Quarterly Report

L1 CAPITAL

L1 Capital International Fund (Managed Fund)

December 2024

In this Quarterly Report, we have outlined:

- Our assessment of the current investment environment including:
  - Why interest rates continue to stay 'higher for longer' in line with our expectations
  - Why 'good' economic news, particularly in the U.S., is currently 'negative' for equity markets
  - The importance of the 'Magnificent 7' and Artificial Intelligence to equity index returns
  - 2025 investment environment outlook and where we are seeing attractive investment opportunities developing in choppy investment conditions
- Our review of the December quarter and 2024 calendar year, including key contributors and detractors to the Fund's performance
- Recent Portfolio adjustments
- Why Microsoft's share price underperformed in 2024, and why Microsoft remains one of the largest investments in the Fund
- Market concerns impacting HCA Healthcare resulting in a 25% pullback in the share price and providing a compelling investment opportunity.

Fund performance (Net) (%)[1]

	Fund	Index[2]	Out-performance
3 months	11.4	11.9	(0.4)
1 year	29.0	30.8	(1.8)
3 years p.a.	11.7	12.2	(0.5)
5 years p.a.	15.3	14.0	+1.3
Since Inception* p.a.	15.8	14.7	+1.1
Since Inception* cumulative	135.7	122.6	+13.1

NAV price as at 31 December 2024	**$6.53**

* Unit Trust Inception is 1 March 2019 (returns measured from Index close). ETMF Inception is 22 November 2023.

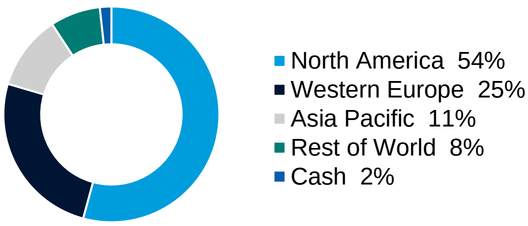
Fund (Net) and benchmark returns since inception[1,2]

1. All performance numbers are quoted net of fees. Net returns are calculated based on the movement of the underlying investment portfolio. Figures may not sum exactly due to rounding. **Past performance should not be taken as an indicator of future performance. 2.** The Benchmark is the MSCI World Net Total Return Index in A$. Neither MSCI nor any other party involved in or related to compiling, computing or creating the MSCI data makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of such data. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in or related to compiling, computing or creating the data have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages. No further distribution or dissemination of the MSCI data is permitted without MSCI's express written consent.

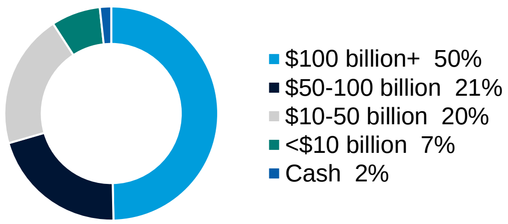
Strategy returns (Net)[3] (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2019			0.8	5.8	(2.7)	4.4	2.8	1.5	(0.5)	(0.7)	4.9	(1.4)	**15.4**
2020	6.0	(2.6)	(8.9)	2.0	3.6	(2.5)	1.5	3.8	(0.3)	(1.1)	3.5	(0.3)	**3.8**
2021	6.1	2.9	5.4	5.9	(0.2)	5.5	3.4	4.6	(4.1)	1.1	3.8	1.1	**41.1**
2022	(4.1)	(5.6)	(4.3)	(3.6)	(0.4)	(6.4)	10.2	(4.3)	(5.5)	7.1	1.3	(6.3)	**(21.1)**
2023	5.4	1.4	6.4	1.9	3.0	3.8	2.2	4.6	(3.1)	(1.1)	5.0	2.7	**36.9**
2024	6.1	5.0	2.3	(3.7)	0.4	0.4	5.8	(1.3)	0.2	4.5	5.0	1.5	**29.0**

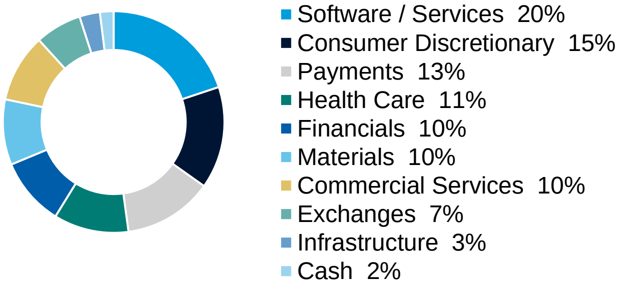
Revenue exposure by region[4]



Market capitalisation exposure (in US$)



Sector exposure[5]



Top 10 holdings

As at 31 December 2024 (In alphabetical order)	**Sector**
AerCap	Financials
Alphabet	Software / Services
Amazon.com	Software / Services / Consumer Discretionary
Booking Holdings	Consumer Discretionary
CRH	Materials
HCA Healthcare	Health Care
Intercontinental Exchange	Exchanges
Mastercard	Payments
Microsoft	Software / Services
Visa	Payments

3. All performance numbers are quoted net of fees. Net returns are calculated based on the movement of the underlying investment portfolio. Figures may not sum exactly due to rounding**. Past performance should not be taken as an indicator of future performance. 4.** Revenue by region is internally estimated on a look through basis based on the underlying revenues of the individual companies held in the portfolio. **5.** Sector exposure is defined by L1 Capital International to best describe the nature of the underlying businesses.

Current investment environment

"Steady effort pays off, even if not always in an immediate, tangible way."

"Long-term success is impossible if you let your heat-of-the-moment reactions trump careful planning."

Garry Kasparov

Introduction

Choosing a favourite Garry Kasparov quote is almost as challenging as choosing from Buffett and Munger's collective wisdom. In the current investment environment, **both Kasparov quotes above are highly relevant to our investment philosophy and approach**, particularly in an environment where high profile themes and headlines are driving day to day market volatility and investment performance in the short term. And while we unfortunately have no access to Kasparov, for those readers looking for a distraction from unsettling world events and investment environment pressures, we can recommend a fantastic chess coach.

In line with tradition, our December 2024 Quarterly Report is partly retrospective, benefitting from crystal clear hindsight on the events, drivers and investment outcomes of 2024. We also peer with considerable intent and effort through the murky outlook for 2025 and beyond.

2024 investment environment reflections

2024, much like the years that have preceded it, was dominated by headlines on regional conflicts, domestic and international politics, extreme weather events and, from a more mundane investment perspective, inflation, Monetary and Fiscal Policy, longer-term interest rates, as well as the evolution of Artificial Intelligence (broadly defined).

Deeply regrettably, conflicts continued in the Middle East, Ukraine, Africa and many other regions of the world. From an investment perspective these conflicts had limited impact in 2024, and our base case is for these conflicts to remain at the edge for most businesses. More economically meaningful international conflict remains a foreseeable investment risk, but one we can only manage to some extent through our developed market centric investment universe and specific company investments.

Weather, at least today, remains at the edge for most investment considerations, and under a Trump administration the explicit investment drivers supported by Environmental, Social and Governance considerations are likely to take a step backwards.

We are not political experts and will keep our political observations short and investing centric. According to Wikipedia, approximately 80 countries, representing around four billion people conducted national elections throughout 2024, including the United States, United Kingdom, Japan, France, Russia, India, Pakistan, Mexico and many others. Among democracies, over 80% saw the incumbent party lose support compared to the previous election. At the risk of making sweeping superficial comments, politic sentiment around the world appears to have shifted Nationalistic and to the Right. Australia will face an election in 2025. Again, without being flippant, we are very fortunate to live in a country where the biggest political dilemma most voters face is whether the democracy sausages will run out by the time they vote.

We continue to see the greatest financial pressure on people with lower socio-economic status, while the affluent are thriving. Crudely, in democracies it is one vote per person, not one dollar per person. We are not surprised to see **political change diverge from economic change.**

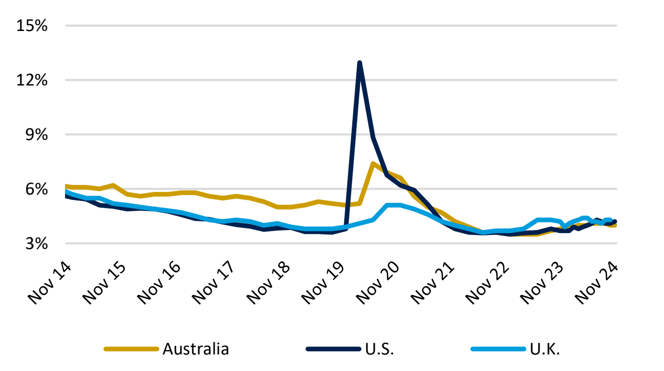
From a macroeconomic perspective, 2024 was consistent with recent trends and our base case expectations. Financial headlines and market volatility can give the impression of rapid and material economic changes. However, if we step back and look at **macroeconomic trends in 2024**, from our perspective **very little changed.**

Going back to our June 2023 Quarterly Report we outlined parallels between 2023 and the mid-1990s' macroeconomic and investment environment. We concluded an economic 'soft landing' was looking more likely and that **rising interest rates alone did not, by necessity, mean the world was heading for a sharp economic recession or that share prices would fall**. In our subsequent quarterly commentary, we have repeatedly outlined a consistent message. Our base case remains that while Central Banks were late in raising rates during this cycle, **we do not expect them to aggressively reduce interest rates** while inflation remains above targeted levels and employment conditions remain robust.

When we look at economic data in the U.S. and most developed markets globally, trends continue to be consistent, **on average**. Our September 2024 Quarterly Report laboured the point about the **limitation of averages** and the **divergences** we identified **below the surface of broad macroeconomic data** without taking away from our conclusion that economic conditions, on average, are pretty good, particularly in the U.S.

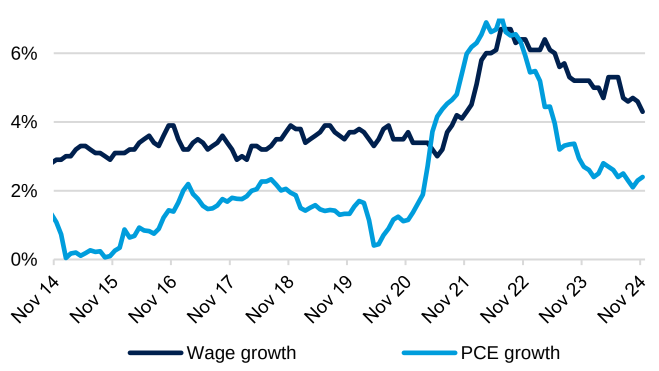
Employment remains robust in most markets (Figure 1) with wages growth exceeding inflation growth (Figure 2).

Figure 1: Unemployment rate



Source: Australian Bureau of Statistics, St Louis Federal Reserve, Office for National Statistics

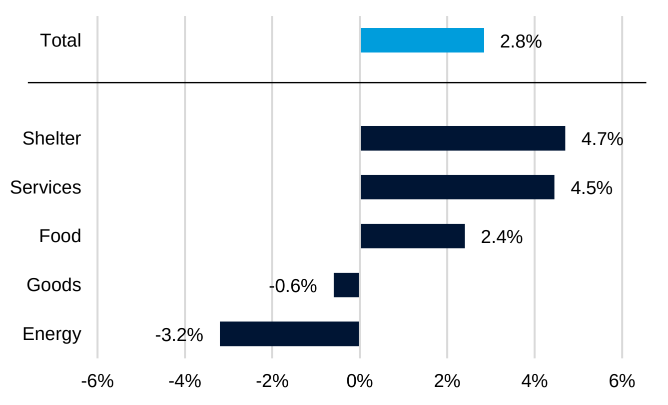
Figure 2: U.S. wages growth compared to inflation



Source: Federal Reserve Bank of Atlanta, U.S. Bureau of Economic Analysis

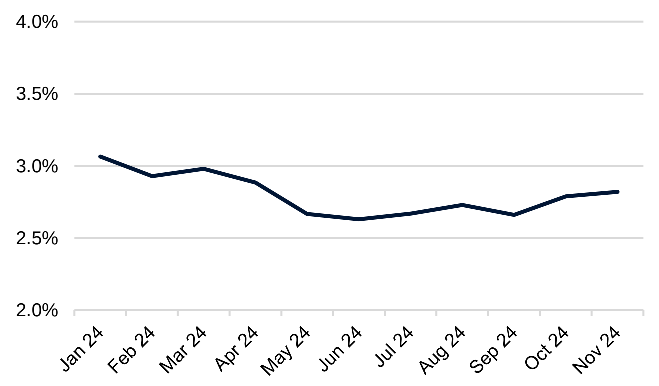
While inflation remains relatively sticky and high in the shelter and in some services categories (Figure 3), overall core inflation remains remarkably stable (Figure 4), and still moderately above most Central Bank long term targets.

Figure 3: U.S. CPI components core inflation in 2024



Source: U.S. Bureau of Labor Statistics

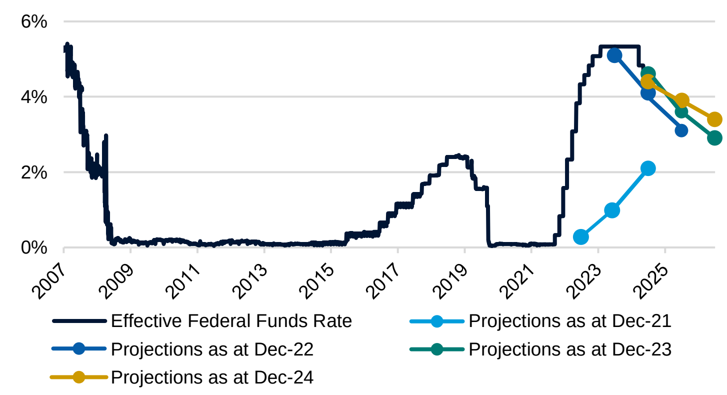
Figure 4: U.S. core inflation in 2024



Source: U.S. Bureau of Economic Analysis

As a result, **FOMC and market expectations for short-term interest rates continue to shift 'up and to the right'** i.e. **short-term interest rates staying higher for longer**, consistent both with our base case expectations for the past couple of years and with our expectations looking forward (Figure 5).

Figure 5: Federal Reserve Funds Rate and expectations

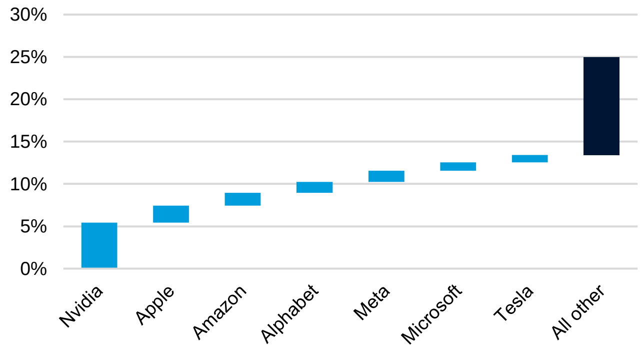


Source: FOMC projections, December 2024, St Louis Federal Reserve

Artificial Intelligence boom and the importance of the Magnificent 7

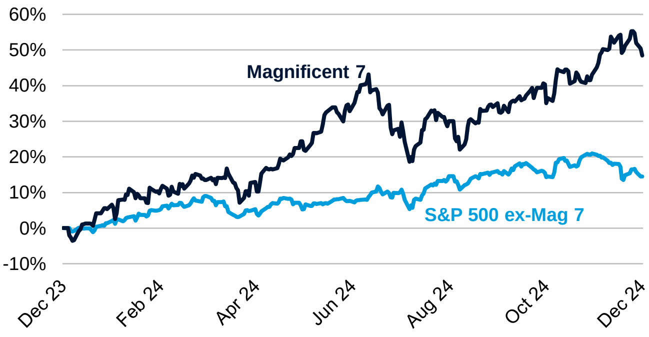
Equity markets delivered strong returns in 2024, particularly in the U.S. The Fund's Benchmark, the MSCI World Index, delivered a total return on 18.7% in USD (30.8% in AUD), while in the U.S., the S&P 500 Index returned 25.0% in USD in 2024 following a total return of 26.3% in 2023. Index returns can be misleading, and the **composition of returns were highly concentrated**, once **again led by the Magnificent 7 and Nvidia**, in particular. **The Magnificent 7 accounted for over 50% of the S&P 500 Index's total return, with Nvidia alone accounting for more than 20% of the Index's total return** (Figure 6). Put another way, the Magnificent 7 provided a 48.4% return in 2024, led by Nvidia's 171% total return, with the S&P 500 excluding the Magnificent 7 returning 14.5% in 2024 (Figure 7).

Figure 6: 2024 total return attribution – S&P 500 Index



Source: Bloomberg

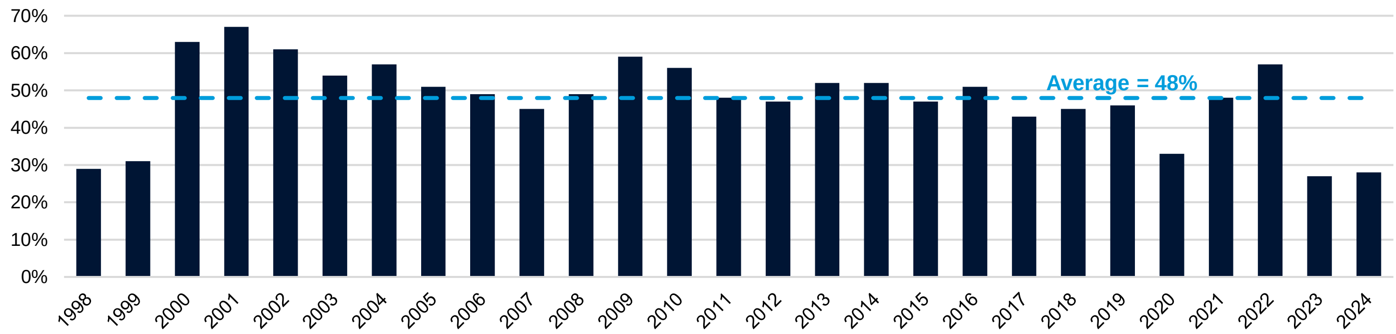
Figure 7: Mag 7 total return vs. rest of Index – 2024



Source: UBS

Another way of seeing the concentrated nature of equity market returns is highlighted in Figure 8**. In 2024, only 28% of the S&P 500 Index members outperformed the Index**, similar to 2023's level of 27%. We must go back over 25 years to see a year in which the number of Index members outperforming the Index was this low and so far below the average of near 50%.

Figure 8: S&P 500 Index members outperforming the Index



Source: Capital IQ

2025 investment environment outlook and Portfolio positioning

We have been consistent in our view that growth is slowing globally. Many consumers, particularly lower socio-economic people are under financial pressure, and in general consumer confidence is soft. Corporates are cautious and are constraining discretionary spending. Government spending has offset some of the private sector pressures, but whether it be the 'Department of Government Efficiency' or other forms of fiscal discipline, there are foreseeable scenarios where public spending is not as supportive of growth as it has been in the COVID and post-COVID years.

Therefore, we are in a rate cutting cycle. Figure 9 summarises Central Bank monetary policy decisions in key markets in 2024. The Reserve Bank of Australia stands out as not starting the rate cutting cycle, but short-term rates did not increase as much as they did in the U.S., and we continue to believe the RBA is somewhat behind the curve in cutting interest rates. **We continue to expect further loosening of Monetary Policy in most markets, the question is how much and how quickly.**

Figure 9: Central Bank overnight rates

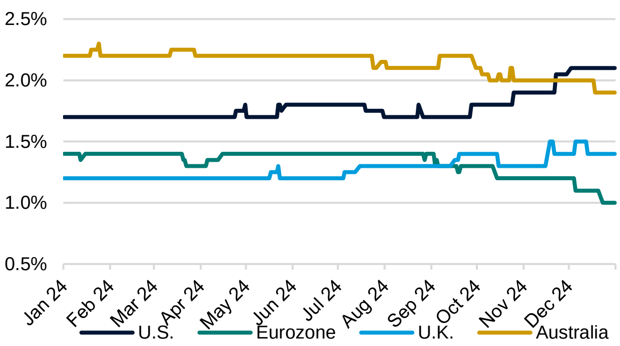
	U.S.	ECB	U.K.	Australia	Canada	N.Z.	China
Overnight rate – December 2023	5.32	4.00	5.19	4.35	5.00	5.50	2.65
Number of rate cuts	3	4	2	0	5	3	2
Overnight rate – December 2024	4.33	3.00	4.70	4.35	3.25	4.25	2.35

Source Federal Reserve Bank of New York, European Central Bank, Bank of England, Reserve Bank of Australia, Bank of Canada, Reserve Bank of New Zealand, Bloomberg

Economic growth expectations remain positive, albeit relatively muted. Interestingly, recognising the limitations of macroeconomic forecasts, over recent months **growth expectations for the U.S. have been increasing**, while **Eurozone growth expectations continue to drift lower.**

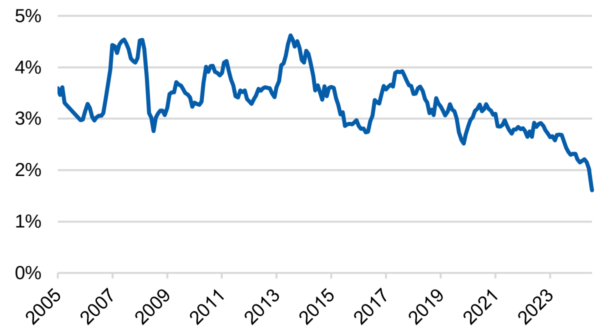
2025 GDP growth expectations for China have remained flat at around 4.5%, but this is more informative about the forecasters than the Chinese economy. A more important indicator to us is long-term interest rates in China which have never been lower.

Figure 10: 2025 GDP growth forecasts



Source: Bloomberg

Figure 11: China 10-year interest rate



Source: Bloomberg

While the recent bump in growth expectations for the U.S. could just be Trump-related optimism, **our view remains economic growth is slowing, not crashing, and the U.S. remains the 'best house on the investment street'** from a macroeconomic perspective, despite some uncertainties. We continue to be **cautious about investing in businesses with meaningful Chinese exposure**. Political tensions are likely to further pressure an already weak Chinese economy.

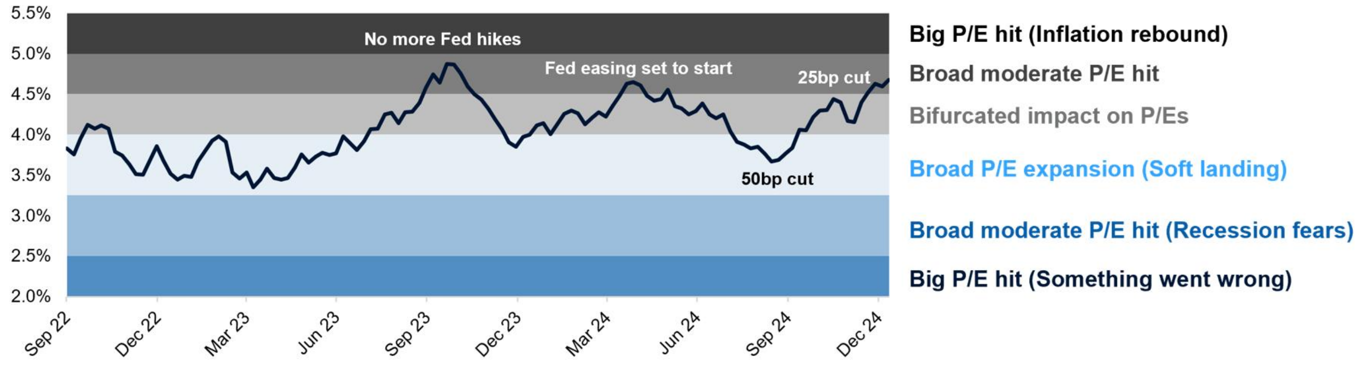
We are often asked what **Trump's presidency** will mean for the world and equity markets. It is an important question, but one no-one can answer with any degree of certainty. We do expect 'interesting' headlines and policy with 'America First' intentions, but mixed outcomes for America and the rest of the world. However, on balance, Trump and the Republican party are capitalists and Trump repeatedly demonstrated in his first presidency that **he considers the performance of equity markets to be a key indicator of his performance** (and within his control). That said, we have been careful to limit our exposure to businesses that could be materially impacted by changes in Government policy.

As discussed during our November 2024 Webinar, market commentary is usually focused on Monetary Policy and short-term interest rates. While these policy decisions are important, **we monitor long-term interest rates as a more important driver of equity market conditions, valuations and returns over a longer investment horizon**.

We are currently in a 'grey zone' for long-term interest rates (Figure 12). In late 2024 long-term interest rates started to increase, with this trend continuing into 2025. It is always difficult to pinpoint exact reasons for movement in market interest rates, especially when assessed over short periods. **Employment conditions, particularly in the U.S. remaining stronger than many forecasters expected, inflation remaining stubbornly above Central Bank targeted levels,** some other positive economic data and concerns about the inflationary pressures from tariffs led by U.S. policy under Trump are likely factors.

From an equity market perspective, we are currently in an environment where 'good economic news' is negative for equity market conditions. This is because it leads to expectations for higher short and long-term interest rates which impacts equity market valuations and future growth expectations**.** While there is no magic around particular interest rate levels and the interest rate bands in the chart below should be considered illustrative only, **directionally higher long-term interest rates are resulting in a 'greyer' investment environment,** with investors becoming increasingly concerned as the U.S. 10-year treasury yield approaches 5%.

Figure 12: 10-year U.S. Treasury Yield



Source: Federal Reserve, Piper Sandler, L1 Capital International

We have already seen a modest market correction, with the companies in our portfolio on average ending 2024 around 12% below their 12-month peak share price, although there is a wide range of price pullbacks within our portfolio, and we did not have investments in all these companies when they were trading at their 12-month peak. While we are not contrarian for the sake of it, **the share price of more cyclical businesses or where valuation is sensitive to long-term interest rates**, such as the infrastructure sector and more highly indebted businesses, **have been under pressure** due to the increase in interest rates. **As a result, more attractive opportunities for investors with a longer-term investment horizon are developing.**

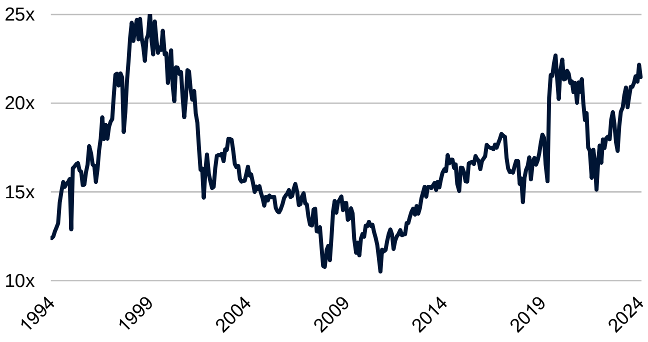
In addition, **higher interest rates are not negative for all people or all businesses**. A retired couple with no mortgage, cash in the bank and no dependents may benefit from higher interest rates. In contrast a young family with a large mortgage (particularly if it is floating interest rate mortgage or due for a reset at a higher base rate), increasing childcare or education costs and other cost of living pressures will likely face further budget pressures from rising interest rates.

It is also important to remember that one of the key reasons why interest rates are staying higher for longer is because economic conditions are relatively robust, particularly in the U.S. There will be winners and losers at the sector and individual business level. Business selection is critical when investing in this choppy investment environment.

Many commentators have highlighted the increasing market multiples for equity indices (e.g. Figure 13) and the strong outperformance of the Magnificent 7 as well as the concentrated nature of market returns highlighted earlier to state equity markets are over-valued. **We consider much of this commentary simplistic and wrong.** The Magnificent 7 companies are indeed magnificent, and their collective share prices have outperformed because they are performing extremely well in large areas of the global economy that are growing strongly such as AI, cloud computing, eCommerce, social media, mobile technology and critical software. As a simple illustration, Figure 14 highlights **earnings expectations for the Big 6 technology businesses (Magnificent 7 excluding Tesla) increased substantially during 2024**, unlike the rest of the market where earnings expectations fell.

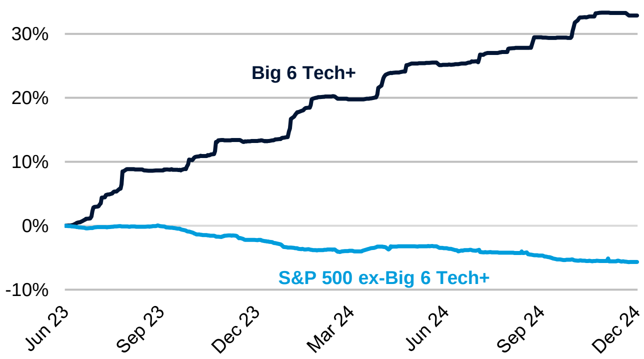
Tesla is in its own category. Tesla's share price does not reflect today's business of manufacturing electric vehicles, but rather the vision of Musk and potential for Tesla to transform industries, particularly autonomous vehicles and robotics. Our investment philosophy is inconsistent with investing in Tesla. In addition to valuation considerations, **we will not back a horse where the racing track is so uncertain and the jockey so unpredictable.**

Figure 13: S&P 500 P/E (next twelve months)



Source: UBS

Figure 14: 2024 EPS revisions



Source: UBS

Artificial Intelligence developments are not a fad, although we are seeing **some pockets of the market where there is clear irrationality and stretched valuations.** We live in a world where tweets by RoaringKitty and joke cryptocurrencies named after a dog are valued and move markets, albeit in niches.

For entertainment, we used an AI engine to design our take on the traditional cat vs. dog battle (Figure 15).

Do not take our attempt at humour as irreverence to AI – we continue to expect AI to be a key driver of economic developments and equity markets going forward. However, **financial discipline and objectivity** will be increasingly critical to achieve strong risk adjusted returns from businesses with exposure to AI.

More generally, volatile and choppy macroeconomic conditions, politics, Monetary and Fiscal Policies and diverging equity market performance at the region, sector and business level present challenges, but also attractive investment opportunities across a range of industries and businesses.

Figure 15: Roaring Kitty vs. Doge as depicted by Artificial Intelligence

Source: Gemini's Imagen 3, L1 Capital International

We remain focused on consistently applying our 'bottom-up' investment philosophy to identify high quality businesses of varying size with long-term favourable business drivers across a diverse range of well-structured industries, led by aligned management. Valuation discipline, as always over the long-term, remains critical. We believe this approach will continue to deliver strong risk adjusted returns from our portfolio of businesses in a range of economic conditions.

December 2024 quarter and 2024 calendar year review

Performance

In the December 2024 quarter, the Fund returned 11.4% (net of fees), compared to the Benchmark return of 11.9% (all in Australian dollars).

The depreciation of the Australian dollar had a particularly substantive positive impact on Fund (and Index) returns in the December quarter when measured in Australian dollar returns. The Australian dollar depreciated 10.5% against the U.S. dollar and depreciated 1.2% against the Euro, increasing the Fund and Benchmark Australian dollar reported quarterly returns. Fund and Index returns were only modestly positive in the December quarter when measured in local currency.

In 2024, the Fund returned 29.0% (net of fees), compared to the Benchmark return of 30.8% (all in Australian dollars). Foreign currency movements also positively contributed to Fund and Benchmark returns over calendar 2024. In 2024, the Australian dollar depreciated 9.2% against the U.S. dollar and depreciated 3.2% against the Euro.

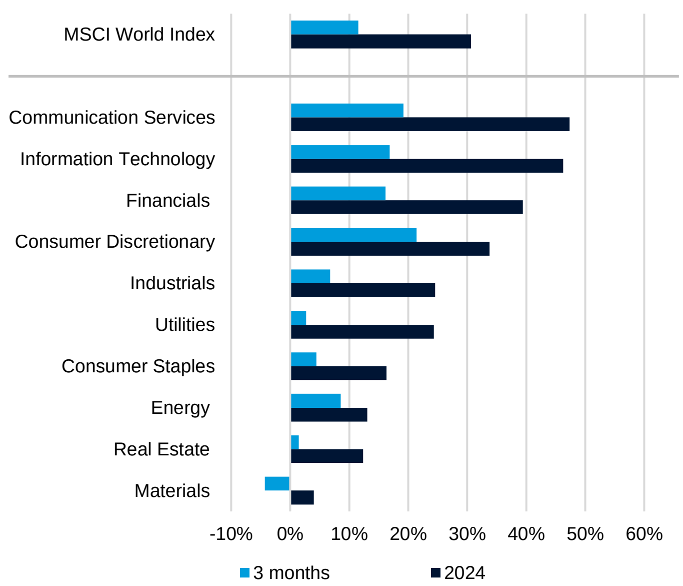
Key contributors and detractors

All sectors, except Materials, delivered positive returns in the December 2024 quarter (measured in Australian dollars), led by Communication Services, Consumer Discretionary and Information Technology, the sector homes of the Magnificent 7 and other technology related businesses. The Financials sector also performed strongly. China related concerns and rising interest rates pressured the Materials and Real Estate sectors (see Figure 16).

Extending the time horizon to calendar 2024, all sectors delivered positive returns when measured in Australian dollars. Communication Services and Information Technology sectors led the outperformance, while Materials and Real Estate sectors lagged.

We have been highlighting mixed equity market conditions and mixed share price performance of companies below headline Index and sector levels for a while. Figure 8 highlights the exceptionally low number of U.S. companies outperforming the S&P 500 Index in 2023 and 2024. **Within our portfolio, we are also seeing divergence of share price performance.** While currency enhanced all Australian dollar returns, 12 portfolio companies outperformed the Benchmark in the December 2024 quarter and 12 portfolio companies underperformed the Benchmark.

Figure 16: MSCI World Index (in A$) – Sector Performance



Source: Bloomberg

Five companies (**Alphabet, Amazon.com, Booking Holdings, Mastercard** and **Visa** in alphabetical order) each positively contributed over 1% to the Fund's performance during the December 2024 quarter, while **AerCap** and **CRH** were just below this return threshold. **HCA Healthcare** was the only company to detract from the Fund's performance by more than 1% in the December 2024 quarter. We discuss the recent underperformance of HCA Healthcare on page 12 of this report. **UnitedHealth Group's** contribution to December 2024 quarterly performance was only fractionally negative (in AUD), but its share price did fall nearly 25% intra-quarter (before partially recovering) following the murder of a senior executive and the increased focus on the role of for-profit insurance in the U.S. healthcare system. While the U.S. healthcare system has many faults and UnitedHealth Group is unlikely to be perfect in its many roles within the system, directionally we believe UnitedHealth Group is focused on maximising healthcare outcomes and reducing waste and misaligned expenditure. Recognising the inherent political and business uncertainties, we have maintained our investment in this business.

Over a more meaningful but still short 12-month investment period, during 2024 the Fund's 29.0% return (net of fees and in Australian dollars) was slightly below the Benchmark return. The slight underperformance against the Benchmark was not driven by poor performance of businesses we have invested in, but rather not having investments in some of the big winners of 2024, particularly **Nvidia**. As highlighted in Figure 6, Nvidia had a massively outsized impact on 2024 investment returns. We have previously discussed our underestimation of the speed and scale Nvidia has been able to monetise its technology leadership including its integrated software and advantaged position in data centre hardware and networking to support the growth in AI. We also retain our view that while Nvidia is a special high-quality business with substantial further growth potential, at around the current share price, Nvidia provides an unattractive risk adjusted return in our central base case scenarios.

2024 portfolio return contributors were diverse by both sector and size of company, reflecting our differentiated approach to assessing 'Quality' businesses rather than the traditional (and in our view deeply flawed) categorisation of investment philosophy and businesses as either 'Growth' or 'Value'.

Measured in Australian dollars, five companies positively contributed over 2% to fund returns (**Amazon.com, Booking Holdings, CRH, Eagle Materials** and **Microsoft** in alphabetical order), while a further seven companies positively contributed by more than 1%. No company detracted from Fund returns by more than 1.0% which is pleasing. That said, we did see material divergence in share price performance at the company level.

Measured in Australian dollars, 27 out of the 30 companies we invested in for some or all of 2024 positively contributed to the Funds returns (26 out of 30 in local currency). However, like the broader market, only about one third of our holdings outperformed the index in 2024. **Position sizing is under-discussed in the context of successful investing. Many of our strongest outperformers were by businesses where our conviction and position sizing were highest.**

We discussed the importance of the Magnificent 7 to index returns in 2024 (and 2023) on page 5 of this report. We are not 'anti-Magnificent 7 and from our perspective, we could invest in these businesses except Tesla which we consider 'uninvestable' for us today. Amazon.com and Microsoft are two of the Fund's largest holdings and Alphabet was also a top 10 holding as of 31 December 2024 (although we continue to reduce the size of this position).

Microsoft's 13% total shareholder return in 2024 wasn't 'bad', but it was well below the rest of the Magnificent 7 and slightly below the returns of the US market excluding the Magnificent 7. We discuss 'Mr Market's' concerns about Microsoft and the **reasons for the relative underperformance** on page 10 of this report.

Portfolio adjustments

The businesses in our portfolio continue to perform largely in line with our expectations, and changes to the portfolio were modest in the December 2024 quarter.

We divested our smaller position in **Graphic Packaging** due to the share price increasing despite our assessment of more challenging shorter term market conditions. Graphic Packaging remains on our 'Bench' of potential investments and with the share price falling materially since we divested the reinvestment opportunity is becoming more attractive.

Eagle Materials benefitted from the 'Trump rally' following the U.S. election. We materially reduced the position size due to valuation considerations and concerns that rising interest rates could pressure U.S. new residential housing activity. Eagle Materials is no longer a top 10 holding, but it is still a portfolio investment. After this partial divestment, U.S. mortgage rates have continued to increase and the share price of businesses in the new residential housing and building materials sectors have been under considerable pressure, including Eagle Materials. We will look to increase our shareholding in Eagle Materials should this share price pressure continue.

We also meaningfully reduced our investment in **Booking Holdings** (Booking). While Booking's operating performance continues to exceed our base case, the share price has increased substantially as the market gains comfort that demand for travel is likely to remain resilient despite rising interest rates and pressure on some consumers. Position sizing reflects expected returns, risk assessment and degree of conviction. Maintaining valuation discipline is a core tenet of our investment philosophy. Our risk assessment and level of conviction in Booking is unchanged, but in our assessment the higher share price and lower base case return profile warranted a smaller shareholding. Booking remains a top ten position for the Fund.

As a reminder, **we generally invest based on a rolling 3-to-5-year investment horizon, we are not traders, and we do not make portfolio changes lightly**. That said, we do not believe any business can be bought and held forever without regard to valuation. As discussed, there has been a high degree of volatility in share price performance of companies within our portfolio and the market in general, with many investors chasing short-term winners and many businesses with a more clouded near-term outlook have been under considerable share price pressure. **We believe having a longer-term investment horizon presents attractive investment opportunities.**

In our assessment **the near-term regulatory uncertainty facing HCA Healthcare following the U.S. elections has led to excessively negative sentiment and pressure on the HCA Healthcare share price**, and we topped up our investment in this business. We discuss these issues in more detail on page 12 of this report.

Starting positions were initiated in two companies. The position size for both companies will likely increase at lower share prices. Other changes were limited, with small adjustments to position sizes to reflect relative share price and base case return expectations within the portfolio.

Over the entire 2024 calendar year we had investments in 30 companies. 16 of the 23 companies held at the end of calendar 2024 were also Fund investments at the end of 2023. **There is likely to be less change in our investments in the businesses in which we have higher conviction and larger Fund positions. This was reflected in 9 out of the top 10 positions at the end of 2024 also being Fund positions at the end of 2023.**

Cash weighting reduced from around 4% at the start of the December 2024 quarter to around 2% by 2024-year end. Cash is an outcome of our investment process, not a target. Over time the Fund is expected to be broadly fully invested.

Why is Microsoft's share price underperforming?

> **"As we look into the future, it's clear that artificial intelligence is poised to become a world-changing General Purpose Technology"**
>
> *Brad Smith, Vice Chair & President of Microsoft, January 2025*

We continue to view AI (broadly defined) as a game changer for most industries, and one if not the most important developments from an investment perspective. AI is a large and complex area with immense potential, but also inherent uncertainty. The technology being developed is ground-breaking, and by definition, unprecedented. There is a myriad of issues that are unknowable, many with significant financial implications for companies operating in the industry today, or who may be affected by AI tomorrow. No-one knows with certainty how quickly AI applications will be broadly developed and commercialised, the cost of developing and servicing this technology, infrastructure requirements such as power and cooling, or the investment return on the tens of billions of dollars being invested.

To frame and assess the AI opportunity from an investment perspective, we have assessed companies in three categories linked to the staged development and commercialisation of AI. We acknowledge that this framework is an over-simplification. Some businesses do or will cross-over categories, while other categories or sub-categories will develop over time.

Category 1 includes companies which provide the 'picks and shovels' to the initial gold-rush stage of AI development. Nvidia is the poster child for category 1, with its semiconductor chips and software providing the compute to power large language models and other generative AI developments. In addition to other semiconductor companies like Broadcom and AMD, companies benefitting from this stage of AI development include businesses providing power supply or cooling technology to data centres. **Many investors place significant emphasis on current operating conditions and tend to over-extrapolate the present**. Share prices for strongly performing companies in this category have increased massively over the past couple of years. There is no doubting that Nvidia is extremely well placed today and Nvidia's financial performance keeps on exceeding our expectations. While there is a risk we continue to under-estimate businesses such as Nvidia, we are finding companies in this category to be fully or more than fully valued presently.

Category 2 includes companies which provide 'AI as a service' and facilitate other companies to develop and implement AI in their business. The hyperscalers such as **Azure (Microsoft), Amazon Web Services (Amazon.com) and Google Cloud Platform (Alphabet) are leaders in this category.** These companies are not in the business of building and selling datacentres as such, rather using the computing power and infrastructure they are investing in to develop a range of products and services, including AI centric capabilities, for their own requirements, as well as for third parties. Again, at the risk of over-simplification, category 1 companies are providing the track and locomotives, while category 2 companies are developing and operating the railway network and providing rail transport and logistics services in the rapidly developing AI world. To stretch our analogy further, it is currently a rush to lay the track and build out the railway network as fast as possible to reach as many customers in as many regions for today and the future. **Management leadership of the big technology companies have openly stated the risk of under-investing in this stage of the AI industry's development is dramatically greater than the potential for over-investing.**

Category 2 is extremely capital intensive, and only the largest technology businesses in the world have the financial resources, people and technical capabilities to lead this investment.

Category 3 includes companies where AI is embedded in their products and services. We believe this category will include a vast array of companies with almost every business potentially incorporating AI in the future to some extent. Early examples of commercialisation of AI include managing call centre inquiries, software development or **Intuit** (a portfolio investment) using AI to help individuals and businesses manage their accounting records or file their tax returns.

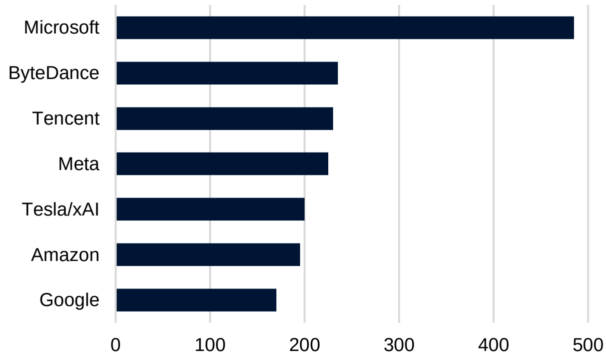
Returning to Microsoft, the company has many leading franchises, including cloud computing infrastructure and services (Azure), computing operating systems (Windows), business productivity software (Office, Dynamics), corporate networking and human resources (LinkedIn), Gaming (Xbox, Activision) amongst others, but **Microsoft has not led in all areas**. Microsoft basically missed the mobile revolution losing out to Apple and Alphabet (Android), with a forlorn late attempt to improve their competitive position through the acquisition of Nokia. In certain areas of hardware Microsoft is a small niche player (Surface) and in Search, Bing is a distant number 2 to Google.

In AI, Microsoft, though ChatGPT and other capabilities, has a leadership position today. Given the importance of AI as a 'world-changing General Purpose Technology', **management is not going to hold back on investment to position Microsoft as a leader of this most important category into the future**.

While there are different ways to measure investment, there is no doubt Microsoft is a leader, if not the leader in capital investment into all things AI related.

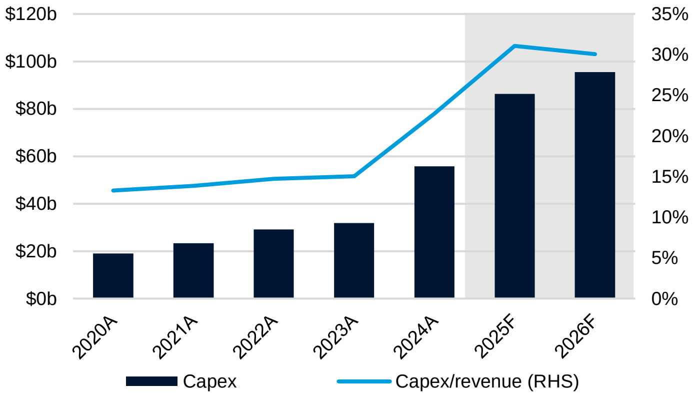
> **"In FY2025, Microsoft is on track to invest approximately $80 billion to build out AI-enabled datacenters to train AI models and deploy AI and cloud-based applications around the world."**
>
> *Brad Smith, Vice Chair & President of Microsoft, January 2025*

Figure 17: Microsoft spending on Nvidia's AI chips compared to competitors



Source: Omdia, Financial Times, L1 Capital International

Figure 18: Microsoft total capex



Source: Microsoft, L1 Capital International

The investment thesis for Microsoft has shifted from being a capital light, software centric business generating enormous amounts of free cashflow, to a business which retains all these software capabilities and associated cashflow but is now **reinvesting a significant proportion of the cashflow generated into AI infrastructure.** While we are incredibly excited by the opportunities for Microsoft to commercialise this investment through the provision of both category 2 and category 3 products and services, to date **the return on this immense level of investment is uncertain. This uncertainty has dragged on the near-term share price performance of Microsoft.**

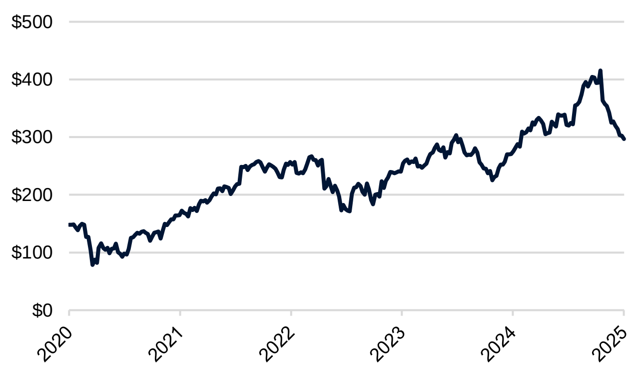
Microsoft, with a market capitalisation of over US$3 trillion, is an extremely large and diverse business. We have not tried to cover every factor affecting the market's assessment of the company. **There is only space for one headline and today AI related developments and sentiment is crowding out all other considerations.** In our view, one of the greatest under-appreciated strengths of Microsoft is its **latent pricing power**. Just as an interesting anecdote to illustrate this point that many readers may be able to relate to, Microsoft recently increases the price of a personal Office 365 subscription in Australia by around 40%, following a 10% increase last year. Microsoft has increased pricing around the world to offset currency devaluation pressures and to reflect their investment in features and services that have been added to the platform. For those of you who have noticed this increased cost of your Office 365 subscription we doubt you will be happy, nor do we expect you cancelled your subscription. You can take some offsetting comfort that you are financially benefitting through the L1 Capital International Fund's investment in Microsoft.

To conclude, it hasn't been a 'bad' year for Microsoft's share price performance, but it has underperformed the rest of the Magnificent 7 materially and the broader U.S. market modestly. **We believe this share price performance reflects unjustified concern about the level of investment Microsoft is making in all things AI, and we expect Microsoft will generate strong returns on this investment over time.** If not, Microsoft will pull back on this level of investment, which will be materially negative for Nvidia and other companies operating in this industry. **At the current share price, we consider Microsoft to be trading at or below the bottom end of our base case fair value range, and the company remains one of the largest investments in the Fund.**

Why has HCA's share price recently fallen over 25% from the 2024 peak?

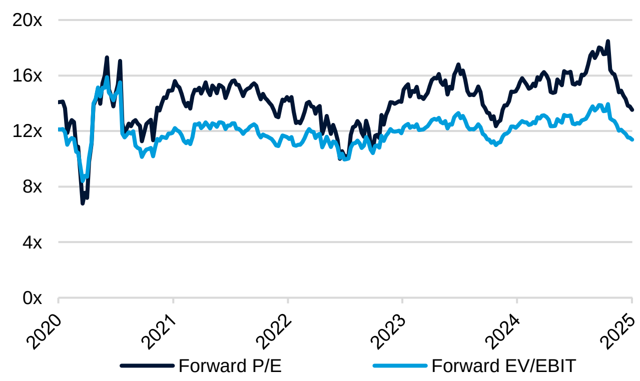
We discussed the rationale for our investment in HCA, the leading for-profit hospital operator and outpatient services provider in the U.S. in our December 2023 Quarterly report. 2024 has been a consistent year of execution by the HCA management team, but a volatile year from a share price perspective. The share price was $270 at the start of calendar 2024, peaked at $415 in October 2024 and ended the year around $300. There has also been a material devaluation of HCA from an earnings multiple perspective.

Figure 19: HCA share price



Source: FactSet

Figure 20: HCA forward P/E and EV/EBIT ratio



Source: FactSet

We discussed on page 6 that we have been careful to limit our exposure to businesses that could be materially impacted by changes in Government policy. **We underestimated the market's sensitivity to the outcome of the U.S. election as it relates to HCA's business outlook.** Mr Market has classified HCA as a 'Democrat/Biden winner' and a 'Republican/Trump loser'. Mr Market is fearful that healthcare policy under Trump and Republicans will be materially adverse for HCA.

This is a highly complex area, but the heart of concerns is people will have less coverage and less access to healthcare services provided by HCA, and HCA will overall receive lower reimbursement for the provision of healthcare services.

One area that has justifiably garnered significant attention is Health Exchanges. This segment of demand accounts for around 7% of HCA's volume, up from 4% pre COVID, and a little over 8% of total revenue. The programs subsidise health care premiums for less affluent Americans, with around 20 million people currently benefitting from lower insurance costs. The subsidies are substantial, with the Congressional Budget Office estimating the cost to the Federal Government is around $30bn to $40bn per annum. It is estimated that millions of Americans will not be able to afford insurance coverage or will have to drop down a tier of coverage if these subsidies are not extended at their maturity date at the end of 2025. Some people may revert to coverage from their employer or may end up being covered by Government programs. Some people will be uninsured. The net impact on HCA cannot be quantified with precision, but if Trump and the Republicans follow through with current expectations for these subsidies to end or at a minimum be restrained, some degree of negative impact on HCA is likely.

Another area is Medicaid, where States have programs in place to provide supplementary payments to cover the cost of providing care for qualified people, with the Federal Government generally providing matching funding. Again, there is concern that these supplementary payments will reduce, impacting reimbursement rates to HCA.

It is important to remember that HCA predominantly operates in Republican States (Texas and Florida alone account for almost 60% of HCA's hospital beds). Republican voters get sick too. Around 60% of HCA's revenue is generated from inpatient service and 40% from outpatient services. Many of HCA's competitors are owned by religious and other not-for-profit groups as well as more rural competitors that lack profitability, balance sheet, scale and diversity of healthcare services and facilities compared to HCA and are less able to absorb reimbursement and occupancy pressures and continue to provide high quality care. Many of HCA's hospitals have regional leadership in the provision of higher acuity care, including experienced physicians and higher quality facilities. **Industry structure and HCA's leading competitive position are key attributes of why we consider HCA to be a high-quality business.**

A few of HCA's hospitals were unfortunately impacted by the 2024 hurricane season, with some of these facilities continuing to be impacted in 2025. Excluding the impact of these storms, **HCA has been exceeding its financial guidance and our base case expectations, and management has recently confirmed operating conditions remain in line with expectations and are expected to continue into 2025.** We also expect insurance to cover part of the hurricane related losses.

While we agree there are risks for HCA, policy support is likely to be less advantageous during the Trump presidency, and some negative impact on HCA's financial performance is likely due to the strength of the election results for Trump and Republican Party, the **HCA share price has materially over-reacted, falling from the top end of our view of the fair value range, to well below fair value,** currently trading below 13x 2025 earnings. HCA's financial position continues to strengthen, with financial leverage reducing over time. **We believe the current base case risk adjusted return is compelling, downside risks are manageable and have been using the share price weakness to increase our investment in this very high-quality business.**

Fund Information

Name	L1 Capital International Fund (Managed Fund)
Portfolio Manager	David Steinthal, Chief Investment Officer
Types of investments	Listed securities globally. Developed market focus. No shorting, no leverage.
Number of investments	20 to 40
Cash weighting	0% to 25%
Minimum initial investment	$25,000
Hedging	Unhedged
Structure	Dual Registry
Inception	Unit Trust: 1 March 2019. ETMF: 22 November 2023
Domicile/currency	Australia/$
Management fee*	1.20% p.a.
Expenses	Nil (included in Management Fee)
Benchmark	MSCI World Net Total Return Index in $
Performance fee**	15% over Benchmark
High watermark	Yes
APIR / ISIN / ASX Ticker	ETL1954AU / AU0000302960 / L1IF
Platform Availability	Asgard, Australian Money Market, BT Panorama, CFS Firstwrap, Hub24, Macquarie Wrap, Mason Stevens, Netwealth, North, Powerwrap, Praemium, Xpand

L1 Capital International overview

L1 Capital International is an independent active manager of global equities. We apply a detailed investment process built on a fundamental assessment of quality and value. We aim to deliver attractive risk-adjusted returns by investing in high quality companies that have favourable cashflow-based valuations in well-structured industries. Capital preservation over the investment horizon is central to our investment philosophy and process. We view risk as the potential for a permanent loss of capital as opposed to volatility in share prices. Additional information on L1 Capital International is available at www.L1International.com.

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Key service providers for the Fund are: Responsible Entity – Equity Trustees Limited, Fund Administrator and Fund Custodian – Apex Group, Fund Auditor – EY, Legal Advisor – Baker & McKenzie. There have been no changes to key service providers since the last report.
* All fees are quoted inclusive of GST and net of RITC. ** There must be positive absolute performance (adjusted for distributions) in the performance period. Otherwise, positive relative performance carries forward to next Period.
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