LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

31 October 2023

Dear Lakehouse Investor,

Fund Metrics	
Companies Held	23
Cash Allocation	9.5%
Top 5 Portfolio Holdings	35.3%
Net Asset Value per Unit (mid)	$1.2727
Fund Net Asset Value	$200.4 million
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

Geopolitical events and economic data weighed on markets during October. Broadly speaking, volatility remains elevated -- for example the market largely recovered its October losses in the first week of November alone. There's growing evidence that developed market central banks are collectively nearing the top of this interest rate cycle as economic data softens.

At the time of writing in early November, the U.S. economy reported weaker-than-expected employment numbers and revised down previous month employment figures. This caused a decline in long-dated bond rates and a rally in equities as market participants warmed to the possibility the Federal Reserve is near the top of its rate rising cycle.

For our part, we remain aware of the macroeconomic and geopolitical events, but aren't over-reacting to the news flow. We continue to make investment decisions based on the fundamental long-term drivers of the businesses we invest in, that we believe have the potential to weather economic challenges and prosper over the long-term.

The Fund returned -11.2% net of fees and expenses during the month compared to -5.5% return for the benchmark. Since inception in mid-November 2016, the Fund has produced a net total return of 82.7% compared to 35.6% for the benchmark. In annualised terms, the Fund has returned 9.0% per year, net of fees and expenses since inception compared to 4.5% per year for the benchmark.

	1 Month	1 Year	3 Year (p.a.)	5 Year (p.a.)	Inception (p.a.)
Lakehouse Small Companies Fund*	-11.2%	3.3%	-8.7%	4.4%	9.0%
Benchmark**	-5.5%	-5.1%	0.5%	2.5%	4.5%
Excess Return	-5.7%	8.4%	-9.2%	1.9%	4.5%

** 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 October were to information technology (38.3%), healthcare (17.1%) and financials (16.2%) while the benchmark's largest allocations are to materials (24.5%), consumer discretionary (17.6%), and real estate (12.0%). 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, namely intellectual property, network effects, and loyalty.

Company News

Turning to specific companies, the Fund's most significant contributor to performance during the month was Frontier Digital Ventures (+6.8%) and the biggest detractor was Impedimed (-34.3%). More on both shortly.

The Fund's five largest holdings as of the end of the month accounted for 35.3% of the portfolio and are named in order of the Fund's allocation: Netwealth, Audinate, Nanosonics, Siteminder and Xero.

Firstly, our biggest contributor, Frontier Digital Ventures (FDV) which remains a small business and small holding for the Fund. The 'risk off' investing environment saw the price of almost all stocks across the portfolio fall during October and that led to one of our smallest positions being the most significant contributor.

FDV also provided a quarterly update where revenue increased 25% and the business marked its third consecutive quarter of positive operating cash flow. Throughout the past few quarters, there has been a consistent emphasis on cost management as FDV's properties navigate challenging economic environments. Pleasingly, this pursuit of growth has remained profitable, with operating margins doubling from 6% to 12%. This is tempered by Zameen continuing to face outsized economic challenges and uncertainty in Pakistan, though even this appears to be shifting with a noticeable increase in leads, transaction volumes, and revenue compared to the previous quarter. Despite the ongoing challenges, Zameen remains EBITDA positive and continues to assert its market dominance over their closest competitor.

Impedimed was the Fund's biggest detractor during the month as the company implemented significant board changes and provided a quarterly update. Lakehouse supported the board changes at the October meeting and are constructive about the appointment of McGregor Grant as chairperson (who is well known to the Lakehouse team through his former role as the chief financial officer of Nanosonics). We are pleased the company now has the distraction of the board spill behind it and can focus on executing on the significant opportunity that lies ahead.

Turning to the quarterly update which was a mixed bag. There's a lot of noise in the company's headline numbers as it positions to grow off a low base. Headline revenue declined -12% as a clinical trial SOZO was servicing came to an end. The company's revenue is yet to fully benefit from the inclusion of SOZO and Bioimpedance Spectroscopy (BIS) in the NCCN Guidelines.

While the company continues to make progress signing up private payors, it did move the goal posts out on its ambitious timeline. For our part, we remain comfortable with the pace of progress of SOZO / BIS being added to reimbursement policies and are confident the payor landscape will look very different for the company 12 months from now. It's also worth calling out the increased number of contracts being signed at the higher pricing tier of US$2500 per month (versus US$1000 to US$1500 per for legacy contracts), which should also drive pricing for the existing installed base once broad reimbursement with payors is achieved and accelerate the path to breakeven. The opportunity for Impedimed is compelling, with execution being a key determinant of success from here.

Netwealth's first quarter of fiscal 2024 saw funds under administration grow 23.6% on the prior year, to $72 billion. It has been a tough environment for the business as it battles an ongoing trend of high-net-worth investors moving funds off platform, slowing the growth of net inflows. Netwealth has been disproportionately impacted by this trend versus peer platforms. The revenue impact is less than it first appears as around half of the money moved is in accounts that are above the $2.5 million admin fee cap, and therefore non-admin fee earning, but it remains a trend working against the business. Netwealth has taken a number of steps to stem this impact, including launching new functionality and new financial products.

SiteMinder held its first ever Investor Day as a listed company during the month. We came away with a deeper understanding about the different client segments and the products that they tailor to serve each market. With the current product portfolio, the business has ample opportunity to grow, especially on the smaller end of the market. Despite being the leader in the channel management space, SiteMinder only has a 2.4% penetration amongst single property operators in the global hotel industry. There is still significant room to win new clients and lift average revenue per user (ARPU) in this highly fragmented market.

Two upcoming products to help their hotel and distribution partners were also showcased. On the hotel side, the company will offer Dynamic Revenue Plus, a product that will help predict, recommend, and automate price changes based on upcoming events, competitive pricing, and forward insights to seize opportunities. On the distribution side, the company will offer Channels Plus, a product suited for smaller, regional online travel agencies (OTAs) to bring additional hotel inventory onto their platform. This is a way for partner OTAs to be able to scale their hotel offerings in areas which they have less presence.

Overall, the future looks promising for SiteMinder. The company's first quarter update signalled an acceleration in subscriber growth and strength across all regions. Management also reiterated its medium-term guide of 30% organic revenue growth, along with underlying operating profitability and free cash flow positive in the second half of this fiscal year.

Thank You

As always, thanks to all our investors for your time, trust, and support. While the economic environment feels uncertain to many investors, our focus remains on executing our investment process and positioning the portfolio for long-term growth.

Best Regards,

Lakehouse Capital

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