L1 CAPITAL

April 2020

L1 Long Short Fund Limited

(ASX Code: LSF)

Key Details

ASX code	LSF
Share price	$1.06
Market capitalisation	$701m
Shares on issue	661,084,982
Listing date	24 April 2018

Net Performance*

	NTA pre-tax
One month	23.16%
Three months	(11.57%)
Six months	(16.45%)
One Year	(9.53%)
Total return since inception	(24.89%)

*Source: Mainstream Fund Services. Net performance is defined as the movement in NTA pre-tax. Performance is shown after all applicable fees and charges. Past performance should not be taken as an indicator of future performance.

The L1 Long Short Fund returned 23.2% in April.

The Fund performed strongly due to a recovery in many stocks that had been oversold in March, along with some significant buying the Fund did near the market lows.

We remain very excited and optimistic about the medium term outlook for the portfolio. Valuations for numerous high quality stocks look exceptionally attractive at present. We recognise the outlook for the global economy is uncertain and market volatility is likely to remain elevated in the near term, however, the Fund is well placed to navigate these events.

Global equity markets recovered some of the extreme losses suffered in March, given the enormous policy support shown from central banks and Governments. The ASX200 Accumulation Index recovered just over a third of its March losses, rallying 8.8%, (MSCI World 10.8%, S&P500, 12.7%, Euro stoxx 6.3%, FTSE 4.0%, Nikkei 6.7%). The best performing sectors in Australia were Energy (+24.9%), Information Technology (+22.5%) and Consumer Discretionary (+15.9%), while Consumer Staples (+2.4%), Utilities (+2.7%) and Financials (+2.8%) lagged.

The Fund delivered its strongest monthly return on record, with performance very broadly spread by stock and sector. In total, 23 stocks contributed more than 0.5% to returns.

Some of the key contributors to performance in April were:

Scentre Group (long) – Owner of Australia's best group of shopping centres that continues to enjoy a strong position within the retail sector. Shares had fallen by more than 60% (from $4.00 to around $1.50) and were trading at less than half of NTA ($4.46) when we began building a position and it has since rallied 40% to $2.10. Scentre's distribution in FY19 was 22.6c (15% trailing yield at purchase price), which highlights how much downside is being factored into forward expectations. Scentre owns 7 of Australia's top 10 shopping centres and has achieved more than 99% occupancy continuously for more than 20 years. We anticipate a large near-term impact from the lock-down and an ongoing impact from a weaker domestic economy. While e-commerce presents a clear, longer term headwind for the sector, we believe Scentre is well placed to continue to provide a strong proposition to both customers and retailers for many years to come. Scentre is unlikely to breach any debt covenants, but could elect to sell some assets to avoid equity dilution. Even in a conservative scenario where equity dilution is factored in (to de-gear the balance sheet) we believe the shares continue to represent attractive value.

Worley (long) – The Fund bought back into Worley around $6.80 (after fully exiting the position at the start of the year around $10-$13). After falling by over 50% during the March quarter, Worley shares staged a modest recovery in April. We believe Worley is much better placed to handle this downturn relative to the last cycle. Post the Jacobs ECR acquisition, Worley is more diversified across sectors and geographies, with upstream oil and gas capital expenditure now representing only 20% of group project work and ~45% of revenues derived from customers' operating expenditure (rather than capex investment). Worley's non-upstream business lines should remain relatively resilient in this environment.

While upstream capex will likely be very subdued in the near-term, this should normalise over the medium term given the global oil industry faces depletion rates of ~5-6% p.a. requiring oil companies to increase investment just to maintain production levels. We have been adding to our Worley position as we believe the shares are very oversold with the market incorrectly regarding the entire business as a direct exposure to the oil price. In late April, Worley provided a very positive market update that showed considerable resilience over the last couple of months and highlighted a proactive approach to managing costs and staff utilisation levels going forward.

Boral (long) recovered strongly in April after its extreme sell-off in March (the shares had fallen from $4.50 to less than $2 by mid-March). Boral has had a series of earnings downgrades over the last couple years, with the most recent major disappointment being the identification of financial irregularities in its North American Windows business which would result in a one-off impact to EBITDA of US$20-$30m. We significantly reduced our Boral position in mid 2019 (around $5.00-5.50) given the weaker operational outlook. Given the large fall in the share price in March, we significantly increased our position at around $2.20 as we believed the shares were extremely oversold. While the near-term outlook is challenged by lower housing activity in Australia and North America, we continue to remain optimistic on the longer term outlook for Boral given its strong leverage to the growth in infrastructure construction that is set to occur on the east coast of Australia over the next few years. We note the current high gearing levels and we are encouraging the Boral board to focus on asset sales rather than a capital raising to simplify the business and reduce balance sheet risk. While the business is facing a challenging year ahead, we believe Boral's market cap of approximately $3b dramatically understates the asset value and mid cycle earnings power of Boral.

Star Entertainment (long) fell from over $4.00 at the end of February to a low of around $1.60 in March due to the forced closure of public venues, including casinos, announced by the Government in March. This closure caused concerns regarding the potential for Star to endure large operating losses and require an emergency capital raising. Star recently announced an increase in borrowing facilities that will enable them to manage for a prolonged period of closure without the need to raise equity. Star's market cap of $1.8b (at the time of topping up in mid-March) is a fraction of the underlying value of its marquee portfolio of casinos, hotels and licenses. Star shares recovered strongly in April as the market began to anticipate a re-opening of casinos some time in the coming months and also due to Blackstone taking a 10% stake in rival Crown Resorts.

Other strong performers in April included Atlas Arteria, Downer, Oil Search and Alacer Gold.

Investors should expect heightened Fund volatility in the short term, given very elevated market volatility, ongoing news flow regarding COVID-19, changes in economic activity, policy responses and investor sentiment. We encourage investors to take a longer term view around their investment in the Fund rather than reacting to the 'noise' in short term share price moves. The companies that the Fund own are well placed to withstand a wide range of potential economic outcomes. Each investment represents a strong combination of value and quality and we expect them to deliver attractive returns over the years ahead.

Portfolio Exposures (month end)

Number of positions	93
Number of long positions	68
Number of short positions	25
Gross long exposure (%)	185%
Gross short exposure (%)	85%
Gross exposure (%)	270%
Net exposure (%)	100%

Investment Guidelines

Typical number of positions	50-100 securities
Geographic exposures	Max 30% gross outside of Aust/NZ
Net exposure limits	Max 150% of NAV; typically 30-90%
Gross exposure limits	Max 300% of NAV; typically 150%-300%

Net Tangible Assets Per Share (as at 30 April 2020)*

NTA pre-tax	$1.5022
NTA post-tax	$1.6601

*Source: Mainstream Fund Services. The NTA pre-tax is calculated before the provision for deferred tax on unrealised gains and losses on the investment portfolio. The NTA post-tax is calculated after all taxes.

Board of Directors

Andrew Larke	Independent Chair
John Macfarlane	Independent Director
Harry Kingsley	Independent Director
Raphael Lamm	Non-Independent Director
Mark Landau	Non-Independent Director

Key Contacts

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Overview and Investment Philosophy

L1 Long Short Fund Limited has been established to invest in a portfolio of predominantly Australian and New Zealand securities, with up to 30% invested in global securities. The Company has the ability to both buy and short-sell securities, which provides a flexible strategy to deal with changing stock market conditions. The objective is to deliver strong, positive, risk-adjusted returns to investors over the long term. The portfolio is managed by L1 Capital Pty Ltd, which has established a reputation for offering clients best of breed investment products. L1 Capital manages money for a range of clients including large superannuation funds, endowment funds, financial planning groups, asset consultants, family offices, high net worth individuals and retail investors.