LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

31 March 2022

LAKEHOUSE CAPITAL

Dear Lakehouse Investor,

The war in Ukraine continued to impact the global economic landscape throughout March, as did inflation and interest rate expectations, and to a lesser extent, COVID-19. There's certainly plenty of fodder for the worriers in the world, but history has shown equity markets' ability to 'climb the wall of worry' despite such significant, albeit temporary, events.

The full impact of the West's economic sanctions against Russia are still evolving, but the impact on higher near-term energy and commodity prices is spilling over to equity markets with these sectors among the best performing in recent months. The recent tick-up in commodity and energy prices does not impact our long-term view that those sectors – whilst economic building blocks – are typically capital-intensive, and price takers, with limited long-term structural advantages. It is not an area where we see ourselves having an investing edge.

For our part, Lakehouse embraces an investment process that focuses on businesses we believe possess superior economics that are likely to win out over the long-term. Specifically, our investing process 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. technology, healthcare, consumer products) while are rarely found in others (e.g. commodities), hence Lakehouse's continued focus in these areas despite recent events.

	1 Month	3 Month	1 Year	3 Year (p.a.)	5 Year (p.a)	Inception (p.a.)
Lakehouse Small Companies Fund	3.3%	-22.5%	-15.8%	8.8%	17.0%	15.3%
Benchmark	5.3%	-4.2%	9.7%	9.6%	9.9%	10.3%
Excess Return	-2.0%	-18.3%	-25.5%	-0.8%	7.1%	5.0%

*** 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.*

The Fund returned 3.3% net of fees and expenses during the month compared to a 5.3% return for the benchmark. Over the last 12 months, the Fund has returned -15.8% compared to 9.7% for its benchmark. Since inception in mid-November 2016, the Fund has produced a net total return of 115.2% compared to

69.4% for the benchmark. In annualised terms, the Fund has returned 15.3% per year since inception compared to 10.3% per year for the benchmark.

The Fund's largest sector allocations are to information technology (48.8% of total capital), financials (16.3%) and healthcare (11.1%) while the benchmark's largest allocations are to materials (25.2%), real estate (14.4%) and consumer discretionary (12.9%).

Company News

Fund Metrics	
Companies Held	21
Cash Allocation	4.5%
Top 5 Portfolio Holdings	37.9%
Net Asset Value per Unit (mid)	$1.6681
Fund Net Asset Value	$300.4 million
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

Turning to specific companies, the Fund's most significant contributor to performance during the month was EML Payments (+24.9%), which updated the market on some recent contract wins. The biggest detractor was Cettire (-48.4%), after the founder sold down a portion of his holding. We'll discuss both in more detail below.

The Fund's five largest holdings as of the end of the month accounted for 37.9% of the portfolio and are named in order of the Fund's allocation: Netwealth, EML Payments, Bapcor, Pinnacle Investment Management and Xero.

EML shares performed strongly in March, as the company announced two significant deals that the company signed in Europe. The two deals show progress in the company's core growth initiatives, namely open banking and reloadable card programs. The company communicated the potential opportunity of the deals but did not set any revenue expectations.

As we see it, winning such large programs represent an improvement in the relationship with the Central Bank of Ireland (CBI) and a positive sign that EML continues to win large clients despite its recent issues with its regulator. On that point, we don't expect the CBI will ever hang out a sign saying the regulatory process is complete, instead investors will be left to make their own assessments. It appears the market is beginning to appreciate the underlying fundamental growth of the business, which we remain enthused about, plus the profit potential from rising interest rates on EML's $2 billion in float.

Turning to Cettire: a relatively new, and previously undisclosed, portfolio holding. Cettire is a fast growing ecommerce portal focused on branded and luxury fashion. The business operates a capital light drop-shipping model, which means, unlike traditional retail businesses, the company does not hold inventory. In fact, the business operates a negative working capital balance where they are paid by their customers up to 60 days before having to pay their own suppliers. This efficient funding model allowed founder, Dean Mintz, to boot-strap the business from its founding in 2017 to $85 million in annualised monthly sales at IPO without any outside funding. This business model also allowed Dean to own 100% of the business up until he sold a third of it through the IPO in December 2020.

Cettire has continued to grow at an extraordinary rate since listing, delivering revenue growth of 181% over the 12 months to December 2021. To give a sense of Cettire's scale, in FY21 the company processed over 170,000 orders across 53 countries, with over 90% originating outside Australia.

The primary catalyst for the recent precipitous decline in the shares is in part due to Dean further reducing his stake from 66% to 57%, which the market took as a strong negative signal. For our part, we don't begrudge a founder reducing their exposure to their single largest asset. Indeed, an eventual sell down was a consideration in our investment thesis, it will diversify the shareholder base and add to liquidity over time.

The other contributing factor to the share price weakness was the escalating customer acquisition costs revealed in the half year results. Cettire spent $25.9 million on advertising and marketing, compared with just $3.9 million a year ago, affecting the company's profitability. This rightly is cause for concern, but needs to be balanced with the fact the company is pushing into new markets and spending ahead of attracting customers in those markets.

Increasing customer acquisition costs is something we have witnessed across the landscape over recent periods. We remain cautious on consumer-dependent businesses given consumers appear to be pulling back on spending given the elevated inflation and rising interest rate environment. Our caution is represented in portfolio sizing, with Cettire as the Fund's smallest position, as we also acknowledge the business is early in its life, and there is a wide range of outcomes. However, we are attracted to what the business has achieved in five short years, Dean's strong focus on optimising the business for long-term growth, and that it continues to grow at high-double-to-triple-digit rates.

During the month Nearmap announced it had reached $150 million in annualised contract value (ACV), which included signing their largest ever government contract. The company also reaffirmed that they expect FY22 ACV to come in toward the top end of guidance, pointing to growth of around 25% for the year. Despite this, over 5% of Nearmap's share register is sold short – there was some short covering on the day of the announcement with shares jumping 16% – as Nearmap continue their legal battle against US-rival EagleView. On that front, Nearmap recently filed a challenge to parts of the ongoing patent case. We see the case potentially dragging on for years, though we still haven't seen any impact on Nearmap's growth and do not see the outcome of the case having a significant impact on the company's revenue or $110 million cash pile.

Looking Ahead

April sees quarterly reporting flow through for some of our companies, plus the team will attend a number of broker conferences where we'll catch up with both current and prospective portfolio companies. We look forward to sharing more on both fronts in the next monthly letter.

As always, thank you to all our investors for your time and trust.

Best Regards,

Lakehouse Capital

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