L1 CAPITAL

October 2020

L1 Long Short Fund Limited

(ASX Code: LSF)

Key Details

ASX code	LSF
Share price	$1.49
Market capitalisation	$938m
Shares on issue	629,344,452
Listing date	24 April 2018

Net Performance*

Net Performance*	NTA pre-tax
One month	(2.37%)
Three months	8.07%
One Year	(3.60%)
Two Years (p.a.)	4.00%
Total return since inception	(13.34%)

**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 -2.4% in October (ASX200AI 1.9%).

The Fund continues to be positioned for a gradual improvement in the outlook for COVID-19, given the likely progress with vaccines, treatments and rapid testing over the coming year.

In October, the L1 Capital Long Short strategy was nominated as a Finalist for the 5 Year Award at the 2020 AsiaHedge Awards, recognising the Fund's strong long term performance track record.

An investor briefing will be held on Monday, November 9 at 2pm (AEDT). Click here to register for the webinar.

Global markets declined in October (S&P500 -2.7%, FTSE100 -4.7%, Euro Stoxx 50 -7.3%, Nikkei -0.9%). Markets started the month off strongly however, they sold off abruptly in the back half of the month on growing concerns of an acceleration in COVID-19 case numbers in Europe and the U.S., including proposed lockdowns in key European cities and further delays in finalising the next U.S. fiscal stimulus package. The ASX200AI returned 1.9% in October outperforming most global markets. The strongest sectors were Information Technology (+9.0%), Financials (+6.3%) and Consumer Staples (+4.8%), while Industrials (-3.9%), Utilities (-1.5%) and Materials (-1.2%) fell.

The Fund was modestly down in October after a strong period of performance from April to September. The abrupt shift in investor positioning was triggered by delays to the interim data readout from Pfizer, potential lockdowns in Europe and U.S. election uncertainty. We expect each of these factors to be short term and transitory in nature.

We believe the outlook for COVID-19 is likely to improve during 2021. Numerous vaccines, treatments and rapid testing is expected to come to market over the next 6-12 months, which will encourage investors to rotate back into COVID-19 impacted sectors (travel, casinos, shopping centres, tollroads, energy, etc). Our portfolio positioning is based on what we see as the best risk-reward on a 1-2 year view and has been consistent since March. While we recognise there will be periods of short term volatility, we are comfortable that the companies we are invested in are well placed as they have large upside to valuation, strong industry positions and conservative balance sheets.

Some of the key contributors to Fund performance in October were:

Nine Entertainment (NEC) (long +19%) had a strong month as advertising markets started to show tangible signs of improvement with a recovery in economic activity and key advertisers returning to the market. Segments that are supporting this trend include Auto, Government and e-Commerce. As a result, available advertising inventories on TV have substantially reduced, driving an improvement in yields and creating a positive environment for Nine heading into the important pre-Christmas period. This backdrop is also supportive for Nine's digital advertising businesses such as 9Now (live streaming and catch up TV) which continues to see audience growth and is attracting an increasing share of media spend. Nine's other key Digital businesses of Stan and Domain are also well positioned for growth going forward. During COVID-19, Stan has been able to consolidate its position as the #2 streaming service in Australia (behind Netflix), and is on track to be a meaningful earnings contributor to the broader Group from FY21.

Looking forward, we expect media spend will continue to recover as the economy re-opens further and companies seek to reinvest in their brands. The lifting of restrictions in Victoria and the expectations of state borders re-opening should drive increased confidence for advertisers, including the key travel and tourism sectors. While the market has begun to upgrade earnings estimates to reflect improving conditions, our view remains that consensus earnings forecasts are excessively bearish on the outlook and we expect further EPS upgrades to come through over the next 6 months that are not currently reflected in Nine's share price.

Unibail-Rodamco-Westfield (URW) (long +11%) shares partially recovered in October after the sharp decline in September with the announcement of a €9b capital reset plan to strengthen the balance sheet including, €4b in asset disposals and a €3.5b capital raise. An EGM to approve the capital reset plan will take place on 10 November with a consortium of major investors (holding ~5% of issued shares) intending to vote against the equity raise and favouring a structured sell down of the U.S. portfolio and a re-focus on the European asset base. We share the views of the consortium that URW's liquidity position remains stretched but manageable in the context of the challenges it faces, with continued access to bond markets and no covenant breaches likely in the near term. When we established our position in May (after the shares had already fallen more than 65% since January), our valuation views incorporated a potential capital raise to bolster the balance sheet until restrictions eased. While we believe the company's reset plan has been poorly structured and timed, we continue to believe URW shares are materially undervalued irrespective of whether an equity raise is carried out or not. URW is currently trading at an ~80% discount to the last reported Net Tangible Asset Value and at a substantial discount to the likely asset value post a potential equity raise (and allowing for further devaluations and asset sales). Further clarity on the equity raise process, execution of the asset sale program and a continued recovery in foot traffic should all act as share price catalysts over the next 6-12 months.

CIMIC (CIM) (long +16%) shares rallied after announcing the sale of a 50% interest in its mining services business (Thiess) to Elliot Advisors for an enterprise value of ~A$4.3b. We had flagged this potential catalyst in our September monthly report. The cash proceeds of ~A$1.7b to A$1.9b from the sale will enable CIMIC to return the balance sheet to a net cash position and provide capital management optionality going forward. The majority of CIMIC's construction work is government related and the medium to long term infrastructure pipeline remains substantial. As part of its recent results, CIMIC noted it was bidding for A$70b of work to be awarded in CY20 and ~A$470b from CY21 onwards. We expect this pipeline will increase as governments look to boost infrastructure spending to help stimulate economies post COVID-19. We continue to believe CIMIC is materially undervalued, trading on a normalised P/E of only ~9.7x despite this structural industry tailwind and its industry leading positions across construction and mining services.

Some of the key detractors to Fund performance in October were:

Atlas Arteria (ALX) (long -7%) shares fell after the French government imposed a minimum 4 week lockdown from 30 October in response to rising daily COVID-19 infection rates. ALX is part owner of one of France's best quality tollroad networks, the 2,318km APRR. While ALX will be impacted by the lockdown and associated traffic declines, this temporary impact does not materially change our medium term valuation view. ALX raised ~$495m to strengthen the balance sheet in May and remains well funded to weather near term COVID-19 related volatility. We still see further substantial upside in ALX as dividends return in 2021 and 2022 towards our previous expectations.

Aurizon (long -11%) shares declined due to concerns on the outlook for domestic coal production and exports after the company reported Q1 FY21 rail coal volumes 5% below the prior period. Aurizon is Australia's largest rail freight operator, with its main asset comprising the 2,670km Central Queensland Coal Network. Despite the softer start to the year, Aurizon has retained its full year coal volume and EBIT guidance, implying an expected recovery in 2H FY21. We believe Q1 was the seasonal low point. From this low we should see a recovery in volumes as demand in India and Japan improves and China imports return after a temporary curtailment (to satisfy its aggregate annual import quota). Australian coal remains in high demand offshore due to its lower cost and higher quality compared to domestic alternatives. Aurizon has a strategic asset base that cannot be replicated and is well placed to deliver stable earnings and solid cash flows over the coming years. We believe the shares are significantly undervalued trading at an implied FY22 yield of ~7.5% p.a., in an environment where long term bond yields continue to trade at 0-1% p.a.

We remain extremely positive about the medium term outlook for the portfolio, given the unusually large number of stocks in the Fund that presently have more than 50% upside to valuation. As the market becomes more confident that an effective COVID-19 vaccine or treatment is coming, we expect to see a large share price recovery in many of these oversold companies, along with a major rotation into value and cyclical stocks that would act as a further tailwind to performance.

Portfolio Exposures (month end)

Number of positions	93
Number of long positions	72
Number of short positions	21
Gross long exposure (%)	202%
Gross short exposure (%)	85%
Gross exposure (%)	287%
Net exposure (%)	117%

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 October 2020) *

NTA pre-tax	1.7332
NTA post-tax	1.8375

*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.