models we've embraced including ecommerce, digital payments, cloud computing, among others. It makes perfect sense that such companies, many of which have grown at impressive rates, despite shocking contractions in broader economic activity, would be re-rated higher given the acceleration in growth and de-risking of the odds that these companies successfully scale.

We won't pretend to know where markets will head over the short-term, as usual, and remain resolutely focused on long-term outperformance. In the meantime, we take comfort owning a portfolio of cashed-up companies with strong competitive positions and tailwinds that we expect will continue to gain market share regardless of whether the economic recovery is shaped like a V, W, or &.

The Fund's largest sector allocations are to information technology (60.7% of total capital), financials (16.0%), and health care (12.4%) while the benchmark's largest allocations are to materials (20.5%), consumer discretionary (16.4%), and real estate (12.7%). Our differentiated style should look familiar and our general preference to shy away from cyclical, capital-heavy sectors and companies has also rewarded the Fund very well in calendar 2020.

Company News

Turning to specific companies, the Fund's most significant contributor to performance during the month was **Nearmap** (+35.1%), and the biggest detractor was **Bravura Solutions** (-12.2%). We will comment further on both shortly. The Fund's five largest holdings as of the end of the month accounted for 40.2% of the portfolio and are named in order of the Fund's allocation: Nearmap, **Netwealth**, **EML Payments**, **Pro Medicus**, and **Xero**. All of our top five holdings reported during the month, save for Xero, and we will address each in turn.

Fund Metrics	
Companies Held	20
Cash Allocation	10.9%
Top 5 Portfolio Holdings	40.2%
Net Asset Value per Unit (mid)	\$1.9677
Fund Net Asset Value	\$310.8 million
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

Nearmap full-year results struck us as thesis affirming. Churn rates and growth in annualised contract value (ACV) both improved in the second half despite the pandemic, 43% of annualised contract value is now via multi-year deals compared to 35% in 2018, and the business left June with \$34 million in cash and having reached run-rate cash flow breakeven.

We are pleased to see the company continuing to invest into the product -- through the likes of 3D, AI, roof geometry and new camera technology -- to expand the use cases and penetrate deeper into customer workflows. Simultaneously, we're optimistic about the company's large and growing addressable market, including potential for further geographic expansion in the near-term as the North American business tips toward profitability.

We discussed Netwealth in some detail [last month](#) following a pleasing business update and the full year results did not change our long-term thesis. Netwealth has a market share of less than 4% today but is gaining more in net dollar flows than any other platform in the market. Incredibly, the company's net flows of \$9.1 billion through the 12 months ended in March exceeded the total combined net flows of the second, third, and fourth fastest-growing competing platforms. All that's to say that the business has a long runway for growth ahead with increasing optionality.

EML Payments reported a good set of numbers considering the weakness in malls due to lockdown restrictions. In a tough year, EML, inclusive of the recent PFS acquisition, was able to increase gross dollar volume (GDV) and revenue by 54% and 25%, respectively. We believe that the demand for

EML's programs will only grow as digital transformation continues to be top of mind for merchants. We continue to see strength in the reloadable business especially in the salary packaging, fintech, banking-as-a-service and government verticals.

EML also shared an update on the company's strategy. We're excited to see the company improve on its backend infrastructure, transition into a more rail-agnostic platform that will widen its ability to partner across payment networks, push hard for more functionality, and leverage their strong balance sheet to accelerate growth. We're also pleased to see improvements in gross debit volume (GDV) trends from the April lows and the positive growth in July GDV run rates. Though there's still a wide range of outcomes while COVID-19 drags on, particularly on the malls side of the business, we take comfort in knowing that EML has around \$120m of cash in the bank, sticky and loyal customers, and a management team that has been able to execute throughout tough periods.

Pro Medicus was heavily impacted by COVID-19 as many elective and non-urgent radiology examinations throughout the U.S. were deferred from March onwards. In spite of this, full-year underlying revenue and pre-tax profit increased by 24% and 33%, respectively. Earnings margins also continued to widen, with further upside driven by volumes growing above contracted minimums with no incremental spend required. It was also pleasing to see a fully remote installation for Ohio State University was successfully completed which speaks to the capability of the Pro Medicus team and their technology, and gives us confidence that the implementation pipeline won't be derailed in the event of further lockdowns. Zooming out, the company's Visage product continues to lead the market in terms of speed, functionality and scalability, and the optionality and reinvestment runway around the platform continues to grow.

Finally onto Bravura, who delivered an underwhelming result with top-line growth of 6% and operating profit growth of 15% for the year. While recurring revenue increased slightly to 77% of total revenue, and profit margins widened, the market was disappointed that over 80% of the revenue growth came from acquisitions. Add to that management's outlook that full-year earnings possibly may be similar to fiscal 2020 and one can understand why the shares sold off.

For our part, we understand that few companies may be looking to make expensive wholesale changes to their enterprise workflow systems during a time of such uncertainty, but we take on face value that Bravura's pipeline has been delayed rather than cancelled. System upgrades cannot be put off forever and we remain comfortable with the longer term opportunity for legacy systems to move to more modern platforms like Sonata, for services to move to the cloud and demand for continuous deployment via microservices like FinoComp. With a modern tech platform and fortress balance sheet with over \$100m in net cash, Bravura remains well placed over the longer term

Looking Ahead

We continue to have a long list of meetings through September and look forward to learning more from the management teams of our portfolio holdings, prospective companies, and their plans for the future.

Thanks again to all our investors for your time and trust. We appreciate it a great deal and hope you and yours are well during this challenging time.

Best Regards,
Lakehouse Capital

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