LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

31 October 2022

Dear Lakehouse Investor,

Persistently high inflation continued to dominate market headlines throughout October and weigh on investors' minds. The wealth-eroding impact of inflation across the entire economy leaves central banks with little option but to continue raising interest rates until they have it beat. To that end, numerous central banks increased rates throughout the month and into early November, including the seventh consecutive raise by the RBA on Melbourne Cup Day.

It is a challenging investing environment, highlighted by returns from both bonds and equities being negative at the same time. For our part, we continue to take a balanced view of the current economic backdrop and remain focused on finding and backing businesses that we believe have the potential to weather economic challenges and prosper over the long-term. A number of portfolio companies provided trading updates throughout October and we will cover the key results shortly.

Fund Metrics	
Companies Held	21
Cash Allocation	4.5%
Top 5 Portfolio Holdings	41.6%
Net Asset Value per Unit (mid)	$1.2325
Fund Net Asset Value	$221.8 million
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

AGM season is upon us, which is when shareholders have the best opportunity to provide feedback to companies through board engagement, and most importantly, proxy voting. Alongside our usual workflow the team met with board representatives of three portfolio companies, and voted resolutions for six companies during the month. The team look forward to further board engagements throughout November, along with voting proxies for a further 11 portfolio holdings ahead of their AGMs.

On to performance, the Fund returned 7.0% net of fees and expenses during the month compared to 6.5% return for the benchmark. Over the last 12 months, the Fund has returned -39.2% compared to -18.3% for its benchmark. Since inception in mid-November 2016, the Fund has produced a net total return of 76.9% compared to 42.9% for the benchmark. In annualised terms, the Fund has returned 10.0% per year since inception compared to 6.2% per year for the benchmark.

	1 Month	3 Month	1 Year	3 Year (p.a.)	5 Year (p.a)	Inception (p.a.)
Lakehouse Small Companies Fund	7.0%	-1.3%	-39.2%	-3.9%	6.8%	10.0%
Benchmark	6.5%	-4.9%	-18.3%	1.5%	4.2%	6.2%
Excess Return	0.5%	3.6%	-20.9%	-5.4%	2.6%	3.8%

*** 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's largest sector allocations are to information technology (45.2% of total capital), financials (16.7%), and healthcare (15.1%) while the benchmark's largest allocations are to materials (22.7%), consumer discretionary (14.0%), and real estate (13.6%).

As we frequently remind investors, our investment process seeks out and emphasises *Investment Fascinations;* businesses with extremely loyal customers, network effects, and/or unique and enduring intellectual property. Most of those businesses tend to be more concentrated in specific sectors (e.g. technology, financials, healthcare) and rarely found in others (e.g. commodities).

Company News

Turning to specific companies, the Fund's most significant contributor to performance during the month was **Cettire** (+118.1%), following a pleasing quarterly update. The biggest detractor was **Whispir** (-38.5%), on a disappointing quarterly result. More on both companies shortly.

The Fund's five largest holdings as of the end of the month accounted for 41.6% of the portfolio and are named in order of the Fund's allocation: **Netwealth, Nearmap, Nanosonics, Altium**, and **Pinnacle Investment Management.**

Turning to the biggest contributor, Cettire. The stock has been deeply out of favour with investors due to its recent high cash burn as it spent up on sales and marketing. At the full year results, the management team committed to turning around the cash burn, and the recent results suggest they are on the right path. Sales revenue grew 70%, and delivered adjusted EBITDA of $5.5m, with positive quarterly cash flow and the net cash balance increasing toward $30 million. The first quarter of the fiscal year is not typically a strong sales period for the company, though we are pleased to see management deliver on their commitment ahead of the busy Christmas retail season. Cettire is one of the smaller, and riskier, positions in the portfolio as the investment thesis has a wide range of outcomes which we see skewed to the upside from recent prices.

The Fund's biggest detractor for the month, Whispir, fell following a very disappointing quarterly update which saw annualised recurring revenue (ARR) go backwards as state health departments pulled back on spending with COVID communications settling down. The company continues to invest in its product development efforts and has committed a significant amount of spend moving forward. Disappointingly, these investments have yet to materially contribute to the company's revenue, and it is likely Whispir comes back to the market for additional funding.

Netwealth provided a sluggish business update during the quarter. Funds Under Administration (FUA) stood at $58.1 billion at the end of September, up 4.4% in the three months since 30 June in the face of a $0.5 billion negative market movement. Over the last 12 months, FUA grew 11.8% despite the headwind of a $5.7 billion in negative market movement over the period. This level of growth appears lethargic against the 30%+ compound annual growth rate of the past 5 years, but needs to be considered in the context of broad declines in most asset classes.

The company points to a very strong pipeline and win rate for new business across all key market segments. FUA growth was outpaced by account growth of 15.8% over the year, which is broadly in keeping with the 16.1% compound annual growth rate of the past 5 years. Netwealth is launching its Multi Asset Product (MAPs) in the current quarter, along with integration of its mobile app with data provider Xeppo allowing a platform-agnostic whole of wealth view for clients, both of which have potential to broaden the platforms' appeal in the market over time. Netwealth remains Australia's fastest growing platform provider by net flows; accounting for 45% of industry net fund flows against only 6% market share. We see plenty of runway ahead and increasing optionality as the business continues to scale, with profits positively tied to rising interest rates.

Takeover target, Nearmap, released its scheme booklet during the month. We remain of the view that the current $2.10 takeover offer remains well below fair value for the company, and note it is below the midpoint valuation in the independent expert's report. In our opinion, too much focus has been put on the share price prior to the release of full year results to justify the deal. We are of the view that prior to accepting Thoma Bravo's bid price, and agreeing to break fees, the Nearmap board ought to have released the company's strong annual results to the market, especially the expectation that the company will reach cash flow breakeven by the end of the current financial year with a pro forma cash balance of $66 million to $71 million. There was no opportunity for this information to be reflected in the share price ahead of the board agreeing to break fees and recommending the $2.10 takeover price. It should come as no surprise that the Fund voted its shares AGAINST the proposed scheme as we believe material upside remains from the company remaining listed as it rapidly approaches profitability, even if a higher bid does not materialise.

Pinnacle Investment Management provided an update at their recent AGM. Total affiliate funds under management (FUM) were down -4% in the three months since 30 June, and -10.8% over the year, driven by falling equity markets. The business had $1.6 billion in domestic institutional outflows during the quarter which was partially offset by $400 million of combined inflows from retail and offshore investors. The nature of the inflows is particularly helpful given those clients are typically at healthier profit margins versus the domestic institutions, consequently the company pointed to a negligible impact on overall management fee revenue.

We caught up with representatives of the Nanosonics board during the month to discuss voting resolutions ahead of the AGM. A key focus of our conversation was their framework to assess return on investment for the company's increasing research and development (R&D) spend. We came away with a better understanding of the board's focus on delivering the CORIS platform in the year ahead after a very drawn out expectation-setting with the market. Launch of CORIS will be an important milestone for the business after years of R&D spend as it will move the business toward its ambition of being a genuine multi-product company. In the meantime, we expect the existing trophon platform to continue growing at a healthy clip and generating a satisfactory annuity-like income stream.

Looking Ahead

The past year in markets has certainly been challenging, though thankfully, it has flown by. As someone quipped during the month: the UK has had four chancellors in four months, its only two chancellors until Christmas.

The Fund will receive further trading updates in upcoming AGMs and we look forward to sharing any key takeaways. The next investor letter in early December will be our last for calendar 2022, and the letter for the month ending 31 December will be out toward the middle-to-later part of January due to the holiday period.

The investing environment remains challenging, though, periods like this often look like opportunity in hindsight. As always, thank you to our investors for your continued support and trust.

Best Regards,

Lakehouse Capital

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