L1 CAPITAL

November 2020

L1 Long Short Fund Limited

(ASX Code: LSF)

Key Details

ASX code	LSF
Share price	$1.96
Market capitalisation	$1,217m
Shares on issue	622,650,966
Listing date	24 April 2018

L1 Long Short Fund returned 31.9% (net) in November (ASX200AI 10.2%), its strongest month on record.

The Company has returned 26.7% (net) over the past 12 months (ASX200AI -2.0%).

Over the past six months, we conducted an enormous amount of detailed COVID-19 vaccine research and made numerous investments with large, asymmetric upside to capitalise on our expectation of positive vaccine news.

The vaccine results in November from Pfizer, Moderna and AstraZeneca were exceptionally strong, indicating high efficacy and safety levels from Phase 3 trial data. We believe the vaccine roll-out will give people the confidence to resume their pre-COVID lifestyles and trigger a large and enduring rotation into value and cyclical stocks in 2021. We have positioned the Fund to capture this major positive driver of performance.

Global markets rallied strongly in November driven primarily by positive vaccine news. The ASX200AI returned 10.2% in November, its highest monthly return for 32 years. The strongest sectors were Energy (+28.4%), Financials (+15.2%) and Communication Services (+13.6%) while Consumer Staples (-0.7%), Utilities (+1.2%) and Healthcare (+2.7%) lagged.

The Fund has performed very strongly in 2020 to date, with our aggressive and decisive buying of oversold stocks in March being a key reason for this pleasing performance. As we have stated consistently since March, we believe the current environment is the most attractive backdrop for equities since the GFC. The combination of massive central bank and fiscal stimulus, defensive investor positioning, widespread 'non-fundamental' selling, numerous bombed-out sectors and the likelihood of positive vaccine progress represents an exceptionally attractive risk-reward profile for equities.

The quality and rigour of our vaccine research gave us the confidence to position the Fund for a strong, positive vaccine outcome – the benefits of which have barely begun to flow through to the Fund in November. **We believe we have only just seen the start of the 'vaccine trade', given that we expect investors will now accept that they need to re-position their portfolios to reflect a much-improved outlook for COVID-19. Those stocks that were hardest hit by the pandemic should equally be the biggest beneficiaries of the cure. As such, we continue to expect a strong recovery in many oversold value and cyclical sectors, such as travel and energy.**

Net Performance*	NTA pre-tax
One month	31.94%
Three months	29.64%
One Year	26.72%
Two Years (p.a.)	21.04%
Total return since inception (24 April 2018)	14.34%

* *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.*

Fund performance in November was extremely broad, with 32 stocks each contributing more than 0.5% to Fund returns, while only 2 stocks detracted more than 0.5% from Fund returns. In total, there were 26 long positions that each rallied more than 20% in November.

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

Lovisa (long +38%) is one of the most exciting retail stocks in Australia, given it has established itself as a truly global, high growth, fast-fashion business. We built our position in Lovisa after the shares had collapsed as a result of falling same store sales trends due to COVID-19. Lovisa sells affordable jewellery to fashion-conscious young females and the pandemic caused a collapse in demand for fashion jewellery, as socialising and parties were effectively banned globally. Lovisa's same store sales had fallen by 32% when management updated the market in June. Our view has been that Lovisa was very well placed to survive the crisis, based on its healthy, net cash balance sheet and extremely high operating margins. We also expected the competitive landscape to dramatically improve, given its main Australian competitor, Colette, had gone into administration and its new owners are planning to close roughly 75% of their stores. In Europe, Lovisa recently bought out a major competitor (Beeline GmbH) and effectively paid nothing for the business (consideration was a mere €70). Lovisa is also fortunate to have Brett Blundy, arguably Australia's best retailer, as Lovisa's chair and 40% shareholder, along with the Founder and highly-regarded CEO, Shane Fallscheer, who is also a 3.8% shareholder. We believe Lovisa has the potential to become a major global fashion brand, like H&M or Zara, given it has strong customer loyalty, attractive margins, high returns on capital and a relatively weak set of competitors.

Qantas (long +28%) shares rose with the positive vaccine news, as well as a re-opening of state borders in much of Australia. We believe Qantas is exceptionally well-positioned as it emerges from the worst aviation crisis ever. Qantas is set to enjoy a rapid recovery in earnings due to huge pent up leisure travel demand, improved market share (given Virgin's new strategy of becoming a smaller, more profit-focused network) and an improved cost base (facilitated by Qantas' $1b cost out program over the next 3 years). We participated in Qantas' capital raise back in June at $3.65/share and continued increasing our position subsequently.

We have long viewed Qantas as one of the world's highest quality airlines, with its dominant industry position, high-growth loyalty (frequent flyer) division and outstanding management team.

Webjet (long +65%) shares rallied strongly with the potential for a solid uplift in domestic and international travel in 2021. Webjet operates through two segments: (i) the B2C OTA (Online Travel Agency) division, where webjet.com.au is the leading online travel booking portal in Australia and New Zealand, and (ii) B2B hotels division, which is the 2nd largest and fastest growing "bed bank" operator globally. Bed banks act as an online intermediary between hotels that are looking to fill hotel rooms and travel providers that are looking to source rooms for end consumers. Webjet has been impacted significantly by the pandemic, which reduced its revenue to close to zero and caused a material working capital unwind, as customers had to be refunded up-front, whilst supplier receipts were delayed and in certain cases not recoverable as many smaller travel agents went out of business. We participated in the recapitalisation of the company at ~$1.70 / share in April during the peak of the crisis (today's share price is around $5.70). We continued increasing our position after the raise as we were confident Webjet would emerge from the pandemic as a better business with a stronger industry position. Webjet now has one of the most robust balance sheets in the industry, has cut its operating costs significantly and is better positioned with many of its competitors having either closed or scaled back operations materially. Webjet is led by a high quality, experienced and passionate management team and we believe the company is well placed to deliver strong earnings growth as pent-up demand for leisure travel becomes evident over the next 1-2 years.

Oil Search (long +42%) shares rose strongly over the period driven by a ~26% increase in crude oil prices and a broader rotation to energy stocks (energy was the best performing sector on the ASX in November, recovering some of its underperformance from the prior months). Oil Search is one of the highest quality energy stocks listed in Australia, with its low cost of production, long life assets, attractive growth options and partnership with a high quality operator (Exxon Mobil). Oil Search has a large stake in two very substantial growth projects in PNG and Alaska. Whilst little value is currently factored into the share price, we believe as oil prices recover, and with a possible change in government in PNG, there are potential catalysts for these projects to deliver meaningful value over the medium term. Furthermore, we expect broader consolidation in the oil and gas industry as a response to the difficult macroeconomic conditions, with Oil Search a likely target given its high quality asset base. While we expect continued share price volatility in the near term, we believe that Oil Search is very well-placed over the medium to long term to benefit from a recovery in oil prices.

Worley (long +37%) shares rallied due to the strong recovery in oil prices mentioned above. Worley is a leading engineering consulting firm in the energy, resources and chemicals sectors, with a highly diversified revenue base and little exposure to large, fixed price contracts. Worley has commenced a $275m cost out program (~26% of FY20 EBITDA) which together with synergies from the ECR acquisition should help deliver improved margins despite the current subdued revenue environment. We believe FY21 will be the trough in earnings for Worley due to the transitory impact of the pandemic. Worley is exceptionally well-placed to deliver strong earnings growth thereafter given its improved competitive positioning, likely recovery in oil and gas project spend, and the global transition to green energy spending. The Fund also holds a long position in **Wood Group**, Worley's closest competitor, which has a similar, reimbursable-focused contracting model to Worley. Wood Group shares rose 40% in November. We are positive on the industry backdrop for both companies going forward. The oil and gas market has been impacted by two major downturns in the last five years and a number of Worley's and Wood Group's major competitors are facing bankruptcy or scaling back their operations. This has allowed both companies to become the clear global leaders in engineering consultancy in their segments and has contributed to incremental market share gains as a greater proportion of work moves to a lower risk, reimbursable cost model. We believe both Worley and Wood Group are materially undervalued with the market underappreciating the flexibility of their business model and the diversified and resilient nature of their operations.

Safran (long +35%) shares rallied strongly in November as a result of the improved outlook for air travel. Safran's key business is the sale of jet engines and parts for narrow-body Airbus and Boeing planes. In our view, Safran is the highest quality aerospace business globally, given it controls 60% market share of all jet engine sales for narrow-body aeroplanes and it now has the most reliable and youngest engine fleet, which provides incredible predictability and visibility regarding its long term earnings outlook. Even during the depths of the crisis, while virtually every aerospace competitor and airline was loss making, Safran continued to generate more than €1b of free cash flow, highlighting the incredible resilience and quality of its business. We believe Safran is likely to triple its earnings per share over the next few years, based on the likely strong recovery in air travel, the benefits of its €2b+ cost out program and a potential re-start of its share buyback program. We believe Safran represents everything we look for in a great long-term investment: a highly cash generative business, with huge barriers to entry, best in class management, accelerating operating trends and an undergeared balance sheet.

Unibail-Rodamco-Westfield (URW) (long +76%) shares rallied strongly on the back of positive vaccine news along with shareholders blocking the Board's proposed €3.5b rights issue. As we have mentioned in prior reports and presentations, we believed the proposed capital raising was very poorly structured and timed and we worked hard behind the scenes, together with a consortium of activist shareholders (led by Aermont Capital), to block the capital raising. Given URW was not facing an imminent covenant breach and has sufficient liquidity to meet debt rollovers over the next few years, we believed conducting a capital raise at an 80% discount to Net Tangible Assets (NTA), was a terrible option for shareholders. We fully endorse Aermont's proposal to sell some non-core U.S. assets as a superior alternative. URW shares rallied 41% on the day of the capital raise being blocked and ended up rallying 76% in November given the prospect of a strong recovery in shopping centre foot traffic as the vaccine rolls out through Europe and the U.S. We continue to see large upside in URW shares, given the enormous share price discount to NTA, much improved decision making with Aermont representatives joining the board and the prospect of improving operating trends through 2021. As a further validation of the decision not to raise equity, in late November, management raised €2b of bonds with an average cost of debt of 1% and an average debt maturity of more than 8 years.

The Fund also holds a long position in **Scentre Group**, the owner of Westfield shopping centres in Australia and New Zealand. Scentre Group shares rose 33% in November on the back of an expected recovery in shopping centre foot traffic in Australia over the coming year.

Empire State Realty Trust (ESRT) (long +68%) is a New York-focussed office REIT with approximately half of its portfolio value comprising the Empire State building, arguably the "world's most famous building". We initiated the position in June after a substantial fall in the share price post the onset of COVID 19 as we believed we had an exciting opportunity to invest in an iconic property asset at incredibly depressed pricing. Around half the revenue from the Empire State building is derived from the famous observatory, which is currently open with restrictive capacity limitations. Both the observatory and the wider office portfolio have benefited from a huge capex improvement program over the past 5 years and look set to outperform the broader New York City office market over the coming years as New York recovers from the impacts of COVID-19. We believe the observatory is underappreciated by REIT investors despite a long history of strong compound revenue growth which should continue post recovery. ESRT remains well capitalised to overcome near-term headwinds, with significant liquidity headroom and no debt maturities due until 2024. Even with the strong share price rally in November, ERST still trades ~35% below is pre-pandemic share price of ~$14 and we believe there is significant upside to come as the New York City office market recovers and tourist visits to the observatory re-commence.

The senior investment team significantly added to their personal investment in the Long Short strategy in August/September and again in November. We remain extremely positive about the medium term outlook for the portfolio given the unusually large number of stocks in the Fund that have significant upside to valuation. We continue to believe that the 'vaccine trade' has much further to run, given investors are yet to see the improved operating trends for those businesses that have been hard hit by COVID-19. We believe the vaccine news and roll-out will trigger a major and enduring rotation into value and cyclical stocks (which lagged the market dramatically in 2020). We expect that any rotation into this part of the market would be a major positive driver of Fund performance in 2021 and beyond.

Portfolio Exposures (month end)

Number of positions	92
Number of long positions	75
Number of short positions	17
Gross long exposure (%)	205%
Gross short exposure (%)	76%
Gross exposure (%)	280%
Net exposure (%)	129%

Investment Guidelines

Typical no. 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 November 2020) *

NTA pre-tax	2.2867
NTA post-tax	2.2263

* *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.*

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

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Company and Manager Overview

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, pension funds, financial planning groups, asset consultants, family offices, high net worth individuals and retail investors.