LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

29 February 2024

Dear Lakehouse Investor,

February was a busy and productive month as the team digested half-yearly results. For the most part we were pleased with the operational and financial updates from our portfolio companies. Another point that warrants mention is the Altium takeover offer and the Fund's subsequent sell down of its entire holding. More on these events shortly.

Fund Metrics	
Companies Held	22
Cash Allocation	9.7%
Top 5 Portfolio Holdings	40.0%
Fund Net Asset Value (NAV)	$247.5 million
NAV per Unit (mid)	$1.6441
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

Some high-level observations after sitting through numerous presentations and meeting with business leaders, include; consumers are faring better-than-feared in the higher interest rate environment, concerns for a pronounced economic slowdown have not materialised, and combing the better-than-expected economic conditions with the broad corporate cost reductions of 2023 saw widening profit margins come to the fore for a number of the portfolio businesses.

While there are still risks on the horizon from geopolitical tensions and persistent inflationary pressures -- particularly from the services sector, increased housing costs and supply chain disruptions -- the headwind of rising interest rates over the past couple of years has plateaued, with the potential to turn into tailwinds, particularly for smaller fast-growing companies.

The Fund returned 11.7% net of fees and expenses for the month compared to 1.7% return for the benchmark. Since inception in mid-November 2016, the Fund has produced a net total return of 136.0% compared to 59.8% for the benchmark. In annualised terms, the Fund has returned 12.5% per year, net of fees and expenses, since inception compared to 6.6% per year for the benchmark.

While it has been a pleasing reporting period, our team does not judge itself on short-term performance and neither should investors who embrace our long-term, high-conviction strategy. As ever, we remain focused on our ultimate objective of long-term outperformance.

	1 Month	1 Year	3 Year (p.a.)	5 Year (p.a.)	Inception (p.a.)
Lakehouse Small Companies Fund*	11.7%	29.0%	-3.8%	8.3%	12.5%
Benchmark**	1.7%	7.8%	1.4%	4.4%	6.6%
Excess Return	10.0%	21.2%	-5.2%	3.9%	5.9%

** 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 February were to information technology (38.0%), financials (18.6%) and healthcare (16.1%) while the benchmark's largest allocations are to materials (22.0%), consumer discretionary (18.5%), and real estate (12.3%). 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 40.0% of the portfolio and are named in order of the Fund's allocation: Audinate, Netwealth, SiteMinder, Pinnacle Investment Management and Xero.

The Fund's most significant contributor to performance during the month was Audinate (+40.4%), which announced another record set of financial results. The business benefited from the uninterrupted supply of semiconductor chips, coupled with a backlog in demand, which drove a 48% increase in revenue to US $30.4 million. The company's scalable operations and strategic investments in offshore labour markets significantly accelerated EBITDA. Although off a very low base, EBITDA was up by 137% to $10.1 million, with margins expanding 2.3 percentage points to 21.7%. Research and development investments remained stable which drove a 151% increase in free cash flow to $3.5 million. The market responded positively to these results which helped push the company into the ASX200.

Despite a cautious stance from management due to uncertain macroeconomic conditions, we remain pleased with how the company is leveraging its dominant position in the audio sector to increase the odds of success in the video segment, and ultimate long-term goal of becoming the operating system software for professional AV systems. Despite audio units making up most of the sales in this recent reporting period, we are pleased with Audinate's progress in the video market having reached its target of 30,000 video units sold, six months ahead of schedule. The video market is twice as large as audio, and although still in the early stages, the video development pipeline is robust. The total number of video products has tripled compared to the previous year, with 50 original equipment manufacturers (OEMs) now licencing Dante video technology -- up from 30 in the same period last year.

Dante technology has become synonymous with audio over internet protocol within the AV community. Its audio technology was front and centre at Las Vegas's Allegiant Stadium, the venue for the recent NFL Super Bowl, NRL season opener and the upcoming Taylor Swift Eras Tour. We think Audinate is one of the most monopolistic businesses in our investible universe and continues to be one of the largest holdings in the portfolio as we've let this winner run.

The Fund's biggest detractor was Impedimed (-24.6%), which reported a 16% fall in revenue compared to the previous corresponding half as an AstraZeneca clinical program came to an end. The slowdown in revenue follows a period of distraction at the company (as discussed in the October 2023 investor letter) but needs to rapidly accelerate from its current base of $10.9 million in annual recurring revenue. The business has come a long way since the NCCN updated its guidelines in March last year recommending regular screening for all cancer survivors at risk of lymphoedema. In the 11 months since, the company has achieved 80% reimbursement coverage from private health insurance payors or Medicare in 15 U.S. states. Reimbursement coverage is essential plumbing for the business to enable increased sales velocity.

We continue to like the long-term opportunity for BIS (bioimpedance spectroscopy) to establish itself as the standard of care -- replacing the humble tape measure -- to monitor lymphoedema. As the only FDA-cleared device in market, Impedimed is well placed to capture a healthy share of the market. But with around $35 million in cash, and an aggrieved shareholder base, the business is in a race against time to reach breakeven. We acknowledge that Impedimed has a wider range of outcomes relative to other positions in the portfolio, however this is balanced via a modest position size.

Netwealth reported healthy growth over the half with revenue and net profits up 20% and 28%, to $123 million and $39 million, respectively. Net profit margins widened 2.6% to 31.9% as the business rolled past a period of heavier investment. Potential remains for profitability to further improve in the second half off the back of a strong pipeline of new business and slower growth in headcount. Big picture, Netwealth continues to take share from the much larger legacy platforms, growing its scale and efficiency while continuing to invest and innovate. Netwealth has around 8% market share against almost 40% share of incremental flows and remains well positioned to benefit from long-term structural growth.

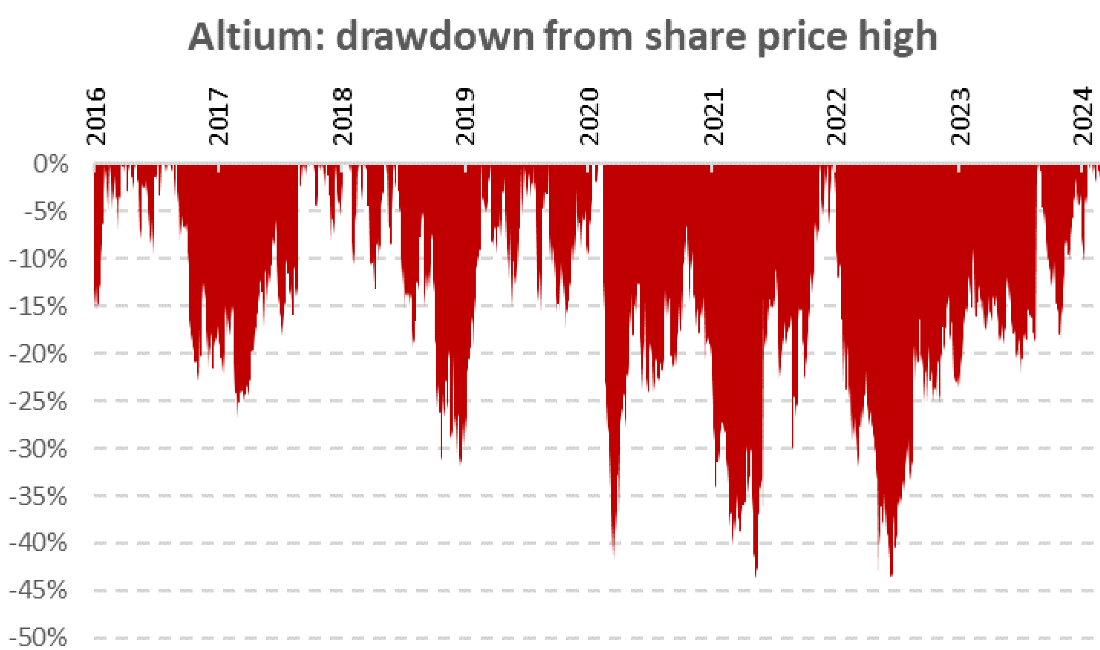
SiteMinder reported a strong result that was mostly covered in their previous month's quarterly update. Unit economics are healthy and improving. Customer lifetime value (LTV) is up 20%, driven by a 36% increase in take-up of transaction products, along with subscription upsells and price increases. Customer acquisition costs (CAC) decreased by 19%, as sales teams start to benefit from scale efficiencies. Further, scale efficiencies continue to improve group gross margins -- to 67.4% -- despite a growing mix towards transaction revenues. This has led to an LTV/CAC ratio of 5.3x, up from 3.6x in 1H23. Overall, the business is improving the value and quality of its customer base and spending less to win them. The company is on-track to hit its underlying EBITDA and free cash flow positive target in the second half of FY24.

Management also shared the upcoming product pipeline that will support the company's target for organic revenue growth of 30% in the medium term. The most noteworthy update was on the Channels Plus product, signing major online travel agencies (OTAs) such as Agoda and Hopper. This product helps properties expand their distribution to other channels and helps OTAs scale and access the long tail of hotel inventory. It's an organic extension of the channel manager and allows SiteMinder to participate and capture a bigger share of the value that it creates.

Xero recently held its investor day where the company shared its longer-term strategy and aspirations. The event highlighted the depth of the recent leadership hires in both product and distribution. 'Focus' was one of the key messages, increasing efforts in winning three key markets (Australia, U.S. and the U.K.) and three main offerings (accounting, payroll and payments), while efficiently scaling to improve profitability. To further penetrate key markets, Xero will need to both build and partner to increase the value of its offerings.

The management team were excited to announce new partnerships with NYSE-listed BILL and Avalara (a former Lakehouse Global Growth Fund holding), embedding accounts payable and receivable capabilities, and automating sales tax calculations within the Xero platform. Over time, the company aims to leverage its strong position in accounting software to further entrench itself within other categories. We believe the company is in a strong position and back the management team to achieve its strategic growth targets in the years ahead.

And finally, turning to Altium which received a recommended all-cash takeover offer of $68.50 per share during the month. Lakehouse has owned Altium since launching in 2016 -- and generated healthy compound returns of over 20% per annum -- but as the chart below shows, it hasn't been a smooth ride. The stock has fallen from its highs by more than 25% six times, and by over 40% on three occasions during our investment period. The biggest drawdown was over 44% in the depths of the growth stock selloff in May 2022.



Investing in growth businesses can be highly profitable but returns certainly won't be delivered in a straight line. Investors should expect to have their mettle tested many, many times throughout their investing journey, just as we have with Altium over the past seven-plus years.

The bid was at a healthy 31% premium to the company's all-time-high closing share price; equal to around 18 times fiscal 2024 revenue or 50 times operating profit. After weighing deal certainty against the opportunity cost of staying invested until close, and the upcoming dividend payment with interest income on the proceeds, we decided to fully exit our Altium stake shortly after the deal was announced. For added context, Altium accounted for 2.5% of this month's 11.7% return and the exit pushed Fund cash levels to a peak of 13.4%.

The team has been busy investing the Altium proceeds back into companies that stood out as having the brightest growth prospects during the reporting period, including SiteMinder and Objective Corporation. We've spoken at length about SiteMinder in these letters and past webinars. Regarding Objective Corporation, it's a business we have owned in prior years -- but exited due to high expectations in the share price alongside limited liquidity in the stock -- and have reinitiated a position in the past six months. As a quick recap; we are drawn to the business' sticky customer base, strong balance sheet, impressive history of capital allocation, high insider ownership, and relative lack of meaningful institutional attention. We continue to build out positions in two other names that we will share in due course. As of the end of February, the cash balance returned to 9.7%.

Looking Ahead

We are grateful to all our investors' support and trust on this investing journey for the long term.

Best Regards,

Lakehouse Capital

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Lakehouse Small Companies Fund's Target Market Determination is available here - https://www.lakehousecapital.com.au/lscf/. It describes who this financial product is likely to be appropriate for (i.e. the target market), and any conditions around how the product can be distributed to investors. It also describes the events or circumstances where the Target Market Determination for this financial product may need to be reviewed.

Lakehouse, its directors, employees and affiliates, may, and likely do, hold units in the Fund and securities in entities that are the subject of this report.