LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

31 August 2023

Dear Lakehouse Investor,

August was a busy and fruitful month for the Fund as it marks the full year reporting season for the majority of companies in our investment universe. We will discuss the results of the five largest positions in more detail below, but broadly speaking, we were pleased with the fundamental performance of companies across the portfolio.

Fund Metrics	
Companies Held	22
Cash Allocation	7.0%
Top 5 Portfolio Holdings	36.8%
Net Asset Value per Unit (mid)	$1.4684
Fund Net Asset Value	$236.9 million
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

The Fund returned 2.7% net of fees and expenses during the month compared to -1.3% return for the benchmark. Since inception in mid-November 2016, the Fund has produced a net total return of 110.7% compared to 49.5% for the benchmark. In annualised terms, the Fund has returned 11.6% per year, net of fees and expenses, since inception compared to 6.1% per year for the benchmark.

	1 Month	1 Year	3 Year (p.a.)	5 Year (p.a.)	Inception (p.a.)
Lakehouse Small Companies Fund*	2.7%	14.8%	-3.8%	5.0%	11.6%
Benchmark**	-1.3%	-1.1%	3.0%	2.4%	6.1%
Excess Return	4.0%	15.9%	-6.8%	2.6%	5.5%

** 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 as of the end of August were to information technology (39.2%), financials (18.0%) and healthcare (17.4%), while the benchmark's largest allocations are to materials (24.4%), consumer discretionary (17.4%), and real estate (12.6%). We expect to have material allocations to these sectors over time as the sectors, or at least subsets of them, are overweight business models that lend themselves to strong long-term performance.

Company News

Turning to specific companies, the Fund's most significant contributor to performance during the month was Audinate Group (+48.3%) and the biggest detractor was Nanosonics (-11.4%), following the market's response to their respective full year results. More on both shortly.

The Fund's five largest holdings as of the end of the month accounted for 36.8% of the portfolio and are named in order of the Fund's allocation: Netwealth, Audinate, Siteminder, Altium and Nanosonics.

Netwealth delivered pleasing full year results, growing its topline 21.6% in the face of industry-wide headwinds (discussed in last month's letter), while continuing to invest in platform resilience and future growth. Net profit after tax grew by a similar 20.9%, to $67.2 million, and the annual dividend also increased 20%. Netwealth's platform remains market-leading; rated #1 for overall satisfaction by its clients in *Investment Trends May 2023 Adviser Technology Needs Report* for the 11th consecutive year.

The company announced a relaunch of their less-feature-rich 'Core' product to increase market share in the mass affluent and emerging affluent segments. While the company's focus in recent years has been on the high net worth market, a broader opportunity remains to reach up to 65% of Australian adults. Netwealth also announced a cash product alternative allowing advisers to offer differential interest rates to clients in an effort to address term deposit leakage. Results from both these initiatives are yet to be seen, but alongside recent investments in non-custody and mobile app offerings, it highlights the company's healthy appetite for innovation.

Following release of the results – in almost customary fashion – the Heine founding-family sold 5% of their holding, equal to 2.7% of the company, leaving them with a still sizable 49.8%. We have no issue seeing the family progressively reducing their stake, particularly when you contemplate that at a market capitalisation of $3.8 billion, Netwealth sits just outside the ASX100 Index in terms of size but will require a good bit more selling from the Heine family to be considered for inclusion on liquidity grounds.

Finally, looking to the year ahead, there are early signs that sentiment among financial advisers is more buoyant and inflows are picking up. Netwealth remains well placed to continue growing from its current 7-8% market share as it captures a disproportionately larger slice of industry net fund flows, rolls past a period of heavy investment, and the benefits of increased capability and scale drive profitability.

Nanosonics turned in a fundamentally sound result with revenue growing 38% to $166 million, but fell short of market expectations on installed base growth and a further delay to the commercial launch of Coris in North America. Revenue growth was boosted by Trophon 2 renewals continuing apace, however, fundamental growth of the installed base was more tepid at 9%. This equates to 2600 new units for the year versus the market expectations for 2800-3000. Management expressed confidence in being able to return to this level of new units per annum but the market is unconvinced. The Coris delay stems from the

FDA insisting human factor testing be done on U.S. soil, despite previous Trophon EPR and Trophon 2 human factor testing occurring in Australia where Nanosonics have an existing facility. Given FDA submission is the key priority, this change impacts timing for commercialisation in other markets.

Turning to Audinate which grew to be the Fund's second largest holding during the month off the back of strong full year results. The company declared the COVID-induced supply chain challenges are behind it as sales surged 51% to $69.7 million and improved chip availability satisfied pent-up demand. The number of Dante hardware and software units shipped increased by 30%, including further video segment units. After years of investment-induced cash burn, the company provided a strong signal to the market generating positive free cash flow of $2.5m in the second half of the financial year. Management expects this momentum to continue into fiscal 2024, marking a pivotal turning point towards being a profitable, growing technology company.

The outlook remains promising, with pipeline demand remaining high and the pending release of new audio, video and cloud-based products. The Dante ecosystem has never been stronger, boasting 142 design wins, of which 26 are in the video segment. The penetration into video remains in its early stages for Audinate, with most of the video design wins yet to translate to new sales. Nonetheless, its growth trajectory is tracking well, with the adoption and rollout of video being 3 times faster than audio at a similar point in its lifecycle. With a proven record in audio, the company remains well placed to replicate its success in the video segment, ensuring the continuation of growth and further solidifying the Dante ecosystem within the professional AV community.

SiteMinder reported a strong set of full year results, which were largely pre-announced during the quarterly update as covered in our previous month's letter. It's pleasing to see that unit economics maintain an upward trajectory. Average revenue per user (ARPU) increased by 18.9%, driven by an increase in attachment of transaction products, subscription upsell and price increases. Monthly revenue churn remained stable at 1%, in-line with historical rates, while the customer acquisition cost (CAC) decreased by 14%. As a result, the LTV/CAC ratio increased to 4.8x in the second half of FY23, compared to 3.2x in the previous corresponding period. The healthy and improving unit economics bode well for future growth and profitability. We view the business as maintaining current growth rates as it expands its product portfolio and tips into free cash flow positive in fiscal 2024.

Altium reported strong financial year results with revenue increasing 19.2% to US$263.3 million and operating profit growing slightly faster, up 20.3% to US$96 million. It was more or less a continuation of the previous half, with stronger average revenue per subscriber (up 22.5% on the prior year) and healthy subscriber growth (up 7.5% on the prior year) more than offsetting weaker performance in Octopart, Altium's search engine for electronic components, and sales in China.

The company's customers (particularly in the United States) are finding greater value in Altium's products, and are willing to pay for higher priced Pro and Enterprise offerings to access more powerful features in its design software. Octopart continued to see further deceleration from its strong COVID performance, growing revenue 12% as supply chains normalised. China is also seeing slower recovery than expected as the management team reorganised resources in the country during COVID. Altium is now refocusing their efforts there, as well as making key executive hires across the globe to execute on its sales pipeline.

There seems to be signs that that company's TAM is expanding, with management noting that they're receiving inbound calls from companies they wouldn't normally. It announced a multi-million dollar deal with Renesas, a leading semiconductor manufacturer in Japan wanting to standardise its design software onto Altium's cloud electronics development platform Altium 365. Looking ahead, the business still has a significant runway for growth, with revenue expected to grow at least 20% in FY24 and a nice balance of profitability with operating profit margins of at least 35%, giving it a best-in-class rule of 55.

Looking Ahead

With the full year reporting season behind us, the team continues to meet with management of current and prospective companies, and will start meeting board representatives of some of the holdings as we head into AGM season. It's a busy and exciting time of year for the team.

As always, we thank all our investors for their continued support and trust.

Best Regards,

Lakehouse Capital

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