LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

31 March 2023

LAKEHOUSE CAPITAL

Dear Lakehouse Investor,

Fund Metrics	
Companies Held	21
Cash Allocation	6.3%
Top 5 Portfolio Holdings	40.7%
Net Asset Value per Unit (mid)	$1.2766
Fund Net Asset Value	$214.9 million
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

"There are decades where nothing happens; and there are weeks where decades happen" – Lenin

While we won't claim that decades happened, March 2023 can be marked in the financial annals as the point when things 'started to break' following the most rapid rise in interest rates in four decades.

We saw a run on US regional banks – including the collapse of Silicon Valley Bank and Signature Bank, the second- and third-largest bank failures in US history, respectively – leading to intervention by the US government to rescue depositors, and across the Atlantic, the forced wind-down of Credit Suisse. The impacts reverberated through the financial system, and likely has further to play out.

The banking system appears to be suffering a liquidity problem – in the face of excess liquidity in the system – due to an uneven distribution: regional banks are suffering deposit flight while larger banks experience net deposit inflows. In effect, the bigger banks are getting bigger and the smaller tail is slipping in the mud.

But in terms of what's changed in the investment landscape: bond markets have shifted across the 2-10 year yield curve – both domestically and in the US – 0.5% to 0.8% lower than February, central banks are mulling a pause to their raising cycle, including the RBA pausing in April after 10 consecutive interest rate rises, and the US Federal Reserve has stepped in to get investors' backs again.

Recent events may – or may not – prove to be a turning point for the current interest rate cycle, financial markets and asset prices. Regardless of what happens next, we remain clear about our focus: paying a sensible price for businesses in growing markets, with durable competitive advantages and pricing power, that are led by founders or well-aligned management teams, and with strong balance sheets. We are confident these investment characteristics will stand investors in good stead over the long-term.

Turning to performance, the Fund returned 0.1% net of fees and expenses during the month compared to -0.7% return for the benchmark. Over the last 12 months the Fund has returned -14.9% compared to -13.2% for its benchmark. Since inception in mid-November 2016, the Fund has produced a net total return of 83.2% compared to 47.1% 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*	0.1%	7.6%	-14.9%	7.2%	5.7%	10.0%
Benchmark**	-0.7%	1.9%	-13.2%	13.1%	3.9%	6.2%
Excess Return	0.8%	5.7%	-1.7%	-5.9%	1.8%	3.8%

** 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. Past performance is not indicative of future returns*
*** Benchmark: S&P/ASX Small Ordinaries Accumulation Index.*

The Fund's largest sector allocations remain information technology (36.3% of total capital), financials (20.8%) and healthcare (18.4%), and while the benchmark's largest allocations are to materials (26.8%), consumer discretionary (16.1%), and real estate (12.6%).

As we remind investors each month, 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 **Nanosonics** (+12.1%), with no fundamental news. The biggest detractor was **SiteMinder** (-16.3%), as the business was jarred by exposure to Silicon Valley Bank and weakening sentiment toward discretionary sectors. More on both companies shortly.

The Fund's five largest holdings as of the end of the month accounted for 40.7% of the portfolio and are named in order of the Fund's allocation: Nanosonics, **Netwealth**, **Altium, Xero** and **Promedicus**.

Moving to our biggest contributor, Nanosonics. The company saw its share price move with no fundamental updates after reporting strong half year results in February. We did, however, observe; increased activity by brokers and investors to understand the Coris endoscope reprocessing opportunity, and also a reduction in short positions equivalent to around 3.1% of shares outstanding. We remain enthused about Nanosonics prospects as it exited the first half with accelerating revenue growth, a more profitable direct sales model in North America, and clearer path to the Coris launch.

We covered SiteMinder in some detail in last month's letter when it was the Fund's biggest contributor, and this month it has swung to being the biggest detractor. The almost 30% intra-month move is a good reminder of volatility in equity markets. There was very little fundamental news released, other than the company disclosing its exposure to Silicon Valley Bank, which was subsequently revised to 'no longer be expected to impact cash holdings'. Yet in the current market, it was enough to spook investors, along with concern about the outlook for discretionary spending, including travel. For our part, we'd point back to the relative resilience of SiteMinder's subscription revenues during the pandemic despite global travel grinding to a halt during that time.

Xero's newish CEO, Sukhinder Singh Cassidy, put her stamp on the company during March announcing a major cost out program to drive operating leverage and strategic shift toward profitable growth. Specifics of the program include reducing 700-800 roles across the business (approximately 15% of the workforce), and targeting an operating expense to revenue ratio in fiscal '24 of 75%. Sukhinder revealed she is more profit focussed than the market anticipated, and is taking a more disciplined approach to reinvestment of cash and generating long term shareholder value. We applaud the sharpened focus and look forward to Xero's full year results in May.

Turning to Tyro. After further engagement and reflection on the situation, Lakehouse shifted to publicly supporting a transaction with Potentia in the range of $1.80 to $2.00. In an interview with the Australian Financial Review on 3rd April, we commented that:

> *"Jon Davey has delivered on his mandate to cut costs and shift the business to consistent profitability.*
>
> *If you take a long-term view, there's more value here. But the truth is, the market is not willing to ascribe much value to the banking business, which is a long-term growth opportunity.*
>
> *I think $1.80 to $2.00 is a price where the board, management team and investors will likely support it. That includes us."*

Tyro is growing at fundamentally strong rates, soundly executing a cost out plan to drive profitability, and selling for less than four-times gross profit, though we can see superior investment opportunities for the portfolio if the board are able to consummate a deal with Potentia.

Looking Ahead

With the books now closed on the third quarter of the financial year, we look forward to receiving quarterly updates from many of our portfolio companies during April, and updating our investors in due course.

We thank all our investors for their continued support and trust.

Best Regards,

Lakehouse Capital

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