LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

31 October 2020

Dear Lakehouse Investor,

October was an eventful month for equity markets with volatility picking up as US political drama escalated and COVID-19 cases accelerated again across much of the Northern Hemisphere. For our part, we remained focused on executing on our investment process and turning over rocks. Indeed, our team held 29 virtual meetings with current and potential portfolio companies in October, bringing the total since inception just under four years ago to more than 600 meetings.

We were more active than usual in buying and selling as we exited two positions entirely, both of which we'll discuss later and one of which was sold subsequent to month-end, and opened a new position in a company we've been following for 18 months. As the Fund hasn't set its stake in the new holding, we'll hold off on discussing it at this time.

The Fund returned 5.2% net of fees and expenses during the month compared to a 0.5% return for the benchmark. Over the past 12 months the Fund has returned +20.5% compared to -2.4% for its benchmark. And, since inception in mid-November 2016, the Fund has produced a net total return of 139.9% compared to 33.5% for the benchmark. In annualised terms, the Fund has returned 24.7% per year since inception compared to 7.6% per year for the benchmark.

	1 Month	3 Month	1 Year	3 Year (p.a.)	Inception (p.a.)
Lakehouse Small Companies Fund	5.2%	10.8%	20.5%	23.4%	24.7%
Benchmark	0.5%	4.7%	-2.4%	4.6%	7.6%
Excess Return	4.7%	6.1%	22.9%	18.8%	17.1%

COVID-19 continues to stir up volatility and inflict real human and economic costs across the globe. We remain focused on the long-term, though, and on businesses that can continue to shine in spite of the disruption. Particularly, the portfolio has benefitted from and still backs opportunities where there is a structural pull-forward in adoption including the likes of ecommerce, digital payments and cloud software and computing. 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.

The Fund's largest sector allocations are to information technology (57.9% of total capital), health care (13.0%), and financials (12.8%) while the benchmark's largest allocations are to materials (21.3%), consumer discretionary (17.1%), and real estate (13.0%). 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 **Netwealth** (+13.8%), and the biggest detractor was **Catapult** (-20.1%). We will comment further on both shortly. The Fund's five largest holdings as of the end of the month accounted for 38.7% of the portfolio and are named in order of the Fund's allocation: **Netwealth**, **Pro Medicus, Nearmap, EML Payments**, and **Xero**.

Fund Metrics	
Companies Held	21
Cash Allocation	14.3%
Top 5 Portfolio Holdings	38.7%
Net Asset Value per Unit (mid)	$1.9944
Fund Net Asset Value	$321.6 million
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

The combination of quarter-end, and AGM season, saw us receive trading updates from most of our portfolio companies throughout October. For the sake of brevity, we'll focus on the material updates from some of the Fund's largest holdings.

Starting with Netwealth, which continues to gobble up market share. The business added an industry-leading $1.9 billion in net inflows to its platform in the September quarter -- a 26.7% increase in net flows on the previous year -- and equivalent to approximately a 0.23% market share gain. After taking account of investment gains, Netwealth's total funds under administration surpassed $34 billion -- a 34.4% gain from the same time last year -- which we estimate takes the business past 4% market share. We have discussed our investment thesis a number of times in recent months, and we remain comfortable continuing to invest alongside the deeply-aligned founder-led management team.

Pro Medicus announced a $10 million, 7-year contract with one of the largest university hospitals in Europe: LMU Klinikum, Munich. While this was welcome news hot on the heels of the $25 million, 7-year deal with NYU Langone Health in the U.S. in September, it was more notable for being the first big deployment of Visage 7 in Europe. We have long seen Pro Medicus making headway with tier 1 academic hospitals in the U.S., but large European hospitals have been difficult to penetrate as they typically standardise on IT platforms from large, multinational imaging equipment vendors. This significant milestone provides Pro Medicus with a strong reference client from which to grow in the European market.

EML provided a positive quarterly update, with gross dollar volume (GDV) and revenue both up 20% vs the previous quarter. Volume trends show a continued recovery, led by strong growth in general purpose reloadables (GPRs), specifically in Australian payroll, gaming payouts, banking-as-a-service and government programs. The company also shared its large and growing pipeline of deals, with 46 signed in the last two quarters and 331 more being worked on. When it comes to COVID-19 impacts on the business there's still a wide range of outcomes, as lockdowns potentially impact overall volumes during the important holiday period. Over the long term, though, and regardless of lockdowns, we expect EML to continue to retain loyal customers, sign new deals, and improve functionality through FinLab partnerships.

Catapult shares fell during the month on no news, however, the accelerated spread of COVID-19 throughout the northern hemisphere and potential for it to again cause sporting shutdowns, and slow sales, appears to have concerned investors. While there's legitimacy to these concerns we also note that it is in the financial interests of professional athletes, team owners, local governments, and media-rights holders for sports leagues to continue playing. We also think any impact is likely to be short-lived relative to our investment horizon, plus we take comfort from the fact that Catapult's fiscal 2020 churn remained low at 6.5% despite COVID-19 (only marginally above 6.3% in the prior year).

Also of note is that the Fund exited two positions. The first involves a rapid strategic pivot that we question, the second where a thesis has just not worked out and we're moving on.

The Fund exited its stake in **HUB24** following the announcement of a $90 million capital raise to fund the acquisition of 3 businesses. As a starting point, we are typically cautious of acquisitions for any company, unless the management team has a strong, proven capital allocation track record. Unfortunately, we don't yet have that confidence with HUB24 following the Paragem and Agility acquisitions. We are also concerned about the industry consolidation role HUB24 may seek to play going forward given the race to scale and management team incentives tilted toward growth in funds under administration. While there are many elements we like about the business, given our existing exposure to Netwealth, and the fact that the share price rallied on the news while our concerns were heightened, we decided to exit and watch from the sidelines.

The other position we exited was **Xref**, which was only mentioned for the first time in April of this year as the Fund's biggest detractor. Xref has been one of the smallest holdings over the life of the Fund on account of it being a lower-conviction position with a wide range of outcomes, and poor liquidity. The company's growth profile, customer retention, and attractive unit economics were all appealing from the point of our initial investment but growth subsequently flagged as did our confidence in the capital allocation skills of the company's leadership team. COVID ultimately compounded matters, leading the company to borrow money at painful rates and with dilutive warrants attached. The confluence of negatives was too much and we ultimately decided to move on.

Looking Ahead

The Small Companies Fund will celebrate its fourth birthday in mid-November. While it doesn't impact anything in our day to day process, it's a brief opportunity to reflect on what we have achieved and to again thank you, our loyal investors, for your time and trust, we appreciate it a great deal.

Best Regards,

Lakehouse Capital

P.S. We're very pleased to announce our inaugural 'Return to Work' internship designed for financial services professionals seeking to transition back into the workforce after putting their careers on hold to focus on family. The Lakehouse 'Return to Work' internship is a competitively remunerated, 4-month program to refresh investing skills, add to existing valuable experience, and build confidence to re-enter the workforce. More information on this Sydney-based role is available here.

For more information call us on +61 2 8188 1510, email investorsupport@lakehousecapital.com.au or visit www.lakehousecapital.com.au

---