LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

31 May 2024

LAKEHOUSECAPITAL

Dear Lakehouse Investor,

The Fund returned 1.8% net of fees and expenses for the month compared to 0.0% return for the benchmark. Since inception in mid-November 2016, the Fund has produced a net total return of 140.2% compared to 62.2% for the benchmark.

In annualised terms, the Fund has returned 12.3% per year, net of fees and expenses, since inception compared to 6.6% per year for the benchmark.

Fund Metrics	
Companies Held	22
Cash Allocation	5.4%
Top 5 Portfolio Holdings	39.2%
Fund Net Asset Value (NAV)	$244.4 million
NAV per Unit (mid)	$1.6735
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

The Fund's largest sector allocations as of the end of May were to information technology (40.3%), financials (18.9%) and healthcare (17.1%) while the benchmark's largest allocations are to materials (25.4%), consumer discretionary (15.1%), and real estate (13.1%). 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.

	1 Month	1 Year	3 Year (p.a.)	5 Year (p.a.)	Inception (p.a.)
Lakehouse Small Companies Fund*	1.8%	28.8%	-3.1%	5.5%	12.3%
Benchmark**	0.0%	10.9%	-0.1%	4.2%	6.6%
Excess Return	1.8%	17.9%	-3.0%	1.3%	5.7%

** 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.*

Company News

At the portfolio level, the Fund's five largest holdings at month end accounted for 39.2% of the portfolio and are named in order of allocation: Netwealth, Pinnacle Investment Management, SiteMinder, PEXA Group, and Xero.

The Fund's most significant contributor to performance during the month was Catapult (+32.1%), following release of their full year results. Audinate was the biggest detractor (-16.7%) following resignation of the company's chief financial officer. Both are covered in more detail below.

Catapult reported pleasing fiscal 2024 results with both revenue and annual contracted value (ACV) increasing +20% (to US$100 million and US$87 million, respectively) while crossing the important milestone of free cash flow profitability. Strengthening economics across the business contributed to the outcome. Churn fell 30 basis point to 3.5%, while the shift toward video in the product mix helped drive a 5-percentage point lift in gross margins to 81%, and a jump in recurring revenue to 92%, up from 78% in the prior year.

Catapult's topline growth was driven by a +9% increase in new signings -- taking them to 3,317 professional teams, 5x their nearest competitor -- and a +32% increase in multi-vertical professional teams using both wearable and video products. Catapult's roots are in wearables, but the opportunity to cross-sell video product remains large given less than 15% of their professional team customers currently buy multiple products, and with average revenue per video customer 2-times the value of wearables, the revenue opportunity is larger than it first appears.

Some notable new signings over the period included the iconic New York Yankees baseball, Southampton FC (EPL soccer) and the Pittsburgh Steelers NFL team. Another significant signing announced but not included in Catapult's fiscal year 2024 ACV figures, is an agreement with the NCAA's American Football Southeastern Conference (SEC) for Catapult's video solution following changes permitting the use of sideline video analysis for the 2024 season. It's worth emphasising the entry into sideline video analysis with the SEC is significant both terms of ACV, and as a marquee foundational client given the SEC has been a dominant force in NCAA American Football over the last decade. This contract win has the potential to entice other NCAA conferences to get on board and could even be a precursor to the NFL allowing game day sideline video analysis.

As a market leader in sports analytics, combining wearable and video solutions to support top-tier sports teams and athletes, Catapult is deeply integrated into the sports ecosystem and is well-positioned to continue its profitable growth. With shares selling for an undemanding 3.5-times ACV, and bottom-line profitability set to rapidly expand, we see a path to further upside from here.

Audinate saw its share price further decline following the resignation of Chief Financial Officer, Rob Goss, and is now trading back at levels last seen before release of its strong half year results in February. Rob joined Audinate before its IPO and has helped oversee the company's growth from a market capitalisation of less than $100 million to well over $1 billion in under 8 years. Rob has been the company's key contact with the investor community over that time and will be involved for the remainder of the fiscal year and AGM while the search for a replacement continues. With the business in exceptional financial health, positioned with strong long-term growth prospects, and as a member of the S&P/ASX 200 Index it is well placed to attract a high calibre replacement.

We recently attended Audinate's Technology Day at the Art Gallery of NSW, where a Gallery AV professional shared their Dante experiences, and Audinate's company leaders discussed their strategy. The session provided a clear picture about the benefits of digital over legacy analogue solutions and considerations when managing and scaling a large functional area such as an art gallery. The company's core strategy remains unchanged: to rapidly proliferate Dante's digital AV-over-IP technology throughout the global AV market.

Audinate has historically been a hardware company but is steadily transitioning to becoming software-centric by applying its software directly to devices and offering software for AV users to manage their devices, including in the cloud. For example, in April the company released a suite of software applications that facilitate cloud-based broadcast production, called Dante Connect. Broadly speaking, transitioning from primarily a hardware company to software aims to maintain the same value in gross profit dollars. However, these gross profit dollars will be earned annually rather than once-off, creating a steady stream of higher-value recurring revenue.

A position that that joined our top 5 holdings this month is PEXA, an Australian digital platform for property transactions. Many of you reading this have likely experienced PEXA through a property refinancing, and/or property purchase or sale settlement as PEXA handles approximately 90% of refinance, and sale and purchase transactions throughout Australia. PEXA replaced the previously paper-based Torrens Title property settlements process, which dates back to the 1800s, and has quickly become an important piece of national digital infrastructure. Before PEXA, each party in a transaction required a representative, often a lawyer or conveyancer, to physically attend the land title's office at 'settlement' to register a change of property title. This process was inefficient, prone to errors and delays, and fell short of the expectations of 21st-century tech-savvy consumers. Nonetheless, many developed markets around the world continue to operate in the dark ages, creating opportunity for PEXA to expand abroad.

Australian investors have been burnt many times by local companies seeking to expand offshore, meaning there's a healthy dose of scepticism applied to such corporate strategies, and PEXA was no exception. Since its IPO in 2021, PEXA has pursued expansion to the U.K. and for much of its listed life, a negative value was ascribed to the U.K. business by the market. That may be starting to change. The process of property transactions in the UK is a complex and inefficient, often taking three to six months to complete and resulting in one in three transactions not being completed. Having demonstrated its credentials in Australia, PEXA is seeking to leverage the authority and trust it has built to replicate this success in a market almost three-times larger. To build out adoption of its electronic settlement platform, PEXA is initially focusing on refinancings in the U.K. driven by banks.

The dynamics of retail banking are somewhat similar globally whereby banks are typically reluctant to be leaders of new technology, instead usually preferring to be fast followers. This trend has been observed with past innovations such as ATMs, plastic card payments, online/mobile banking and more recently mobile payments. Today, it's hard to imagine any bank remaining competitive without offering these modern services, and we believe electronic settlement of property transactions will similar.

We added to our investment in PEXA in early May after PEXA signed its first tier-1 bank, NatWest. Although PEXA had already signed multiple second-tier financial institutions, a tier-1 is a far stronger catalyst for other banks to take notice and follow suit or risk falling behind their peers. Mortgages are a crucial product for a bank and are often differentiated by price rather than experience. Banks using the PEXA platform should offer customers a superior experience, with shorter-timeframes and more certainty of completion. This has the potential to drive above system level growth for the early adopters and could lead to fast following by other banks. Given the challenges in the UK settlement market and the competitive dynamics among banks, PEXA has the potential to emerge as a major beneficiary. While success in the U.K. is far from guaranteed, we viewed the probability of success as materially improved as the key domino of landing a tier-1 bank fell sooner than we anticipated, and in our view the market was slow to appreciate what this could mean for PEXA.

Xero reported their full year results during the month which were ahead of analyst consensus and delivered on management's Rule of 40 profitable growth commitment. Full year revenue grew 21% (in constant currency) to NZ$1.7bn, while annualised monthly recurring revenue lifted 26% to NZ$2.0 billion. Topline growth came in roughly equal proportion from increasing subscribers (+11%) and price increases and/or upsell as average revenue per user lifted 10% in constant currency. This growth combined with improved cost discipline resulted in free cash flow increasing to NZ$342 million and a free cash flow margin of 20.0%, improving markedly from 7.3% in the prior year, and surprising the market. In management's parlance, Xero delivered a pleasing Rule of 40 outcome of 41.0% (note: here, Rule of 40 is annual revenue percentage growth of 21% and annual free cash flow margin percentage of 20%).

Lifetime value to customer acquisition costs remain strong, averaging 6.2x across the group, with ANZ being the standout at 14.3x and 3.1x for the International segment. Monthly churn ticked up slightly from 0.9% in the prior year to 0.99% in the most recent result but remains healthy despite some pockets of the small business economy coming under pressure. The business continues to flex its pricing-muscle, which may be responsible for some of the increased churn, announcing further price increases in the high-single-digits in ANZ and the U.K. for a second year running. Overall, the company is getting it done, delivering on its more disciplined profitable growth and a focus on reinvestment of cash to generate shareholder value.

Upcoming webinar: 18 June at 11am

We would like to invite all investors to join us for a live webinar and Q&A at 11am on Tuesday 18 June. The webinar will be held on Zoom and you can **register here**. If you'd like to submit questions ahead of the webinar, please email them to investorsupport@lakehousecapital.com.au. We hope you can join us.. We hope you can join us.

Thank you

Finally, thank-you to all our investors' for your trust in investing alongside us for the long term. We are grateful for your trust and support.

Best regards,

Lakehouse Capital

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