LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

30 November 2022

LAKEHOUSECAPITAL

Dear Lakehouse Investor,

November was a busy and fruitful month for the Fund. We received trading updates from a number of portfolio holdings as part of their annual general meetings (AGMs). We will cover the key companies shortly. We also initiated a new position in a founder-led business that we've been following for some time. As is our usual practice, we won't disclose the company while we are still building out the Fund's stake.

On to performance, the Fund returned 4.1% net of fees and expenses during the month compared to 4.9% return for the benchmark. Over the last 12 months, the Fund has returned -34.4% compared to -14.0% for its benchmark. Since inception in mid-November 2016, the Fund has produced a net total return of 84.2% compared to 50.0% for the benchmark. In annualised terms, the Fund has returned 10.6% per year (after all fees and expenses) since inception compared to 6.9% per year for the benchmark.

Fund Metrics	
Companies Held	22
Cash Allocation	4.7%
Top 5 Portfolio Holdings	42.7%
Net Asset Value per Unit (mid)	$1.2835
Fund Net Asset Value	$230.6 million
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

	1 Month	3 Month	1 Year	3 Year (p.a.)	5 Year (p.a)	Inception (p.a.)
Lakehouse Small Companies Fund	4.1%	0.4%	-34.4%	-4.5%	7.0%	10.6%
Benchmark	4.9%	-0.8%	-14.0%	2.6%	4.4%	6.9%
Excess Return	-0.8%	1.2%	-20.4%	-7.1%	2.6%	3.7%

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

The Fund's largest sector allocations remain information technology (44.8% of total capital), financials (16.9%), and healthcare (16.1%) while the benchmark's largest allocations are to materials (24.6%), Consumer Discretionary (13.7%), and real estate (13.3%).

As we frequently remind investors, our investment process seeks out and emphasises Investment Fascinations; businesses built around 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). And in the webinar we provided commentary on how the team remain focused on investing in strong businesses in growing markets, with durable competitive advantages and pricing power, that are led by founders or well-aligned management teams, while possessing strong balance sheets.

Company News

Turning to specific companies, the Fund's most significant contributor to performance during the month was **Netwealth** (+13.1%) on no company specific news. The biggest detractor was **Xero** (-9.5%) on a disappointing half-year result. More on both shortly.

The Fund's five largest holdings as of the end of the month accounted for 42.7% of the portfolio and are named in order of the Fund's allocation: **Netwealth**, **Nearmap, Nanosonics, Altium,** and **Pinnacle Investment Management.**

Starting with the biggest contributor, **Netwealth**. Although the company held its AGM during the month, no trading update was provided as the company already provides substantial updates on a quarterly basis and there was no company specific news. We note that an analyst at one of the larger brokers initiated coverage with a 'buy' which may have drawn additional attention to the stock. As a recap, here's an excerpt from last month's letter that briefly cover ours thoughts:

> *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.*

The Fund's biggest detractor for the month was **Xero** following release of their half year results, which included the announcement of an upcoming CEO change. The company's results showed subscription growth of 16%, to 3.5 million, which was slightly below market expectations (by around 9,000 subscriptions) due to softer-than-expected sales in the United Kingdom. That said, price increases helped drive revenue 30% higher overall, or 27% in constant currency. Monthly churn was slightly higher at 0.91% (11.5% annualised) and remains an area of much focus given the weakening economic environment. If a deep recession were to grip key markets of Australia, New Zealand and/or the United Kingdom, we could see the natural level of SME failures tick up, negatively impacting Xero's growth.

The company also announced CEO Steve Vamos will be stepping down at the end of January 2022, and is being replaced by Sukhinder Singh Cassidy. While we are yet to meet with Sukhinder, our initial view is that she is a highly capable CEO with over 25 year's experience building and scaling global companies including Google, Amazon, Yodlee, Joyus and StubHub. She now has the opportunity to take Xero to the next level and continue to scale its world-class products globally.

Turning to Nearmap, which will leave the portfolio in December. The scheme of arrangement vote passed on 25 November with 78.5% in favour, narrowly ahead of the required 75% threshold for Thoma Bravo's $2.10 takeover to proceed. Lakehouse expressed its view in prior monthly letters, and the financial press, that the price undervalued the company's bright prospects. However, we are pragmatic, have accepted the vote and have started to put the Fund's cash balance to work ahead of receiving the full Nearmap proceeds on 15 December.

Moving on to Nanosonics, which provided a trading update for the first four months of FY23 at the AGM. Revenue was up 42% compared to the prior corresponding period, partly driven by a strong US dollar (revenue was 36% higher in constant currency), and secondly, due to improved pricing following the move to a direct sales model in North America. The market had its doubts about the move away from GE, though it is looking increasingly like it has unlocked closer customer relationships, which is affording more control over the Trophon upgrade cycle, and higher margins across the board. While management didn't take the opportunity to upgrade full year revenue guidance from the current 20%-25%, given the strength of the first four months and fact that the second half tends to be seasonally stronger, we see potential for an upgrade to full year guidance at the half year results in February.

And now to Altium, who's AGM trading update reaffirmed FY23 guidance for 15%-20% revenue growth and 12%-23% operating profit growth. The California-headquartered company is facing some headwinds for its European sales due to the high US dollar, however management have stated the challenge is entirely manageable. Notwithstanding, the first four months of FY23 were very much a continuation of trends the company saw in FY22, with higher average revenue per user (ARPU) subscriptions for its core design product due to more mainstream customers adopting higher-cost pro-level platform capabilities, as well as growing adoption of its Altium 365 cloud platform. We remain positive about the company's long-term prospects.

Tyro also provided a strong AGM trading update. For the first four months of the financial year, transaction value is up 52% to $14 billion, and gross profit up 57% to $61.9 million. Recently appointed CEO, Jon Davey, has positioned to deliver operating leverage through the cost reduction program, which includes a 10% reduction in headcount, targeting an $11 million in annualised savings with $5 million expected to be realised in the current financial year. Meanwhile takeover interest in the company remains afoot with Westpac looking like the current front-runner on the heels of earlier interest by a Potentia-led consortia. With rapidly improving business fundamentals and multiple indicative takeover approaches, Tyro has an interesting year ahead.

Looking Ahead

This will be our last investor letter published in 2022. The letter for the month ending 31 December will be out toward the middle of January. Beyond that, we're planning to hold another webinar in March, and the team is always around if investors have any questions.

The Lakehouse Small Companies Fund quietly celebrated its sixth birthday in mid-November. While it doesn't impact anything in our day-to-day process, we are pleased with the progress we've made toward long-term outperformance. We're also grateful that most of the Fund's original investors are still invested, which shows a genuine long-term commitment and degree of trust that we'll continue to do our best to honour.

We thank all our investors for their continued support and trust. We wish you and your loved ones an enjoyable and relaxing break over the holiday period.

Best Regards,

Lakehouse Capital

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