LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

31 January 2024

LAKEHOUSECAPITAL

Dear Lakehouse Investor,

Fundamental company news flow picked up in January as several portfolio businesses provided market updates ahead of ASX half year reporting in February. We'll cover the key updates below, and we look forward to sharing more on the results of portfolio businesses in next month's letter.

Fund Metrics	
Companies Held	23
Cash Allocation	4.5%
Top 5 Portfolio Holdings	39.3%
Fund Net Asset Value (NAV)	$225.0 million
NAV per Unit (mid)	$1.4723
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

While 2023 ended well, the new calendar year got off to a slower start. The Fund returned -2.2% net of fees and expenses for the month compared to 0.9% return for the benchmark. Since inception in mid-November 2016, the Fund has produced a net total return of 111.3% compared to 57.1% for the benchmark. In annualised terms, the Fund has returned 10.9% per year, net of fees and expenses, since inception compared to 6.5% per year for the benchmark.

	1 Month	1 Year	3 Year (p.a.)	5 Year (p.a.)	Inception (p.a.)
Lakehouse Small Companies Fund*	-2.2%	13.1%	-7.1%	7.4%	10.9%
Benchmark**	0.9%	2.1%	1.3%	5.4%	6.5%
Excess Return	-3.1%	11.0%	-8.4%	2.0%	4.4%

** 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 January were to information technology (41.5%), financials (18.5%) and healthcare (18.0%) while the benchmark's largest allocations are to materials (22.4%), consumer discretionary (17.6%), and real estate (12.4%). 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

At the portfolio level, the Fund's five largest holdings as of the end of the month accounted for 39.3% of the portfolio and are named in order of the Fund's allocation: Netwealth, Siteminder, Pinnacle Investment Management, Audinate, and Altium.

The Fund's most significant contributor to performance during the month was Netwealth (+9.4%) following a positive trading update. The business delivered quarterly net inflows of $2.6 billion, up +24% compared to the same period last year, as outflows moderated following recent product enhancements to help keep funds on the platform and improved market sentiment. Total funds under administration (FUA) ended December at $78 billion, representing almost 8% market share: a doubling in 3.5 years. We are pleased with Netwealth's continuing steady, organic market share gains and look forward to digging into the company's half year results later in February where we expect to see expanding profit margins following a period of investment, and learn more about growth plans for the years ahead.

The Fund's biggest detractor was Nanosonics (-32.3%), following a disappointing market update due to a material slowdown in capital sales. Macroeconomic headwinds have put pressure on hospital capital budgets, resulting in lengthening sales cycles, lower capital sales and weaker Trophon 2 upgrades. Management's preliminary half year guidance is for the global installed base to grow at a sedate 3.4%, to 33,550. This slower growth alongside lower upgrade sales will cause a -2.4% decline in revenue. The combination of lower revenue and continuing investment in the CORIS launch will likely see profit before tax more than halve to $4.9 million.

The result is disappointing, particularly when considered against annual compound revenue growth of 22.5% over the past five years and market expectations for 15% revenue growth this fiscal year. Given the pressure on hospital capital budgets, Nanosonics is likely to explore alternative sales models heading into the second half, which could cause further noise for near-term profitability. Importantly, we've not found compelling evidence of increased competition for Trophon and believe the current headwinds are more a factor of temporary cyclical weakness, as opposed to any fundamental issues. Whilst a recovery to trend growth is uncertain and CORIS commercial launch is still some time away (FDA submission is not slated until later this year). Needless to say, following recent events Nanosonics is a smaller holding in the Fund and is on a shorter leash.

SiteMinder shared a positive trading update as it continued to grow its hotel management software. Revenue and annualised recurring revenue (ARR) increased by 22.4% and 22.9% in constant currency, respectively. The company ended the quarter with 41,600 property subscribers, up 13.7% year-on-year. It's impressive to see three key metrics show an acceleration in growth. Further, management indicated that more than 50% of net new property additions were SiteMinder products, which targets larger properties than its cheaper Little Hotelier offering. This bodes well for future growth prospects and healthy unit economics. Most importantly, the company is on track to reach its underlying free cashflow breakeven target by the second half of this fiscal year. Moving forward, we're excited to see how the two new products, Dynamic Revenue Plus and Channels Plus, are received by the market.

Pinnacle is another portfolio business that provided a market update during January and, in typical form, quickly followed up with its half year results in early February. Headline half year profit was flat at $30.2 million as the business continued to reinvest heavily in 'Horizon 2' growth opportunities. Although this investment suppresses short term profits, we remain very supportive of the strategy considering it has historically delivered (on our estimates) returns of more than 20% per annum. The business delivered pleasing inflows despite the challenging fundraising environment, achieving $4.5 billion of net inflows for the half. Aggregate funds under management (FUM) ended the period 8% higher than average FUM for the half year, with further inflows added in January after close of the half year reporting period. Combining this with the inherent operating leverage, and strong performance fee potential, sets the business up well for the rest of fiscal 2024.

Looking Ahead

We are grateful to all our investors' support and trust. We look forward to sharing more with you next month after catching up with current and prospective portfolio companies throughout the busy February reporting season.

Best Regards,

Lakehouse Capital

For more information call us on +61 2 8294 9800, email investorsupport@lakehousecapital.com.au or visit www.lakehousecapital.com.au

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