L1 CAPITAL CATALYST

L1 Capital Catalyst Fund

Quarterly Report | DECEMBER 2023

- **During the December quarter, the L1 Capital Catalyst Fund returned 4.0%[1] (ASX200AI 8.4%).**
- **Since inception the L1 Capital Catalyst Fund has returned 11.6%[1] p.a. (ASX200AI 5.9% p.a.).**
- **The Fund's performance during the December quarter was driven by both strong earnings momentum and catalyst realisation in key positions, whilst lower oil prices and having no exposure to the banks and the iron ore majors resulted in underperformance relative to the broader ASX200AI.**

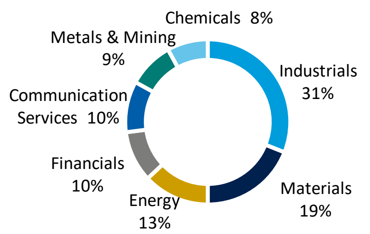
Equity markets were stronger in the December quarter with a sell-off in October more than offset by a rebound across November and December. The S&P500 Index and the MSCI World Net Total Return Index returned 11.7% and 11.4% respectively, whilst the ASX200AI returned 8.4% in the December quarter.

The primary driver of equity market momentum was interest rate expectations. In October, the market narrative was focussed on the need for interest rates to remain 'higher for longer'. In response, bond yields rose sharply, with U.S. 10-year bonds peaking in late October at close to 5%, the highest level since 2007. However, from mid-November, interest rate expectations began to recede quickly across all durations, driven by falling inflation and an increasingly dovish Fed. This supported a broad-based market rally which accelerated into the year end.

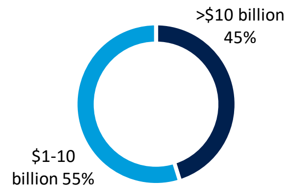
In Australia, the ASX200 was also buoyed by strength in iron ore prices (+19% during the December quarter), which reached 2023 highs of US$143/t. Australian banks also continued to perform strongly on interest rate cut expectations.

Returns (Net)[1] (%)	Catalyst Fund	S&P/ASX 200 AI	Out-performance
3 months	4.0	8.4	(4.4)
6 months	0.9	7.6	(6.7)
12 months	10.6	12.4	(1.8)
2 years (p.a.)	6.3	5.5	+0.8
Since inception (p.a.)	11.6	5.9	+5.7
Since inception (cum.)	31.8	15.5	+16.3

Sector exposure (%)



Market cap exposure (%)



Interest rate sensitive and growth sectors such as Property and Healthcare performed well, gaining back the underperformance seen in the September quarter. The Energy sector underperformed as oil prices declined 19% during the quarter on market scepticism of OPEC's supply response to the growth in global oil inventories and stronger-than-anticipated non-OPEC oil production.

The strongest sectors in the ASX200AI for the December quarter were Property (+16.6%), Materials (+13.4%), Healthcare (+13.1%) and Financials (+8.2%), whilst Utilities (-2.1%) and Energy (-9.1%) lagged.

Portfolio exposures by primary catalyst as at 31 December 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.

L1 Capital Catalyst Fund

Quarterly Report | DECEMBER 2023

L1 CAPITAL CATALYST

Portfolio commentary

Whilst the Catalyst Fund performed well on an absolute basis for the quarter (+4.0%), it underperformed the ASX200AI (+8.4%), largely due to having no exposure to the Banking, Property and Healthcare sectors, in addition to the iron ore majors, which where a major driver of the ASX200AI's quarterly performance.

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

- **Favourable portfolio company trading updates:** The Catalyst Fund's three best performing companies for the quarter were driven by positive trading momentum following previous share price weakness primarily due to short term and transitory external market conditions. One of the best performing stocks was BlueScope Steel, the share price for which rose ~20% for the quarter and reached 52-week highs following a recovery in U.S. steel spreads (U.S. steel prices increased 61% in the 3 months to 31 December) following a resolution of the United Auto Workers strike, which had temporarily disrupted automobile construction and related steel demand. With US steel delivery lead times and prices elevated well above historic averages, we expect this should provide a strong tailwind for the company's second half earnings (to 30 June). In addition, recent M&A activity in the U.S. market, most notably Nippon Steel's agreement to acquire U.S. Steel for ~US$14b (a 142% premium to the last undisturbed share price), provides a strong read-across for the value of BlueScope's U.S. operations.

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

- **Sector positioning:** Together, the three largest iron ore producers and the big 4 banks in addition to Macquarie, which comprise ~40% of the ASX200AI by weight, contributed ~60% of the total ASX200AI performance during the December quarter. Iron ore soared to a 2023 high of US$143/t, partly driven by seasonal re-stocking, and banks strengthened as market sentiment shifted towards expected interest rate cuts in 2024. In addition, the Property (+16.6%) and Healthcare (+13.1%) sectors materially outperformed, driven similarly by expectations of future interest rate cuts. During the quarter the Catalyst Fund had no investments in the banking, property and healthcare sectors, or exposure to the iron ore majors.
- **Decline in Energy and select commodity prices:** The Catalyst Fund is overweight Energy through its investment in Santos which was negatively impacted in the quarter by the declining crude oil price (Brent crude dropped 19% during the quarter from US$93/bbl to US$77/bbl). While the Energy sector as a whole materially underperformed the ASX200AI (ASX200 Energy -9.1% vs. ASX200 +8.4%), portfolio company Santos outperformed the energy sector by 5.4% and its nearest peer Woodside by 11.1%. As discussed in our **September 2023 Quarterly Report**, we believe Santos' asset base has been materially undervalued by the market and that structural options (e.g. demerger, asset sales etc.) could be explored to close the valuation gap. Subsequent to the publication of our September quarterly report, on the 7th of December 2023 Santos announced that it was engaged in preliminary discussions for a potential merger with Woodside, in addition to examining a range of alternative structural options for unlocking value.

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 confident in our portfolio and are focused on identifying and enacting catalysts through active engagement with company management and Boards. We continue to believe this engagement will ultimately create better shareholder returns for investors and outcomes for the companies themselves.

Catalyst Fund reflections on calendar 2023

In the **Catalyst Fund's December 2022 quarterly**, we detailed a number of key drivers that we believed would influence markets and provide opportunities for the Catalyst Fund in calendar 2023. As we look back on calendar 2023, we reflect on whether our expectations for 2023 eventuated below.

Our expectation for 2023	Eventuated	Commentary
1. STRATEGIC **M&A is still on the agenda but awaiting stability in economic conditions and improved funding markets**	?	▪ In 2023, the overall level of Australian M&A activity remained relatively subdued compared to historical levels, despite some major transactions completing during the year and a notable increase in activity towards the end of the calendar year. Major completed transactions included Newmont's acquisition of Newcrest ($27b), TPG Capital's acquisition of InvoCare ($1.9b), and Bain Capital's acquisition of Estia Health ($0.9bn). ▪ As expected, deals were concentrated in the Energy and Resources sectors and often included a scrip component, with other notable transactions including the proposed merger of Allkem and Livent, initial merger discussions between Santos and Woodside, and the proposed (but ultimately withdrawn) acquisition of Liontown Resources by Albemarle. ▪ Our expectation of elevated Technology sector deals did not eventuate. In addition to the challenges created by significantly tighter financing markets, we think that this also reflected the robust share price performance of Technology companies in Australia in 2023 (as inflation moderated and coming back off a material sell-off and valuation downgrade in 2022).
2. FINANCIAL **Companies will focus on managing their balance sheets targeting lower leverage and have higher hurdle returns**	✓	▪ Companies reported that interest costs increased significantly over the calendar year and frequently were higher than consensus forecasts, highlighting increased risk for companies with high leverage and with largely variable interest costs or fixed interest costs that were rolling off to variable rates. ▪ For the first half of calendar year 2023, median interest expense in the ASX200 (ex-Financials) index was 5.4% of net debt. This compared with 4.0% in the prior calendar year, representing a 36% increase in relative interest costs in calendar 2023. ▪ ASX200 leverage ratios on average only declined slightly during 2023, albeit companies are largely yet to report their final leverage position for the year. However, ASX-listed stocks with strong balance sheets significantly outperformed those with weaker balance sheets in 2023, and we expect leverage ratios will remain in focus in 2024.
3. OPERATIONAL **Margins will face further pressure and costs will be a focus**	✓	▪ Australian companies have also been negatively impacted by higher wage rates and rents. ▪ As a result, profit margin expectations have declined significantly, with the CY23 consensus forecast for the ASX200 Industrials index reducing from 7.1% at the start of the year to 6.6% by year-end (representing a 7% decline in profit expectations). ▪ With companies generally finding it harder to pass on higher input costs fully, many have renewed their attention on operating costs to maintain margins. A range of companies announced cost-out measures, including major employers Coles, Amcor, Lendlease, Telstra and Fortescue.
4. GOVERNANCE **The 'G' in ESG and appreciation of regulatory risk will continue to gain importance and prominence**	✓	▪ In calendar 2023 we have seen elevated focus on company Boards and more instances of shareholders seeking to hold them accountable for company performance and behaviour. ▪ Companies that are exposed to more challenging regulatory dynamics have also been in the limelight and have been perceived as more vulnerable to adverse regulatory or legislative changes. ▪ Prominent examples of this have included Endeavour Group and Star Entertainment, each of which have been impacted by government reforms targeting the gambling industry.

2024 themes relevant to the Catalyst Fund

In 2024, we expect a range of themes outlined below to influence the investment strategy of the Catalyst Fund.

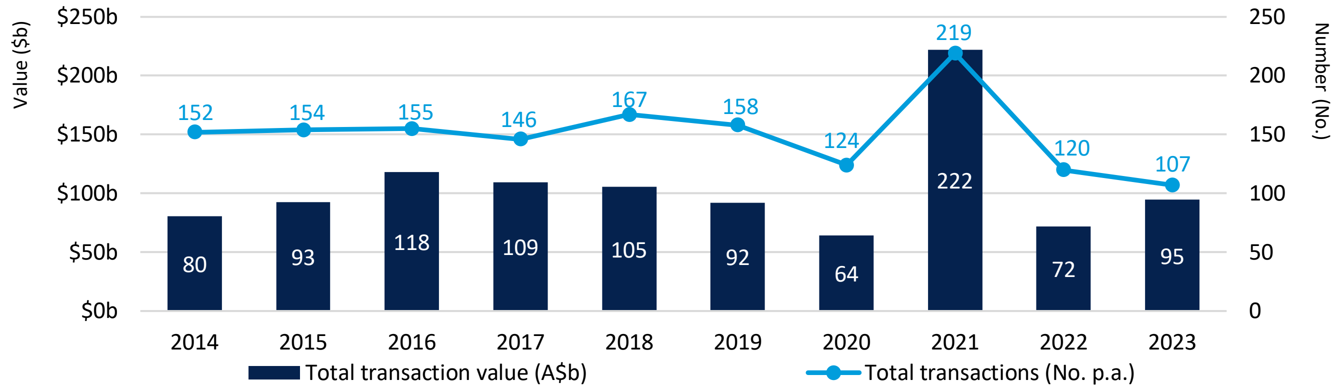
Catalyst exposure types

- **STRATEGIC**: Volume of M&A activity is likely to normalise upwards from a low base as inflation moderates and interest rates peak.
- **FINANCIAL**: Funding costs will continue to increase as existing lower cost debt arrangements roll off, impacting capital allocation decisions.
- **OPERATIONAL**: More frequent instances of cost-out programs will arise to offset input cost pressures.
- **GOVERNANCE:** Large superannuation funds will continue to exert their influence.

STRATEGIC: Volume of M&A activity is likely to normalise upwards from a low base as inflation moderates and interest rates peak.

In 2023, Australian M&A activity remained relatively subdued, notwithstanding a pick-up in activity towards the end of the year. Figure 1 below shows the number and total value of announced Australian M&A transactions with a value >$100m by calendar year. In 2023, total transaction value included a group of large transactions (such as Newmont's $27b acquisition of Newcrest), but was still 10% below the 10-year average between 2014 and 2023. Meanwhile, the total number of transactions in 2023 was 29% below the previous 10-year average.

Figure 1: Australian announced M&A activity



Source: Capital IQ. Includes all announced control M&A deals >$100m.

Recent inflation data and statements from central banks (particularly the latest U.S. Federal Reserve projections), suggest that the Fed Funds rate has likely peaked and interest rates may start to be cut in 2024 from the currently 'restrictive' levels in 2024. We think that this is likely to result in a broad increase in the volume of M&A activity across sectors. In particular, we expect the volume of transactions sponsored by private equity funds to increase, given the huge remaining 'dry powder' for these funds to deploy, the gradual narrowing of the 'bid-ask' spread between bidders and vendors, and improved debt funding availability as interest rates peak.

A number of significant Australian M&A transactions were announced in December 2023, including the agreed acquisition of Link Group by MUFG, an indicative proposal from CRH and the Barro Group to acquire Adelaide Brighton, and the agreed merger of Chemist Warehouse and Sigma, which are potentially illustrative of signs of increased M&A activity in 2024.

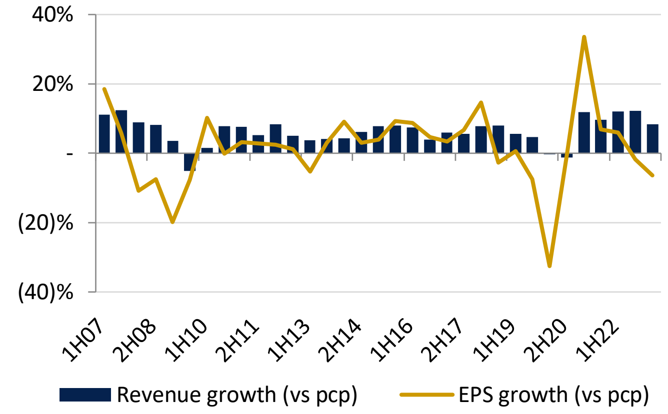
A normalisation of M&A activity and an increase in the level of buyer interest for assets should make it more attractive for companies to divest certain assets or segments where there is strategic rationale in doing so.

FINANCIAL: Funding costs will continue to increase as existing lower cost debt arrangements roll off, impacting capital allocation decisions.

As previously discussed, higher interest rates resulted in a substantial increase in corporate debt funding costs in 2023. This was a key reason why a number of companies experienced a decline in earnings despite positive revenue growth, as shown in Figure 2.

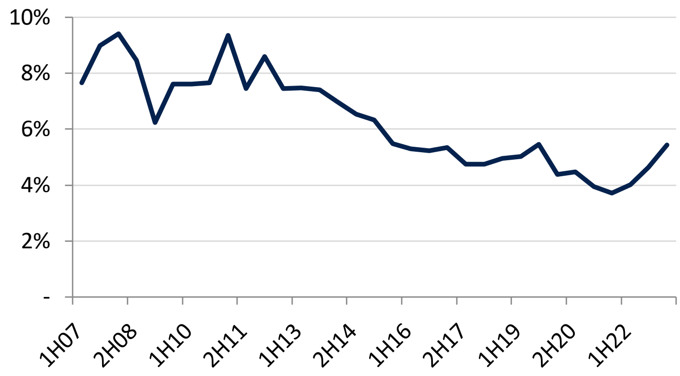
However, as shown in Figure 3, due to the prevalence of fixed interest debt arranged when interest rates where significantly lower than current levels, average interest costs remained relatively low compared with the period in 2011 when the RBA cash rate was last around current levels. This suggests that funding costs will continue to increase and negatively impact corporate earnings in 2024 as this fixed rate debt gradually rolls off.

Figure 2: ASX200 Industrials revenue and EPS growth



Source: Factset, Goldman Sachs Investment Research

Figure 3: ASX 200 ex-Financials interest expense as % of net debt



Source: Factset, Goldman Sachs Investment Research

We expect that reported debt interest costs will continue increasing in 2024, which will amplify scrutiny on company capital structures and capital allocation decisions. In particular, debt-funded acquisitions and organic growth options funded by debt will be harder to justify. Within the Catalyst Fund we have invested in companies with low relative leverage and growth optionality supported by strong underlying earnings and cash flow, which we expect to become increasingly differentiated.

OPERATIONAL: More frequent instances of cost-out programs will arise to offset input cost pressures.

A number of factors, including higher average interest rates, the prospect of lower net inbound migration, reduction in covid-19 related savings, and potential weakness in the labour market, are likely to weigh on consumer spending in 2024 and make earnings growth harder for companies to achieve compared with prior years.

This will coincide with a significant increase in a number of key input costs, including labour and rent. As a result, we expect to see companies initiate and announce more substantial cost-out programs during 2024, including the roll-out of substantial automation projects to offset higher unit labour costs and capitalise on advances in AI technology.

We expect that the combination of weak revenue growth and significant cost inflation will place pressure on profit margins, and that earnings growth will be difficult for many companies to achieve. We have identified and invested in companies that we expect to benefit from a near-term structural earnings inflection point and that are also trading on relatively 'cheap' valuations which we expect to re-rate in the medium-term.

GOVERNANCE: Large superannuation funds will continue to exert their influence.

Australian superannuation funds continue to become more active and willing to engage directly with Boards of ASX-listed companies in which they are typically major shareholders. One prominent example of this has been AustralianSuper publicly expressing its opposition to the proposed acquisition of Origin Energy by the Brookfield and EIG consortium, and then using its substantial shareholding (~17%) to successfully vote against the deal, which ensured the proposed Scheme of Arrangement did not proceed.

We expect this trend to continue in 2024, given Australian superannuation funds' substantial and growing funds under management and long-term investment horizon, and contribute to more public cases of ASX shareholder activism that in previous years. In a weaker growth and returns-challenged environment we also expect this influence to be focussed on financial outcomes, with environment and social issues still an important, albeit lesser priority, than in prior years.

Importantly, we think that the increasing level of active engagement by Australian superannuation funds, and the greater level of overall shareholder activism in the public domain, will accelerate the acceptance of shareholder activism in the Australian market, with activism migrating from being stigmatised to being accepted, as has been the case in the U.S. and even Europe for some time now.

The ongoing trend towards Australian superannuation funds becoming larger and being more actively engaged shareholders will be extremely beneficial for the development of shareholder activism in Australia, ultimately resulting in a larger presence of active domestic investors of scale who have a focus on shareholder returns.

L1 CAPITAL CATALYST

L1 Capital Catalyst Fund

Quarterly Report | DECEMBER 2023

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 FirstChoice, CFS FirstWrap, HSBC, Hub24, Macquarie Wrap, Mason Stevens, MLC, Netwealth, North*, Powerwrap, Praemium

Research house ratings

Zenith Rating[2]

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[3]

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

2. The Zenith Investment Partners (ABN 27 103 132 672, AFS Licence 226872) (Zenith) rating assigned to L1 Capital Catalyst Fund (Jun 23) 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 methodology, ratings definitions and regulatory compliance are available on our Product Assessments and at http://www.zenithpartners.com.au/RegulatoryGuidelines

3. The rating issued for L1 Capital Catalyst Fund (Oct 23) 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.

L1 Capital Catalyst Fund

Quarterly Report | DECEMBER 2023

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.

Contact us

Head of Distribution
Chris Clayton | cclayton@L1.com.au | +61 3 9286 7021

Researchers
Aman Kashyap | akashyap@L1.com.au | +61 477 341 403

Advisors
Alejandro Espina | aespina@L1.com.au | +61 423 111 531
Lisa Salamon | lsalamon@L1.com.au | +61 406 585 322

Private Clients
Alexander Ordon | aordon@L1.com.au | +61 413 615 224

Investor Services
Jeffrey Lau | jlau@L1.com.au | +61 403 194 728

L1 CAPITAL

Level 45, 101 Collins Street
Melbourne VIC 3000 Australia

www.L1.com.au

Scan the QR code for more information

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.

Information contained in this publication

Equity Trustees Limited ("Equity Trustees") (ABN 46 004 031 298), AFSL 240975, is the Responsible Entity for the L1 Capital Catalyst Fund ARSN 650 484 263. Equity Trustees is a subsidiary of EQT Holdings Limited (ABN 22 607 797 615), a publicly listed company on the Australian Securities Exchange (ASX: EQT).

This publication has been prepared by L1 Capital Strategic Equity Management Pty Limited (ACN 648 751 928), (an authorised representative (no. 1286013) of L1 Capital Pty Ltd (ACN 125 378 145, AFSL 314 302)) and its officers and employees (collectively "L1 Strategic"), to provide you with general information only. In preparing it, we did not take into account the investment objectives, financial situation or particular needs of any particular person. It is not intended to take the place of professional advice and you should not take action on specific issues in reliance on this information. Neither L1 Strategic, Equity Trustees nor any of its related parties, their employees or directors, provide any warranty of accuracy or reliability in relation to such information or accepts any liability to any person who relies on it. All performance numbers are quoted after fees. Past performance should not be taken as an indicator of future performance. You should obtain a copy of the Product Disclosure Statement before making a decision about whether to invest in this product.