L1 Capital Catalyst Fund

Quarterly Report | JUNE 2023

- **During the June quarter, the L1 Capital Catalyst Fund returned 2.5%[1] (ASX200AI 1.0%).**
- **Since inception the L1 Capital Catalyst Fund has returned 14.3%[1] p.a. (ASX200AI 3.6% p.a.).**
- **Outperformance over the June quarter was driven by favourable trading/results updates and the ongoing realisation of identified catalysts for select portfolio companies.**

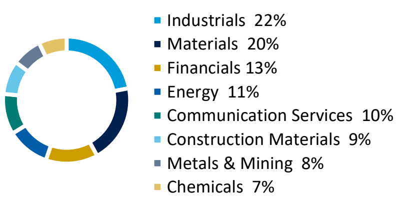
The S&P500 and the MSCI World excluding Australia returned +8.7% and +7.2% respectively, whilst the ASX200AI returned +1.0% in the June quarter.

The ASX200AI lagged the S&P500 primarily due to its relatively low exposure to technology stocks (~5% weighting in the ASX200 compared to a ~35% weighting in the S&P500[2]). These technology stocks (both in the U.S. and Australian equity markets), performed very well during the quarter, driven initially by market enthusiasm towards the potential of artificial intelligence technology.

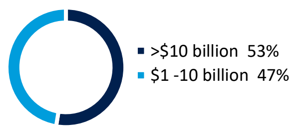
The ASX200AI was negatively impacted by weakness in the materials sector, reflecting the impact on demand for key commodities given a slower than expected economic recovery in China. The consumer discretionary sector also performed poorly following the release of weak trading/results updates by a number of consumer discretionary companies, in part reflecting the impact on consumer demand of the 400bps of cumulative cash rate increases by the Reserve Bank of Australia over the last 18 months.

Returns (Net)[1] (%)	Catalyst Fund	ASX 200AI	Out-performance
3 months	2.5	1.0	+1.5
6 months	9.6	4.5	+5.1
12 months	17.9	14.8	+3.1
Since inception (p.a.)	14.3	3.6	+10.7
Since inception (cum.)	30.6	7.4	+23.2

Sector exposure (%)



Market cap exposure (%)



Inflation, monetary policy, and their combined impact on economic activity continue to be key considerations impacting equity markets. Headline inflation in the U.S. and Australia is declining and appears to have peaked, although 'core' inflation has been more persistent. In addition, the Australian economy is benefiting from high levels of net inbound migration and a strong labour market. However, factors that are contributing to an uncertain economic outlook include the lagged impact of monetary policy, which is amplified by the gradual roll-off of fixed rate mortgages at very low rates, combined with the decline in household savings buffers built-up throughout the pandemic.

The strongest sectors in the ASX200AI for the June quarter were Technology (+21.1%), Utilities (+5.5%) and Energy (+3.6%), whilst Healthcare (-3.2%), Materials (-2.5%) and Consumer Discretionary (-1.7%) lagged.

Portfolio exposures by primary catalyst as at 30 June 2023

	Strategic	Financial	Operational	Governance
Stock 1		✓		
Stock 2	✓			
Stock 3		✓		
Stock 4	✓			
Stock 5				✓
Stock 6			✓	
Stock 7			✓	
Stock 8		✓		
Stock 9	✓			
Stock 10			✓	

1. All performance numbers are quoted net of fees. Figures may not sum exactly due to rounding. Inception date: 1 Jul 2021. Past performance should not be taken as an indicator of future performance. Note: Fund returns and Australian indices are shown in A$. Returns of U.S. indices are shown in US$. Index returns are on a total return (accumulation) basis unless otherwise specified. 2. Source: Goldman Sachs as at 30 Jun 2023. 'Technology' includes for the ASX200 Media & Technology, and for the S&P500 includes Information Technology and Communication Services.

Portfolio commentary

During the June quarter, the Catalyst Fund's performance relative to the ASX200AI was positively impacted by:

- **Favourable trading/results updates:** Four of the Catalyst Fund portfolio companies released strong trading/results updates.
- **Investor education on medium term outlook:** Two of the Catalyst Fund portfolio companies held investor days. These helped to educate the market on each company's strategy, increase investor confidence towards their respective objectives and improve their ability to generate meaningful future shareholder returns.
- **Continued realisation of catalysts:** Individual stock catalysts continued to play out during the June quarter. This included one portfolio company successfully selling assets and another portfolio company achieving a key regulatory approval.
- **Interest rate and inflation beneficiaries:** As highlighted in our **March 2023 quarterly**, the Catalyst Fund holds QBE Insurance Group, which continues to benefit from an elevated interest rate environment. During the June quarter, the U.S. 2-year Treasury Note increased by ~80bps, which benefits QBE given it had ~US$25b invested in fixed income assets (reported 31 Dec 2022 value).

During the June quarter, the Catalyst Fund's performance relative to the ASX200AI was negatively impacted by:

- **Declines in select commodity prices**: Certain portfolio companies were impacted by a decline in the commodity prices to which they have exposure (e.g. Brent crude oil down 5.6%). These movements were driven by a combination of increasing recessionary fears in Western economies as central banks continue to increase interest rates, in addition to a slower than expected economic recovery in China following its COVID-zero policy and continued weakness in China's property development sector.
- **Headwinds impacting domestic discretionary spend**: Across the Catalyst Portfolio, we have one stock, namely Qantas, that is exposed to consumer discretionary spend. Whilst Qantas has materially outperformed the ASX200AI by over 10% since the Catalyst Fund's first investment, and travel spend currently remains resilient, growing market pessimism towards consumers being willing to continue to spend on travel resulted in relative share price underperformance during the June Quarter. We continue to believe that Qantas is fundamentally undervalued and will continue to benefit from its strong industry position, earnings from its high-growth loyalty business and under-geared balance sheet, and that it will be a major beneficiary of the rising middle class in Asia.

The L1 Capital Catalyst Fund continues to find value in low P/E stocks with undergeared balance sheets, strong cash flow generation and realisable near-term catalysts. We remain focused on identifying and enacting these catalysts through active engagement with company management and Boards. We believe this engagement will ultimately create better shareholder returns for investors and outcomes for the companies themselves.

Perspectives on global shareholder activism

The current environment

While activist investing remains a relatively nascent investment strategy in Australia, it is a well-established and high-profile investment strategy in major offshore markets. The Catalyst Investment team actively monitors global developments in shareholder activism to identify key trends offshore.

As shown in Figure 1, we have recently seen a rebound in the number of public shareholder activist campaigns globally, following a quieter period during the COVID-19 pandemic. In our view, this rebound reflects:

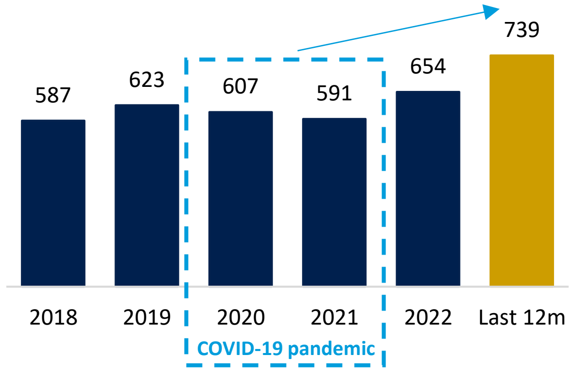
1. more 'Value' investment opportunities following broad equity market declines in 2022,
2. company Boards being more receptive to value-accretive ideas from shareholders in a slowing macroeconomic environment, and
3. the meaningful presence activist investors have developed across major global equity markets with approximately one in four S&P500 and one in three FTSE100 companies having an activist investor on their register, and the rise of shareholder activism in Asia Pacific, particularly Japan and South Korea, from a relatively low base.

These factors have also contributed to the very strong recent performance of shareholder activism as an investment strategy.

As shown in Figure 2, shareholder activism has been the highest returning investment strategy so far in the 2023 calendar year.

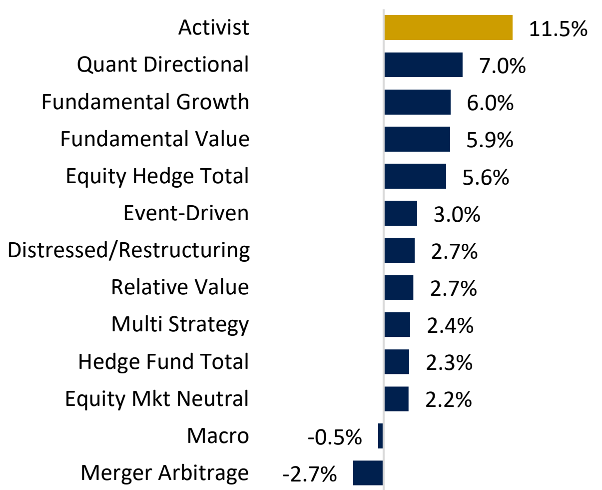
We expect these favourable conditions to continue, as activist investors identify opportunities to accelerate value-creation in weaker macroeconomic conditions and listed company Boards become more receptive to value unlock ideas.

Figure 1: Number of new public shareholder activist campaigns launched globally (2018 – 2023 YTD)



Source: Bloomberg. Data as at 30 June 2023.

Figure 2: Global hedge fund performance by strategy (2023 YTD)



Source: Hedge Fund Research, MST Marquee. Data as at 30 June 2023.

Key trends

Over the last 12 months we have identified three key trends in global shareholder activism:

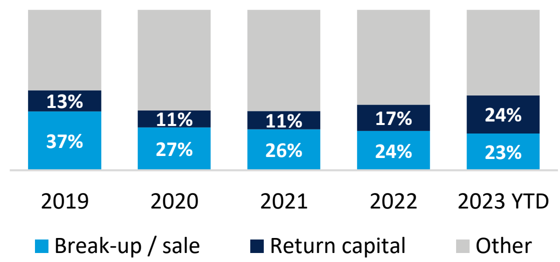
1. Preference for private engagement over public campaigns

- While we have seen a rebound in the volume of public shareholder activist campaigns, offshore activist investors continue to favour private engagement.
- Goldman Sachs estimates that there are approximately three private shareholder activist campaigns for every public shareholder activist campaign, reflecting the breadth of activist investing across global markets and the ability for private engagement to produce attractive outcomes for these investors.

2. Capital allocation focus

- Campaigns from activist investors focussed on a break-up or sale of the company have declined over recent years, while the number of campaigns relating to capital allocation have increased.
- This reflects a weaker M&A market, higher interest costs and investment return hurdles, and downward pressure on profitability from rising input costs and weaker demand.

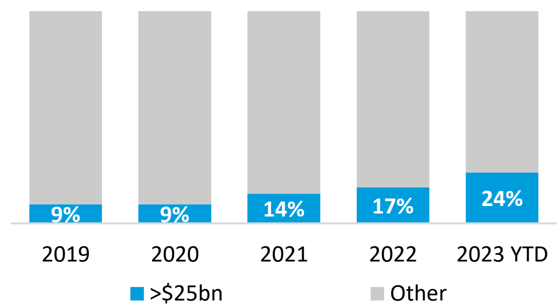
Activist campaign mix by nature of key demand(s)[3]



3. 'Swarming' of multiple large cap targets

- Over recent years we have seen an increasing proportion of public shareholder activist campaigns focusing on large and mega-cap targets.
- Often these companies have been the focus of multiple activist investors acting independently (recent examples include Salesforce and Disney).
- In our view, this reflects the defensive qualities of these companies, the potential for substantial efficiency improvements and the ability for multiple activist investors to build a stake given the large size of these companies.

Mix of public activist campaigns by market cap[3]



3. Source: Bloomberg, Factset. Mix based on number of new shareholder activist campaigns launched each year.

Takeaways for the Catalyst Fund

These offshore trends are highly relevant to shareholder activism in Australia, with three key takeaways for the Catalyst Fund:

1. **Reinforces our company engagement approach:** Private dialogue is the most common form of engagement by activist investors globally, and to date, has been an effective way for the Catalyst Fund to express our views to the company's management and boards within the Catalyst portfolio.
2. **Demonstrates the opportunity to drive value through capital allocation and performance improvement initiatives:** We see a range of ways that the companies in our portfolio can boost shareholder returns and profitability using levers such as process automation to improve operating efficiency. This is particularly important given the existing pressures on company earnings from slowing demand and increasing input costs.
3. **Ability to target large cap targets:** The ASX200 Index, by definition, comprises companies with larger market capitalisations and is the focus of the Catalyst Fund. Recent offshore shareholder activist campaigns aimed at large capitalisation companies demonstrates that activist investors can have significant influence and success engaging with companies of this scale. In these cases, the scale and performance track record of the activist shareholder(s) are especially important.

Fund updates

Zenith rating upgrade

We are pleased to share that Zenith Investment Partners has upgraded the L1 Capital Catalyst Fund from ‘Recommended’ to a ‘Highly Recommended’ rating[4].

Zenith notes:

“Zenith's conviction in the Fund is underpinned by the high calibre of the investment team and the attractiveness of the underlying investment philosophy and process. Despite the Fund's relatively recent inception, we draw confidence from the impressive performance track record of L1's other strategies.”

We are proud to have received such a strong endorsement of the L1 Capital Catalyst Fund and our Australian Equities team.

Fund Manager of the Year – Innovation Award

In June, the L1 Capital Catalyst Fund was delighted to receive the **Innovation Award** at Money Management’s 2023 Fund Manager of the Year awards.

We launched the L1 Capital Catalyst Fund two years ago with three core beliefs. First, that a well-executed activist strategy could deliver superior returns for investors over a multi-year time horizon. Second, that L1 Capital was well-placed to deliver this strategy given our experience, capabilities, relationships and scale, in a way that would create value for investors. And finally, we felt there was a gap in the market, with few activist investors in the Australian market relative to international markets.

Two years after launching, it is really pleasing for us to have those beliefs re-affirmed. We’ve been able to grow funds under management to over $1.4b, we’ve delivered strong performance ahead of our benchmark by ~10% p.a., and we see awards such as the Money Management Fund Manager of the Year – Innovation Award, as being recognition that the L1 Capital Catalyst Fund is a truly differentiated product in this market.

To read more, please click **here**.

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Fund information

Fund/Class Name	L1 Capital Catalyst Fund – Retail Class
Currency	AUD
Investment approach	The Investment Manager seeks to deliver private equity-style returns with listed market liquidity by taking a hands-on 'owner's mindset' to each investment in a tightly focused portfolio of up to 10 companies.
Investment objective	To deliver strong positive risk adjusted returns over the long term.
Benchmark	S&P/ASX 200 Accumulation Index
Minimum investment	$25,000
Management fee	1.28% p.a. inclusive of GST and net of RITC
Performance fees	20.5% (inclusive of GST and net of RITC) over benchmark, subject to any underperformance being recouped
Vehicle	Australian Unit Trust
Launch date	1 July 2021
Platform availability	Australian Money Market, BT Panorama, CFS FirstWrap, HSBC, Hub24, Macquarie Wrap, Mason Stevens, MLC, Netwealth, North*, Powerwrap, Praemium

Research house ratings

Zenith Rating[4]

Zenith notes: *"Zenith's conviction in the Fund is underpinned by the high calibre of the investment team and the attractiveness of the underlying investment philosophy and process. Despite the Fund's relatively recent inception, we draw confidence from the impressive performance track record of L1's other strategies."*

Zenith HIGHLY RECOMMENDED

Lonsec Rating[5]

Lonsec notes: *"The Fund seeks to deliver private equity-style returns with listed market liquidity by taking a hands-on 'owners mind-set' approach to each investment. The owners mind-set is anchored in constructive engagement with companies, driving the realisation of positive change by bringing strategic options, new ideas and thinking to company Boards and management."*

Recommended Lonsec Research

4. The Zenith Investment Partners (ABN 27 103 132 672, AFS Licence 226872) ("Zenith") rating (assigned to L1 Capital Catalyst Fund in June 2023) referred to in this document is limited to "General Advice" (s766B Corporations Act 2001) for Wholesale clients only. This advice has been prepared without taking into account the objectives, financial situation or needs of any individual, including target markets of financial products, where applicable, and is subject to change at any time without prior notice. It is not a specific recommendation to purchase, sell or hold the relevant product(s). Investors should seek independent financial advice before making an investment decision and should consider the appropriateness of this advice in light of their own objectives, financial situation and needs. Investors should obtain a copy of and consider the PDS or offer document before making any decision and refer to the full Zenith Product Assessment available on the Zenith website. Past performance is not an indication of future performance. Zenith usually charges the product issuer, fund manager or related party to conduct Product Assessments. Full details regarding Zenith's methodology, ratings definitions and regulatory compliance are available on our Product Assessments and at http://www.zenithpartners.com.au/RegulatoryGuidelines.

5.The rating issued September 2022 for the L1 Capital Catalyst Fund is published by Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL 421 445 (Lonsec). Ratings are general advice only and have been prepared without taking account of your objectives, financial situation or needs. Consider your personal circumstances, read the product disclosure statement and seek independent financial advice before investing. The rating is not a recommendation to purchase, sell or hold any product. Past performance information is not indicative of future performance. Ratings are subject to change without notice and Lonsec assumes no obligation to update. Lonsec uses objective criteria and receives a fee from the Fund Manager. Visit lonsec.com.au for ratings information and to access the full report.

* Managed account holders only.

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L1 Capital | Overview

L1 Capital is a global investment manager with offices in Melbourne, Sydney, Miami and London. The business was established in 2007 and is owned by its senior staff, led by founders Raphael Lamm and Mark Landau. The team is committed to offering clients best of breed investment products through strategies that include long short Australian equities, international equities, activist equities, a global multi-strategy hedge fund and U.K. residential property. The firm has built a reputation for investment excellence, with all L1 Capital's strategies delivering strong returns since inception. The team remains dedicated to delivering on that strong reputation through providing market-leading performance via differentiated investment approaches with outstanding client service, transparency and integrity. L1 Capital's clients include large superannuation funds, pension funds, asset consultants, private wealth firms, financial planning groups, family offices, high net worth investors and retail investors.

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Key service providers for the Fund are: Responsible Entity – Equity Trustees Limited, Fund Administrator and Fund Custodian – Apex Funds Services (formerly Mainstream Funds Services), Fund Auditor – EY, Legal Advisor – Hall & Wilcox. There have been no changes to key service providers since the last report.