LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

31 October 2021

Dear Lakehouse Investor,

Fund Metrics	
Companies Held	20
Cash Allocation	12.1%
Top 5 Portfolio Holdings	34.7%
Net Asset Value per Unit (mid)	$2.2537
Fund Net Asset Value	$436.7 million
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

October was another eventful month for financial markets as central banks laid out plans to reel in their COVID-19 market intervention, and expectations of an interest rate response to rising inflation continued to gather pace. For our part, we don't spend too much time forecasting the macro landscape -- it is littered with incorrect 'expert opinions'. Instead, we seek to observe what's happening, assess the potential range of outcomes, and position the portfolio to continue growing regardless of what macroeconomic cocktail is served to us.

The team met with 19 prospective and portfolio companies during the month, including some board members of two of our portfolio holdings to discuss their upcoming annual general meetings (AGM). Both were productive discussions which provided further insight into each board's approach to remuneration and the setting of incentives across the management team. The AGMs also saw some of our holdings provide trading updates, which we'll touch on shortly.

The Fund returned 0.3% net of fees and expenses during the month compared to a 0.9% return for the benchmark. Over the last 12 months, the Fund has returned 21.2% compared to 31.0% for its benchmark. And, since inception in mid-November 2016, the Fund has produced a net total return of 190.8% compared to 75.0% for the benchmark. In annualised terms, the Fund has returned 24.0% per year since inception compared to 11.9% per year for the benchmark.

Our concentrated, growth-focused investment strategy means at times the portfolio will zig while the market zags. Our focus remains on generating long-term outperformance and the consistent execution of our process. We are pleased with the progress made toward this goal.

The Fund's largest sector allocations are to information technology (45.2% of total capital), financials (14.8%) and consumer discretionary (9.2%) while the benchmark's largest allocations are to materials (21.7%), consumer discretionary (15.3%), and real estate (13.4%).

We embrace a bottom-up process that seeks out and emphasises businesses with extremely loyal customers, network effects, and unique and enduring intellectual property. Most of those businesses tend to end up in some specific sectors (e.g. IT) while are rarely found in others (e.g. materials), hence our continued differentiation.

	1 Month	3 Month	1 Year	3 Year (p.a.)	Inception (p.a.)
Lakehouse Small Companies Fund**	0.3%	3.6%	21.2%	25.4%	24.0%
Benchmark*	0.9%	3.7%	31.0%	13.5%	11.9%
Excess Return	-0.6%	-0.1%	-9.8%	11.9%	12.1%

*** Performance calculations are based on exit price with distributions reinvested, after fees and expenses, since inception in mid-November 2016. * Benchmark: S&P/ASX Small Ordinaries Accumulation Index. Past performance is not indicative of future returns.*

Company News

Turning to specific companies, the Fund's most significant contributor to performance during the month was **Netwealth** (+18.8%) as the market responded to upgraded full year guidance. The biggest detractor was **EML Payments** (-24.2%), which announced an update on its ongoing issues with its regulator in Ireland. More on that later.

The Fund's five largest holdings as of the end of the month accounted for 34.7% of the portfolio and are named in order of the Fund's allocation: Netwealth, **Tyro, Bapcor, Pinnacle Investment Management,** and EML Payments.

Netwealth provided a quarterly update in October, which included a 25% upgrade in full year guidance for Funds Under Administration (FUA). This is a particularly strong signal, only one quarter into the financial year, from a typically conservative founder-led management team. In terms of fundamental results for the September quarter, the business grew total FUA 52.7% versus last year off the back of a record $4 billion in quarterly inflows. There's little doubt the 9-day-outage experienced at larger platform rival, BT Panorama, helped accelerate churn in Netwealth's favour. Netwealth continues to organically attract the largest share of FUA flows across the industry.

The increasing expectations around rising interest rates creates an important point to revisit for Netwealth. Lakehouse investors will recall the March 2021 announcement that ANZ Bank will end its arrangement which saw Netwealth earn 0.95% above the overnight cash rate on its cash deposits. As a reminder:

> The market had a brutal response to the news, with the shares falling 15% on the day. We thought the reaction was overdone and took the opportunity to grow our position in a business that continues to gain market share. Ironically, this news happens with the backdrop of global interest rates having increased and Netwealth a net beneficiary of that trend.

We still see Netwealth as a beneficiary of this trend, and even though market rates are looking closer to 0.75% above the overnight cash rate, Netwealth's earnings still stand to lift by around 4% for each 0.25% increase in short-term interest rates.

Finally, although it occured after month end, it would be remiss of us not to mention Netwealth's $785 million bid for smaller rival platform, Praemium. The pace of consolidation across the industry has accelerated in the past year, led by former Fund holding HUB24, whose three acquisitions toward the end of last calendar year were followed up by the recent bid for another former holding, Class. In contrast, we view the Netwealth founding-family as being more patient long-term capital allocators, and prefer the tremendous alignment that their 55% ownership stake brings, versus the management incentives in place at HUB24. We suspect this recent bid is the start of a price discovery process for Praemium and there is more to be written in this story. In the meantime, our conviction behind the Netwealth thesis remains strong. We like the combination of a cashed-up, fast-growing, founder-led business that is gaining market share, has many levers it can pull across the business as it does so, and has upside tied to rising interest rates.

Turning to Bapcor, which provided a trading and strategy update at its AGM. First quarter revenue was flat versus last year, which is a good result given Bapcor's stores were under lockdown for twice as long versus the prior corresponding quarter. This demonstrates a level of resilience and potential growth upside to the business for the remaining three-quarters of the year. On the more strategic side, the company upgraded its five-year-target number of stores by 36.4% to 1500, and its target for their 'own-brand' offering from 30% of sales to closer to 45%. The Bapcor team, led by Darryl Abotomey, have executed very well to date. We take notice when an 'under-promise and over-deliver' team with their track record of capital allocation moves the bar higher.

Moving on to EML, which updated the market on its correspondence with the Central Bank of Ireland (CBI). The market was unhappy with the update, as it highlighted the uncertainty of when the issue would be resolved and that the regulator would likely limit the company's growth further than initially expected. The CBI issue will affect short term profitability, as compliance costs go up while the growth in new clients and programs for the PFS business is capped.

On a positive note, the ongoing remediation process signals that the worst case scenario of losing the license is off the table. Meanwhile, EML is in a good position to benefit from economies (and malls) reopening, and is another portfolio holding that benefits from a rising interest rate environment given the $2 billion of float on its balance sheet. Further, the company has other levers to grow the business, such as offering account-to-account payment functionality from its recently acquired business, Sentenial. We remain patient investors despite short term challenges.

Looking Ahead & We're Hiring

The Small Companies Fund will celebrate its fifth 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. We are very excited about the collection of companies we have assembled in the portfolio for the years ahead.

One final thing, Lakehouse is searching for another investment analyst to add to our team. If you, or someone you know, might be interested in joining the team please refer to the additional information here.

Thanks again to all our investors for your time and trust.

Best Regards,

Lakehouse Capital

For more information call us on +61 2 8294 9800, email investorsupport@lakehousecapital.com.au or visit www.lakehousecapital.com.au

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