L1 Long Short Fund Limited

Quarterly Report | SEPTEMBER 2021

L1 CAPITAL

- **The L1 Long Short Fund portfolio returned 12.1% (net)[1] for the September quarter (ASX200AI 1.7%).**
- **Over the past year, the portfolio has returned 78.1% (net)[1] (ASX200AI 30.6%) and the LSF share price has increased 93.0%.**
- **Performance was strong due to numerous positive company updates, along with portfolio positioning designed to benefit from the reopening trade and higher inflation.**

Global markets were mixed over the quarter with positive performance in July and August largely offset by a pull-back in September driven by ongoing fears around high inflation, risks around the potential default of Evergrande (one of China's largest property developers) and a more hawkish turn from the U.S. Federal Reserve (the 'Fed'). The ASX200 had a small gain (+1.7% over the quarter), while most global stock markets were relatively flat (NASDAQ +1.1%, S&P500 +0.6%, MSCI World -0.0%).

Portfolio performance was particularly pleasing over the quarter given the volatility in global markets, with numerous positive company updates contributing to broad-based stock gains (23 stocks contributed 0.5% or more to returns).

Returns (%) (Net)[1]	L1 Long Short Portfolio	S&P ASX 200 AI	Out-performance
3 Months	12.1	1.7	+10.4
6 Months	22.0	10.1	+11.9
1 Year	78.1	30.6	+47.6
2 Years p.a.	34.9	8.3	+26.6
3 Years p.a.	23.8	9.7	+14.1
LSF Since Inception p.a.	14.3	10.6	+3.6
Strategy Since Inception[2] p.a.	23.8	8.2	+15.6

Whilst the sharp rebound in markets has meant that we currently see less upside in equities relative to 12 months ago, we believe markets should remain supported in the near term driven by continued fiscal and monetary stimulus, rising M&A activity and further economic reopening.

Key Stock Contributors for the Quarter

Qantas (Long +22%) rallied as investor sentiment significantly improved for the 'reopening trade'. Vaccination rates across Australia accelerated in the September quarter, while case numbers in NSW peaked, providing improved confidence that Australia was on track to reopen for both domestic and international travel. Qantas brought forward the re-start of its key Sydney-Melbourne route to early November and also its recommencement of international travel from mid-November. While it will take some time for Qantas' flight activity to return to 2019 levels (given lingering quarantining restrictions and some states remaining closed to interstate travel), we believe the outlook for Qantas on a medium-term view is extremely positive. We believe Qantas will re-emerge from the pandemic even stronger than before, given its $1b cost out program, improved market position and the massive pent-up demand for leisure travel. Refer to page 10 where we have included an overview of our Qantas investment thesis.

Imdex (Long +14%) shares rose strongly after reporting FY21 earnings well above market estimates and providing a robust outlook on exploration spending. Imdex is the global leader in exploration drilling technology for the mining sector, with 80% of the business exposed to gold, copper and iron ore. The company has spent significantly on R&D over the past five years (fully expensed through its P&L) and is now in the early stages of launching the industry's best suite of new and improved products. We expect earnings growth of more than 20% p.a. for many years to come, which is not reflected in the current multiple of ~10.8x consensus FY22 EV/EBITDA. Finally, we believe Imdex's secure, cloud-based portal for providing access to validated field data (IMDEXHUB-IQ), will become a major contributor to client retention, will increase product penetration per site and is being quickly adopted across the client base.

[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] Strategy performance and exposure history is for the L1 Long Short Limited (LSF:ASX) since inception on 24 Apr 2018. Prior to this date, data is that of the L1 Capital Long Short Fund – Monthly Class since inception (1 Sep 2014).

Oil Search (Long +15%) shares rose during the quarter due to the announcement of an all-scrip merger with Santos at a modest premium to the unaffected share price, as well from the tailwinds of a positive move in oil prices. 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 Papua New Guinea and Alaska. We believe the combined Santos/Oil Search business led by the highly regarded Santos management team is well-positioned to re-rate as the market reflects on the substantial synergies available, excellent producing asset base and strong suite of growth assets across the portfolio.

SES (Long +20%) shares rallied over the quarter due to significant operational improvements and excitement building around the launch of a new constellation of high throughput 03b POWER satellites, which could accelerate revenue growth in future periods. SES is a French satellite network provider that supplies data and video connectivity to broadcasters, telecommunications companies, governments and airlines globally. In addition, SES also owns a significant band of C-Band spectrum essential for the rollout of 5G services in the US. SES's 5G spectrum was successfully auctioned off to various telecom companies last year. We believe SES remains extremely undervalued with the market currently ascribing limited value to the scheduled C-Band spectrum payments. SES is set to secure ~US$3.2b in cash payments (after tax) over the next 3 years, amounting to ~80% of the company's current market cap. We also believe SES could monetise its valuable spectrum position in Brazil, as well as receive additional payments from US operators.

Entain (Long +22%) shares rallied in the September quarter after the company announced that it had received a takeover proposal from DraftKings at £28 per share (£6.30 per share in cash and the balance in DraftKings Class A common shares), representing a ~46% premium to the unaffected share price. The takeover proposal adds further support to our view that Entain remains significantly undervalued relative to its peers. Entain has a joint venture with MGM Resorts in the U.S. (BetMGM) which is now the second largest player in the overall U.S. sports betting and iGaming market (behind Fan Duel and ahead of DraftKings). We believe the DraftKings offer could act as a catalyst for MGM Resorts to either consider bidding for the whole company or for the remaining 50% in BetMGM that it does not own. MGM had previously made an all scrip bid for Entain in January this year. MGM has a meaningfully stronger balance sheet now with access to more than ~US$10b in cash from a combination of current cash on hand and proceeds from announced asset sales, which positions the company very strongly to make a counter-bid. While there is inherent uncertainty in any takeover scenario, we continue to believe Entain has strong earnings growth potential over the medium term, with possible upside should a strong M&A offer be confirmed.

Webjet (Long +29%) shares rallied over the quarter with investor sentiment significantly improved for the 'reopening trade' and after a positive AGM update where the company flagged a strong recovery in its B2B hotel division which returned to profitability in July. 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) the B2B hotels division, which is the second largest and the fastest growing 'bed bank' operator globally. Webjet 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 over the last 12 months. 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 few years.

Z Energy (Long +29%) performed strongly on the back of Ampol's takeover bid. Z Energy is the dominant fuel distributor in New Zealand with circa 200 Z-branded fuel stops and 133 Caltex-branded service stations country-wide. In August, Z Energy announced that it had agreed to a four-week due diligence/exclusivity period (with a further two week extension announced in September) following a NZ$3.78 per share bid from Ampol – a 35% premium over the unaffected share price. On 11 October, Z Energy announced that it had entered into a binding Scheme Implementation Agreement (SIA) with Ampol, with Z Energy shareholders to receive the NZ$3.78 per share bid price as well as a further NZ$0.05 per share for the interim FY22 dividend.

Downer (Long +16%) had a solid September quarter driven by a strong full year earnings result in August with high cashflow conversion and an optimistic outlook statement across the key divisions. Downer is primarily leveraged to forecast spending increases by their government clients to support further urbanisation in Australia and New Zealand. The defence sector was again highlighted as a key medium-term growth priority as the government looks to prioritise reliable, Australian service providers in the face of a more challenging geopolitical backdrop. The company has successfully disposed of its non-core assets, with the sale of the last asset – the east coast open-cut mining business announced on 11 October 2021 for $150m. We believe the sale of these more capital-intensive businesses will support a further re-rating of Downer as a capital-light (and lower risk) services business exposed to growing, annuity style contracts. Downer continues to execute a 10% buyback while still retaining the balance sheet flexibility to consider bolt-on acquisitions and higher dividends. While near-term earnings may be impacted by the lockdown restrictions in NSW and Victoria, we remain positive on the medium-term outlook.

F45 Training (Long) is a high growth, fitness franchise with more than 1,500 studios worldwide offering innovative, high-intensity group workouts designed to be fast, fun and results-driven. The company operates a capital-light, technology-enabled franchise model that is highly scalable and differentiated relative to key peers. We made a pre-IPO investment in F45 in December 2020 after the outstanding vaccine data from Pfizer and Moderna had been released. We very rarely invest pre-IPO, however, in this instance we believed we had found a highly attractive opportunity with a clear path to value realisation in less than 12 months. When we invested, F45 was facing transitory headwinds due to the COVID-19 pandemic, however the strength of the brand and underlying resilience of the business model (F45 had <1% permanent closures during the depths of the pandemic) remained firmly intact. The company subsequently listed on the NYSE (ticker: FXLV) in July and has a current valuation of around US$1.4b, resulting in a ~60% return for the portfolio's investment. Despite the strong gain, we continue to believe F45 has an exciting future with 1,200+ additional studios already sold to franchisees and expected to open over the next couple of years.

Equity Market Observations

Since early 2021, we have flagged four themes that we expected to dominate markets this year:

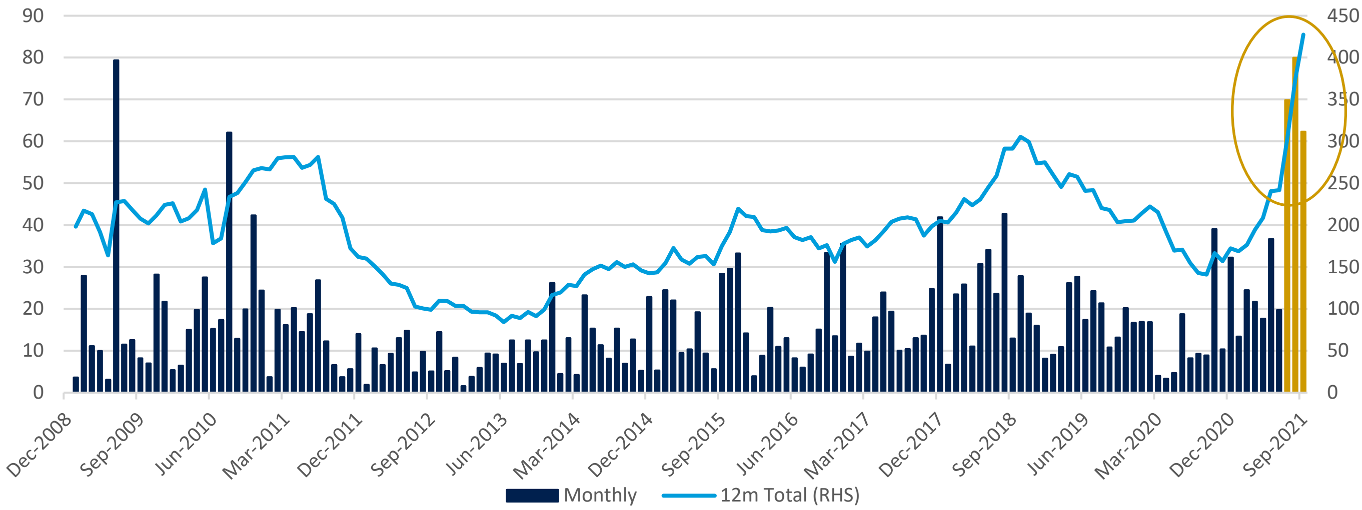
- **Market Rotation** – A rotation into cyclical and value stocks (and away from defensive and growth stocks);
- **Reopening Trade** – The global vaccine rollout enabling a broad-based reopening trade;
- **M&A Wave** – The pre-conditions were in place for an epic M&A cycle, which would support markets and re-focus investors on valuations; and
- **Higher Inflation** – Decade-high producer price inflation, rising energy prices, supply chain tightness and tightening labour markets will set the scene for much higher inflation than consensus expectations.

Over the September quarter, we saw each of these themes dominate market moves, with numerous incremental data points supporting this view:

- **Market Rotation** – From mid-June to August we saw the outperformance of growth stocks as the yield curve flattened with bond yields falling to the lowest levels since early this year. This was partly driven by 'risk-off' market sentiment with concerns over the rapid spread of the Delta variant as well as dovish commentary from the Fed. In September, bond yields rose sharply with the Fed turning more hawkish as U.S. employment levels continued to improve. This led to a steepening of the yield curve and contributed to the outperformance of value/cyclical stocks. We believe this rotation has further to go given the excessive valuation dispersion between growth and value stocks.
- **Reopening Trade** – We believe we are at a major inflection point both globally and domestically in terms of the reopening trade. We remain positive on the ability for vaccines to control the pandemic and see numerous outstanding risk-reward opportunities with many reopening beneficiaries trading at the same levels as 6 months ago despite the outlook improving significantly. We are particularly positive about the reopening path in Australia, given high vaccination rates in NSW and Victoria and signs of recovery in the services economy. On page 5, we have provided our updated vaccine research and our expectations for global recovery. We have also included an overview of Qantas on page 10, which outlines why we believe it will be one of the biggest reopening beneficiaries, with an even stronger industry position going forward.
- **M&A Wave** – We have written about our very bullish view on the M&A cycle in several prior quarterlies. What we have seen over the last quarter is a surge in Australian M&A activity from already elevated levels (refer Figure 1 on the next page). Notable deal announcements include: the $10b takeover proposal from APA Group for AusNet (following the $9.6b takeover proposal from Brookfield), the $19b merger proposal for BHP's petroleum business from Woodside, the $22b proposed merger of Santos and Oil Search, and the $23.6b takeover offer (and subsequent revised offers) for Sydney Airport from a consortium of superannuation and infrastructure funds.

  We believe we are the midst of the first major M&A cycle since 2013 and expect momentum to continue, driven by improved corporate confidence, cheap debt and equity funding and a supportive economic backdrop. As evidenced by takeover offers (or merger proposals) for Z Energy, Oil Search and Entain over the quarter, we expect this activity to continue to be a tailwind for portfolio performance given our skew to undervalued companies that have strategic appeal.

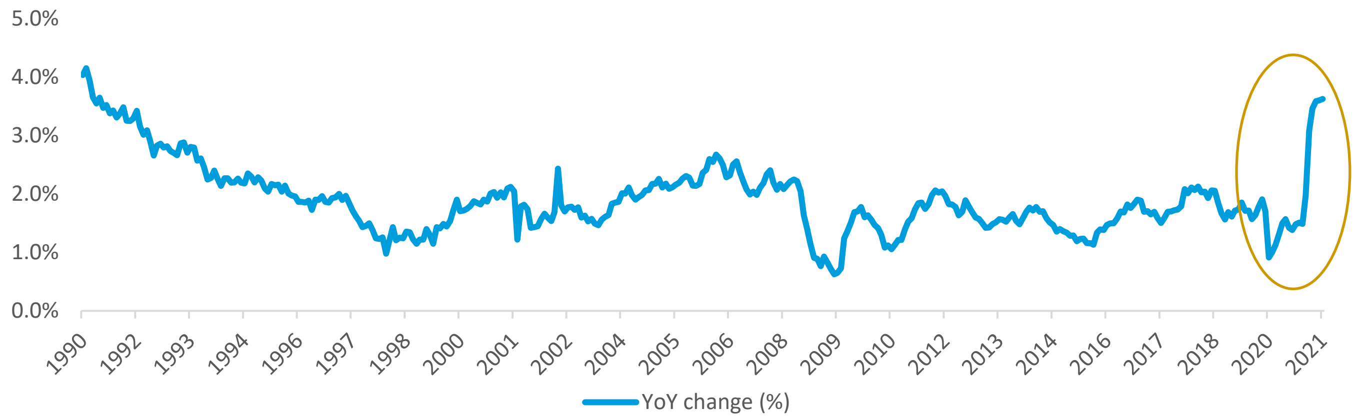
Figure 1: Announced M&A activity involving an Australian Company (A$b)



Source: MST Marquee as at 30 Sep 2021.

- **Higher Inflation** – In June, we noted the key debate in financial markets was whether the inflation spike was transitory or more persistent. Our research indicated there were elevated risks that the current spike in inflation may be more significant and persistent than the consensus view. Over the September quarter, we saw further evidence of this as the Fed's preferred inflation metric, the Personal Consumption Expenditure (PCE) Price Index, grew by 3.6% in August, the biggest increase in more than 30 years (Refer Figure 2 below).

Figure 2: Personal Consumption Expenditure Price Index



Source: Bloomberg

The PCE index differs from the Consumer Price Index (CPI) in that it is based on what people buy, rather than on the prices at which companies sell. Consumers will typically adjust spending habits to avoid paying higher prices for goods, meaning the PCE measure typically runs below CPI. Fed Chair, Jerome Powell, in recent comments acknowledged that “these bottleneck effects have been larger and longer-lasting than anticipated” as the Fed’s rate setting committee lifted their expectation for 2021 year-end inflation rate from 3.4% in June to 4.2% (well above the Fed’s 2% target rate). While Powell continues to expect inflation to drop back to the Fed’s long-term target of 2%, our research continues to indicate the path towards this goal could take longer than the market expects. The recent U.S. CPI print for September (released on October 13) has added a further support to our view, with a 5.4% year-on year increase noted (slightly higher than the 5.3% increase in August) and the component breakdown indicating that while transitory factors continue to roll-off, stickier, more persistent factors (such as rent) are becoming more prevalent. As a result, we continue to believe that short duration assets remain better placed than long duration assets at present. Historically, higher periods of inflation have seen sectors such as gold, energy, mining and financials outperform. Interestingly, most of these sectors are not crowded and are still trading ‘cheap’ versus the broader market.

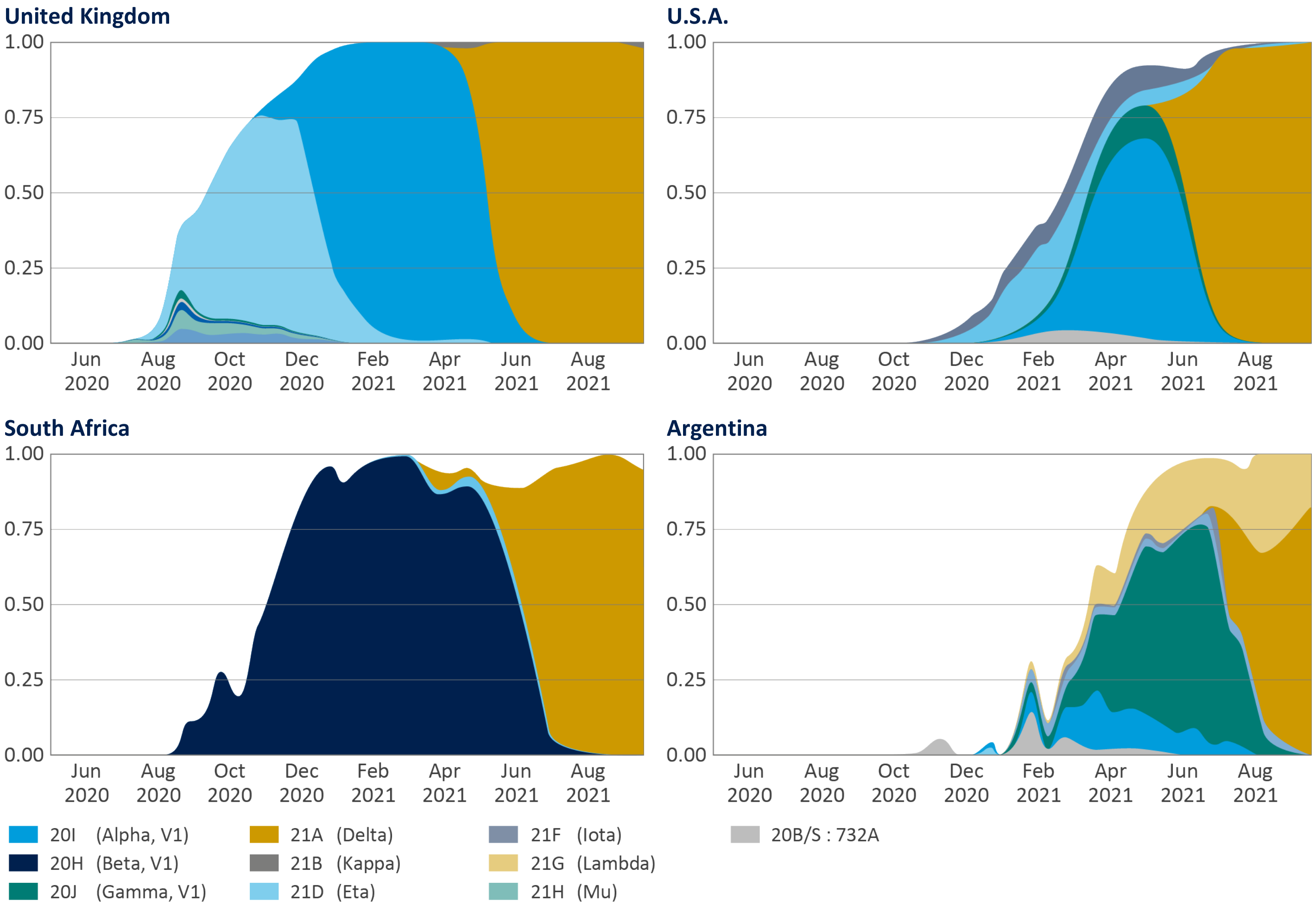
Vaccine recovery

We believe that there are still several factors the market is yet to fully appreciate about vaccine efficacy and the recovery that lies ahead. While the recovery will undoubtedly have some bumps along the way, we remain confident that the global and Australian reopening story remains on track and is not fully factored into market expectations.

Delta dominates, but existing vaccines are highly protective

Globally, the Delta variant has become the dominant strain due to its higher infectivity and has crowded out the emergence of new variants. In the charts below, you can see how once Delta appears in a country, in a very short period of time it completely crowds out all other strains. In the charts below, the gold shading denotes Delta strain and in country after country we have seen Delta emerge and then dominate.

Figure 3: Proportion of total number of sequences, over time, that fall into defined variant groups.



Source: https://covariants.org/per-country Accessed 5 Oct 2021. Date range: 27 Apr 2020 – 4 Oct 2021.

With the onset and rapid growth of the Delta variant, the market has been concerned that the reopening trade has de-railed, resulting in a rotation out of some of the stocks that were set to benefit from it. The Delta variant has essentially caused a pandemic of the unvaccinated, with its rapid spread leading to a slower reopening timeline in many countries around the world (including Australia).

However, what provides us confidence on the path to reopening is that the current vaccines continue to provide a very high level of protection against hospitalisation and death. As outlined in Figure 4 below, the Pfizer and AstraZeneca vaccines provide similar levels of protection against Delta as they did against Alpha. The vaccines provide strong protection against inflection, symptoms and hospitalisations, which is extremely reassuring.

The key difference between the strains is the highly contagious nature of the Delta variant which means that there will be more cases 'coming through the funnel'. Importantly, the vaccine effectiveness is almost identical in terms of protecting against infection, symptoms and hospitalisation.

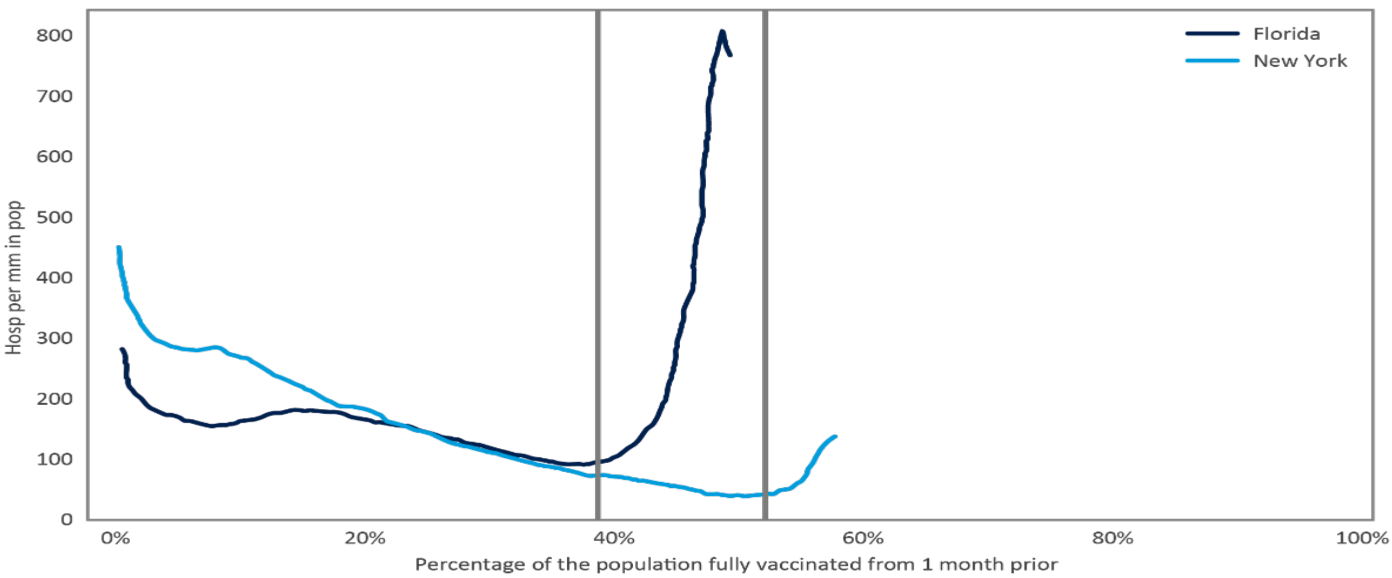
Figure 4: Vaccines offer excellent protection against the Delta variant

Variant		Pfizer – BioNTech (%)	AstraZeneca (%)	Prior infection, not vaccinated (%)
Alpha	Infections	78	79	60
	Symptoms	94	75	80
	Hospitalisation	95	86	N/A
Delta	Infections	80	67	72
	Symptoms	88	67	82
	Hospitalisation	96	92	N/A

Source: Public Health England; Infections/symptoms published in NEJM Aug 2021; hospitalization data in preprint.

As further confirmation of the protection afforded by vaccines, the impacts on vaccination levels and hospitalisation data can be seen in many cities around the world. One such example is outlined in Figure 5 below, which shows the impact of the Delta strain on Florida, which had a ~45% vaccination rate, versus New York, where the vaccination rate was closer to 60%. We see how this differential in vaccination rates resulted in the sharp uptick in Florida cases relative to New York, despite a similar population size and rules around social distancing.

Figure 5: New York saw smaller Delta surge than Florida due to higher vaccination rates



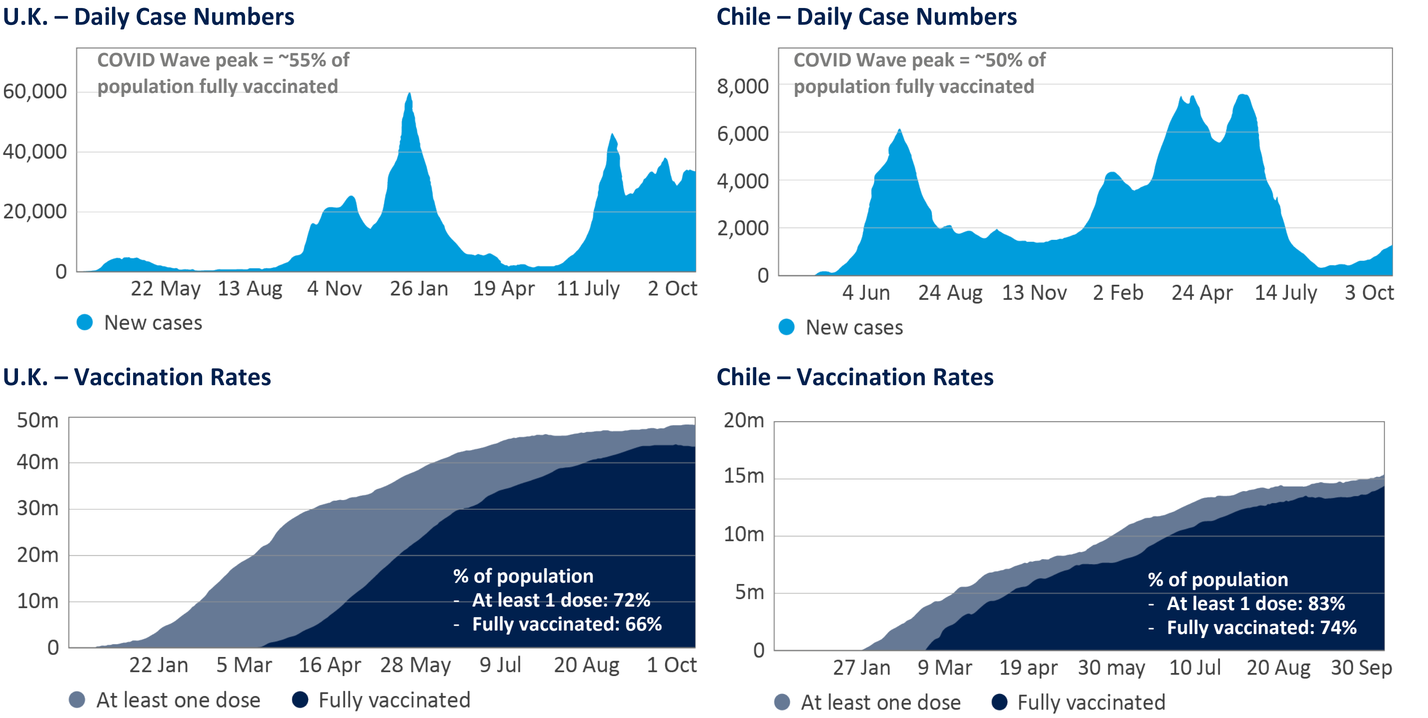
Source: J.P. Morgan, CDC. Date of paper 1 Sep 2021.

Experience from the U.K. and Chile indicates that once 50-55% of a country's total population is vaccinated, growth in case numbers plateaus and then declines.

It is encouraging to look offshore to countries such as the U.K. and Chile, both of which are 3-6 months ahead of Australia in their vaccination campaigns and provide a template for what we may experience in Australia. The U.K. and Chile have significantly relaxed restrictions and are well on the way towards living with COVID-19 active in the community.

As evident in Figure 6, the number of COVID-19 infections in the U.K. ('the COVID wave') plateaued when ~55% of total population was fully vaccinated. At this point, case numbers began to stabilise (despite a removal of most restrictions) but remained present in the community. Similarly, Chile's COVID-19 wave peaked when ~50% of the total population was fully vaccinated.

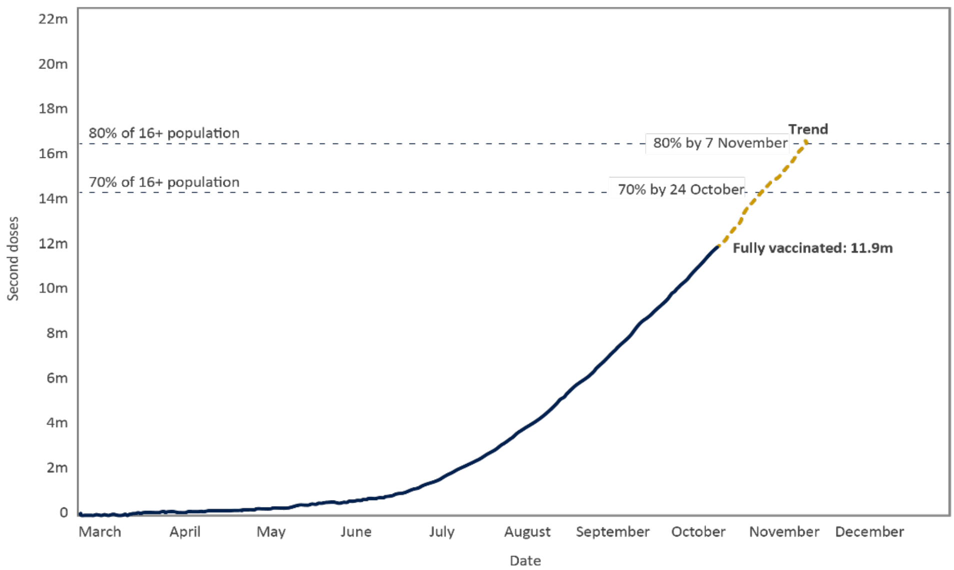
Figure 6: The U.K. and Chile are blueprints for reopening while living with COVID-19



Source: Our World in Data – Official country statistics. Accessed 5 Oct 2021. U.K. COVID-19 Cases date range: 16 Mar 2020 – 3 Oct 2021. U.K. Vaccination rate date range: 13 Dec 2020 – 1 Oct 2021. Chile COVID-19 Cases date range: 16 Mar 2020 – 3 Oct 2021. Chile Vaccination date range: 24 Dec 2020 – 1 Oct 2021

As noted in Figure 7, Australia's vaccination progress has accelerated significantly over the quarter. The Rollout remains on track to reach 80% of people over the age of 16 being fully vaccinated by 8 November (this would amount to ~65% of the total population including those under the age of 16).

Figure 7: Australia % of 16+ year olds fully vaccinated (~65% of total population)



Note: Target of 80% of eligible vaccinated = ~65% of total population measured as % of 16+ year olds. Source: Guardian graphic citing data from Covidlive.com.au as at 11 Oct 2021, Department of Health 14 Mar 2021 COVID-19 vaccine rollout update.

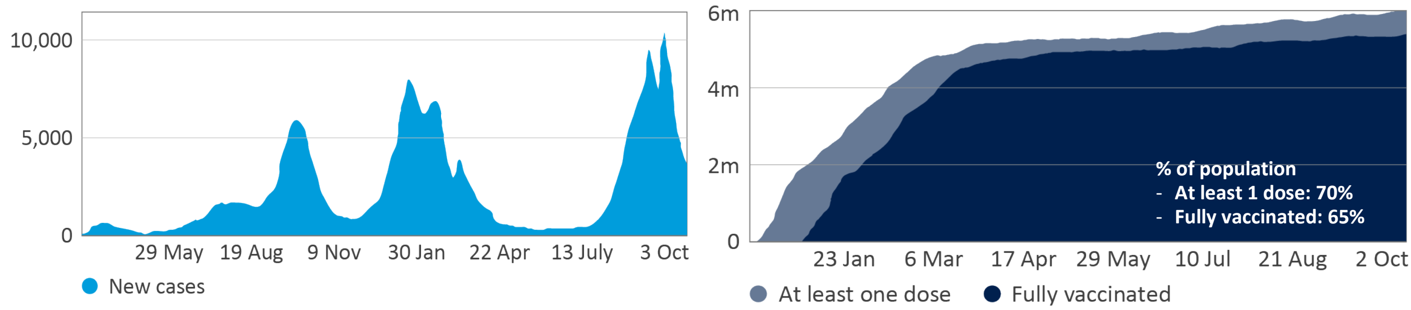
Interestingly, case numbers in NSW peaked once half the total population had been vaccinated, further supporting this theory. The reduction in vaccine hesitancy has also meant that Australia may end up having one of the highest vaccination rates in the world. Based on the experience in the U.K. and Chile, this provides a very encouraging backdrop to manage the case load as we further ease restrictions.

Recent data from Israel confirms that while vaccine efficacy wanes over time, booster shots should provide even better and more enduring protection against COVID-19.

Israel saw an initial spike in COVID-19 cases in September 2020 and January 2021. Once the Vaccination program was implemented and gained traction, the virus appeared to have been virtually eliminated with a 99% reduction in cases, hospitalisations and deaths from April to June 2021. However, as illustrated in Figure 8, in July 2021, cases unexpectedly surged, with many questioning how this could occur given the very high vaccination rates and the prior period of success.

Figure 8: Israel saw a recent resurgence in COVID-19 despite a high vaccination rate

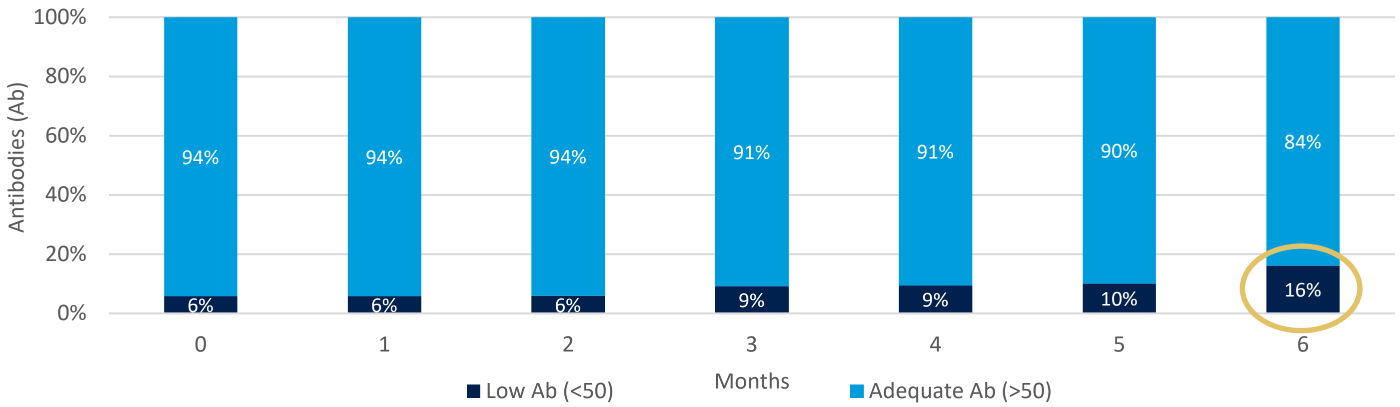
Israel – Daily Case Numbers **Israel – Vaccination Rates**



Source: Our World in Data – Official country statistics. Accessed 5 Oct 2021. Israel COVID-19 Cases date range: 12 Mar 2020 – 2 Oct 2021. Israel Vaccination rate date range: 19 Dec 2020 – 2 Oct 2021.

The primary cause of the resurgence was likely due to diminishing antibody levels (in those that had been the first group to be double-vaccinated) which had reduced the effectiveness of the vaccines. Figure 9 shows a simplified illustration of this drop in antibodies. From three months post double-vaccination, the proportion of vaccinated people with insufficient antibody levels begins to rise. After 6 months, around 16% of 'fully vaccinated' people have insufficient antibody levels to provide meaningful protection from COVID-19. This led to greater vulnerability and appears to be the key driver behind the surge in case numbers from July 2021.

Figure 9: Antibody level after Pfizer vax, by month post 2nd dose

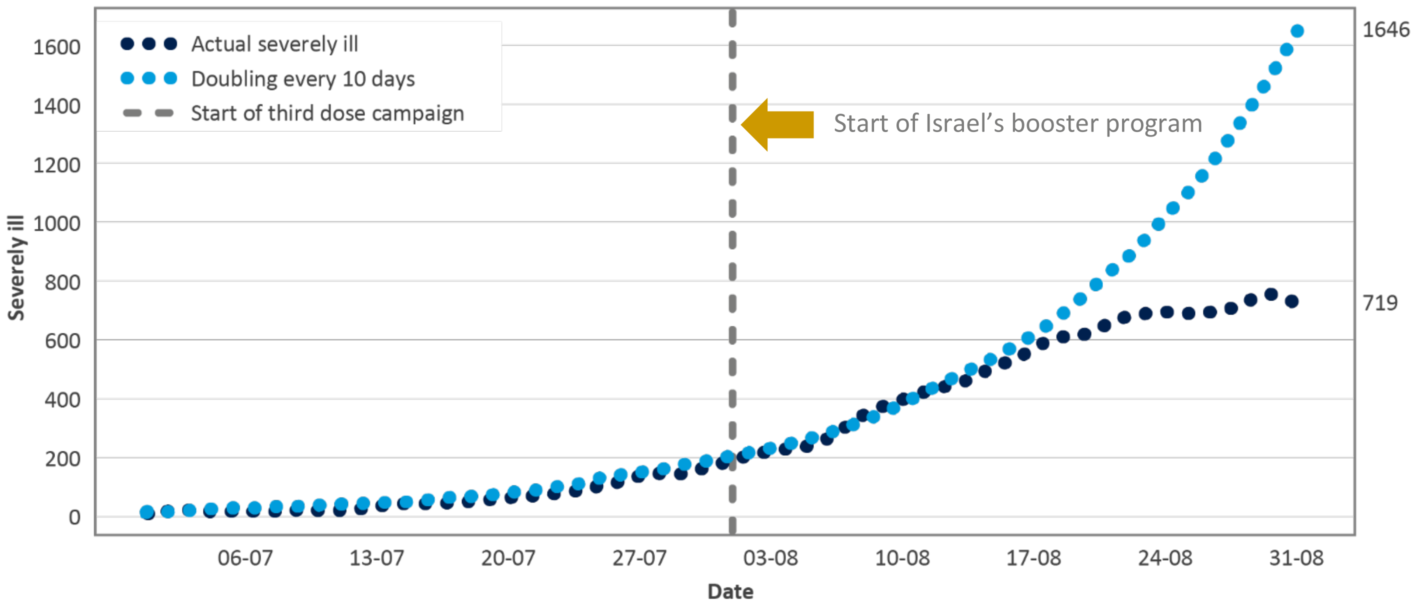


Source: MedRXIV (Israeli study funded by Leumit Health Services)

In order to counter the impacts of the reduction in antibodies, Israel introduced a booster shot (3rd dose) at around the 6-month mark. Encouragingly, these booster shots appear to be highly effective, with early data indicating a marked inflection point in hospitalisations. In Figure 10 on the next page, the light blue line demonstrates an estimate of potential severely ill case numbers had no booster shot been implemented (cases continuing to double every 10 days). The dark blue line on the chart represents actual severely ill cases observed and clearly indicates how the introduction of the third booster shot significantly flattened the curve. Note, the chart shows total hospitalised patients due to COVID-19 (not incremental patients).

Figure 10: Israel – Booster shots highly effective against COVID-19

Total hospitalised patients



Source: Eran Segal's Twitter, Weizmann Institute of Science

Encouraging early data from antiviral treatments indicates that they significantly reduce the risk of hospitalisation and death.

Merck recently announced their antiviral pill molnupiravir reduced the risk of hospitalisation by 50% in an interim analysis of a late state trial. Merck plans to apply for Emergency Use Authorisation to the U.S. Food and Drug Administration (FDA) as soon as possible. If cleared by regulators, we think this could have a profound impact on controlling the pandemic. Importantly, no one who was treated with molnupiravir died from COVID-19, compared to 8 people in the control/placebo arm.

Merck's treatment is in pill form unlike remdesivir (the first antiviral treatment approved by the FDA) which must be administered intravenously or by injection. This would allow the treatment to be scaled very quickly and distributed worldwide, particularly to remote corners of the world that do not have access to more expensive infusion therapies. Merck has already begun mass production of molnupiravir, with 10 million courses of treatment expected to be available by the end of 2021.

The treatment should also be available in a cost-effective manner for many developing economies. Merck has committed to a tiered pricing approach based on World Bank country income criteria and has entered into licensing agreements with established generic manufacturers to provide access to molnupiravir in more than 100 low- and middle-income countries.

Conclusion

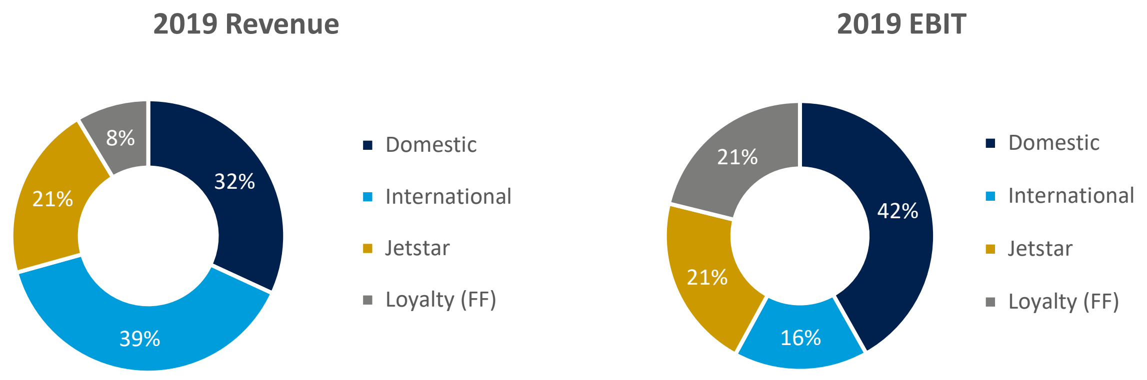
We believe the outlook for economic recovery from COVID-19 remains on track and despite some bumps in the road, we believe there are many share prices that are not reflecting this outlook. We believe our rigorous and independent vaccine research has provided us with the confidence to make investments across sectors previously deemed 'uninvestable', such as travel and energy. Many of these stocks have rallied over 100% over the past year and we see further gains ahead as we hit an inflection point in their operating metrics.

Company deep dive: Qantas

We remain positive about the outlook for Qantas, despite market concerns about the outlook for all airlines. While Qantas is correctly considered the quintessential 'reopening beneficiary', the market has not yet focused on the longer term improvements in Qantas' competitive position, along with boom in leisure travel demand once consumers feel confident that travel is safe and convenient again.

We have long regarded Qantas as a high quality business relative to its airline peers globally. Unlike many of its overseas peers, Qantas has typically generated a high return on capital and strong positive free cash flow. These attributes are a result of its world-class loyalty program (Qantas Frequent Flyer), its large competitive advantages (e.g. superior slots, flight frequency, lounges, code share agreements, joint ventures, breadth of domestic and international network, etc.) along with an exceptional management team. In a typical year, Qantas generates the bulk of its earnings from its domestic and loyalty divisions (see figure 11 below). While the International segment garners a lot of attention and typically draws the most discussion in terms of the recovery path from COVID-19, it is a relatively modest contributor to Group earnings.

Figure 11: Qantas Revenue and earnings (EBIT) segment split



Source: Qantas 2019 financial report. Percentages are calculated before corporate costs / eliminations

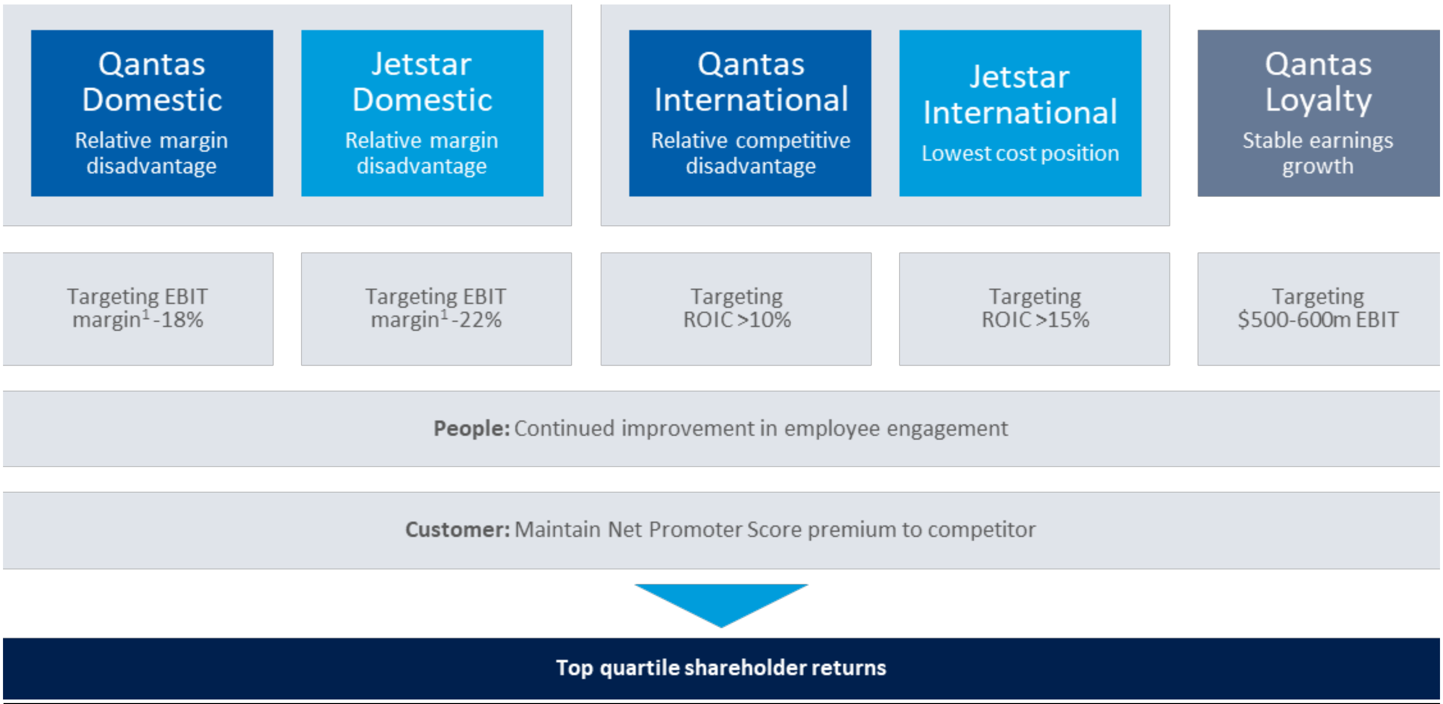
From an ESG perspective, Qantas was also the first airline group to commit to capping net emissions and one of the first to commit to net zero emissions by 2050. The company has also been at the forefront of investing in sustainable aviation fuels, reducing waste and driving towards the elimination of single use plastics.

While COVID-19 caused the worst aviation crisis ever, it has accelerated many of the turnaround plans that Qantas had already been working on. We believe the pandemic will ultimately prove to be an enduring positive for the business for three key reasons:

1. Structural cost out opportunity

Qantas announced a $1b structural cost out program to be delivered by FY23. The company is already well advanced on its 3-year program, with ~$650m in cost reductions already achieved in the first year and more than 90% of all planned initiatives either completed or initiated. The cost-out program has allowed Qantas to reaffirm its FY24 targets (refer Figure 12 on the next page) despite the impacts of COVID-19. These targets were originally projected in 2019 (before the pandemic).

Figure 12: Qantas FY24 targets



Source: Qantas FY21 results presentation

2. Improved competitive position suggests upside for market share and yields

Qantas' main competitor in the domestic market, Virgin Australia, entered into administration in April 2020 and was subsequently acquired by Bain Capital in September 2020. Virgin is now positioning itself as a mid-market carrier, rather than a full-service carrier, which has seen it effectively withdraw from the corporate market and also reduce its route network (several of its routes were loss-making even prior to COVID-19). We believe Qantas could gain an extra 5-10% market share in the domestic market.

Furthermore, Virgin will require significant domestic fare increases relative to 2019 levels to become a more financially viable business and achieve a reasonable return for its new investors. We expect the pricing environment to be relatively favourable for Qantas once domestic travel normalises, with Qantas maintaining its yield premium (over Virgin) due to its superior brand, Frequent Flyer program, lounge network, flight frequency and amenities. One offset is the likely structural reduction in corporate travel, now that many businesspeople have become accustomed to using Zoom/Teams instead of travelling to meet face to face.

3. Working capital benefits will accelerate as the travel recovery gathers momentum

Qantas typically receives cash up front with ticket bookings and settles payables at a later stage, leading to a large working capital benefit. This benefit unwound abruptly when COVID hit and air travel stopped. This working capital unwind placed additional pressure on the balance sheet and contributed to the ~$1.36b capital raise in June 2020. As people start to book flights with restrictions easing, we expect a significant working capital inflow which will help take the company from a slightly over-geared position to being within their target gearing range by the end of FY22.

Based on Qantas achieving its financial targets in FY24, we estimate the company could deliver around 95c of EPS (earnings per share) assuming revenue was to recover to pre-pandemic levels (i.e. no revenue growth compared to 2019). This would amount to a ~70% increase on the 2019 EPS level, despite a ~25% increase in the shares on issue with the capital raise conducted in June 2020. These earnings projections should be viewed as a 'bull case' scenario given lingering COVID-19 and government policy uncertainties, along with significant operational execution risk.

We also have a higher degree of confidence in the targets being met due to the outstanding management team at Qantas. We believe Alan Joyce is one of the best CEOs in corporate Australia and widely regarded as one of the best airline executives and strategists globally. We also find Vanessa Hudson (CFO) and the broader senior management team very impressive and adept at navigating the regular twist and turns of running an airline.

The key risks we see to our investment thesis are:

- **COVID-19 and its lasting impacts** – Investors remain concerned about the outlook for COVID-19 and the trajectory of any recovery in travel demand. Our detailed vaccine work (outlined above on page 5 gives us confidence there is a path to a 'COVID-normal' operating environment in the next 1-2 years.
- **Concerns on business travel** – Business travel may never recover to pre-pandemic levels due to video conferencing and corporate cost outs. However, for Qantas, much of its corporate customer demand is relatively inelastic (e.g. mining, construction, Government, etc.), which accounts for close to 60% of total corporate travel demand. The remaining 40% clearly has downside risk. If we are conservative and say that portion halves, it means a 20% reduction in corporate travel revenue, which would be partially offset by corporate market share gains from Virgin and the ability to improve yields given a lack of alternatives for corporate customers.
- **Rising oil prices** – This is one of the biggest risks in our view given our analysis of the global energy market. We believe the oil market is becoming increasingly tight (due to huge ESG pressure on the oil majors to reduce production, along with the crash in the oil market in 2020, which reduced investor and corporate willingness to invest in incremental production). Fortunately, we have been able to offset this risk with several long oil stock positions, which the portfolio would benefit from in the event oil prices continue rising.
- **Transitory impacts to cash flow** – There will be a period of 'free' flights as people begin to use up some of the points they accumulated (largely through credit card spending) over the past 18 months while travel activity was very depressed. This is a temporary phenomenon which will reduce operating cash flow; however, we expect this to be more than compensated for by working capital benefits as bookings accelerate.

Valuation

Assuming a run-rate EPS level in line with our FY24 forecast of ~95c (outlined above), Qantas looks incredibly cheap, trading on a P/E of only ~6x.

Furthermore, we think there is a strong argument that the shares should trade at a higher multiple than they have historically, with the earnings mix moving towards the higher quality domestic and loyalty businesses. Qantas is aiming to have ~70% domestic market share from the current low 60% level, entrenching their dominant position in one of the most profitable domestic markets worldwide. Qantas also has the best loyalty businesses in Australia with almost every premium domestic consumer being a member (~12 million members and growing). As a stand-alone business we believe it would trade at around 30x earnings given its strong and reliable earnings growth (averaged double-digit earnings growth for over a decade), capital light business model, large barriers to entry and unique offering (by far the best array of domestic and international flight options).

In summary, despite Qantas rallying 100% over the past 12 months, we see further upside in the shares over the next few years. We believe Qantas shares could double again from current levels if management can deliver on their turnaround program and the dam of pent up travel demand breaks (once COVID-19 restrictions ease).

L1 Long Short Fund Limited

Quarterly Report | SEPTEMBER 2021

L1 CAPITAL

Strategy Returns (Net)[4] (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2014	-	-	-	-	-	-	-	-	(2.42)	3.03	2.85	1.61	**5.17**
2015	0.59	9.14	2.42	1.71	3.73	(0.86)	3.30	2.06	5.51	8.49	8.11	4.62	**60.52**
2016	5.81	0.59	5.47	2.46	2.78	(0.89)	3.22	3.92	0.46	(0.13)	0.55	2.22	**29.61**
2017	2.51	1.87	3.15	1.03	4.18	1.70	2.62	1.69	1.93	2.54	0.89	3.56	**31.40**
2018	0.56	(0.47)	(1.64)	(1.32)[4]	(4.05)	(5.96)	1.01	(5.34)	(2.06)	(3.90)	(2.60)	(5.95)	**(27.74)**
2019	4.26	5.11	0.16	3.05	(2.73)	3.87	0.63	0.40	2.54	3.46	0.36	2.06	**25.46**
2020	(7.75)	(6.85)	(22.93)	23.16	10.94	(2.12)	(1.69)	9.99	0.63	(2.37)	31.94	4.29	**29.50**
2021	(0.17)	9.00	(0.14)	5.11	4.07	(0.52)	1.75	5.10	4.86				**32.61**

Portfolio Positions

Number of total positions	85
Number of long positions	71
Number of short positions	14
Number of international positions	32

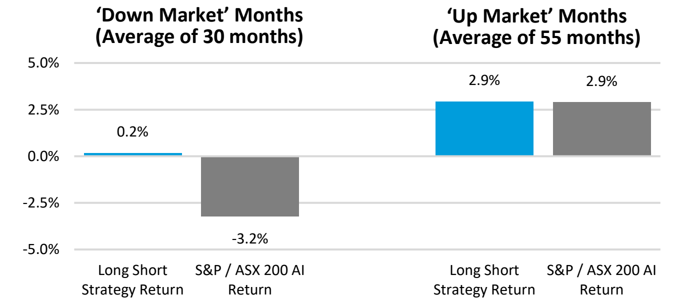
Share Price & NTA per share as at 30 September 2021[5]

Share Price	$2.72
NTA before tax	$3.0842
NTA after tax	$2.8089

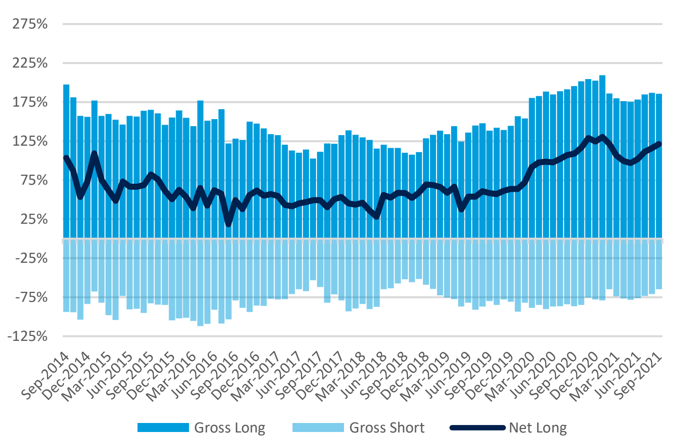
Net & Gross Exposure by Region[4] (%)

Geography	Gross Long	Gross Short	Net Exposure
Australia / NZ	118	58	61
North America	38	6	32
Europe	25	2	24
Asia	5	0	5
Total	187	65	122

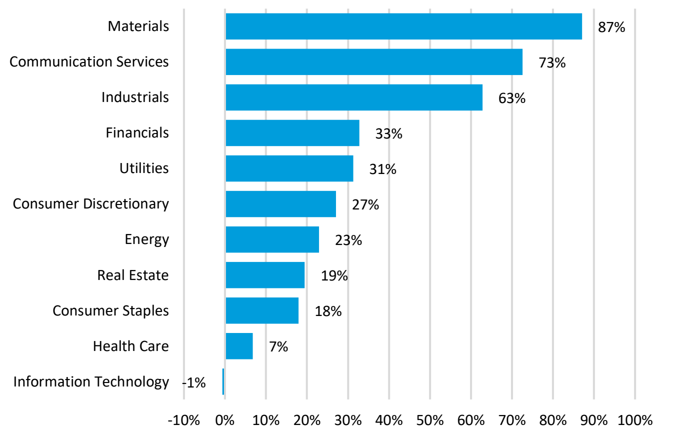
Strategy Performance Since Inception[4] (Net)



Historical Strategy Exposures[4]



Sector Contribution Since Strategy Inception[4] (Net)



[4] 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. Strategy performance and exposure history is for the L1 Long Short Fund Limited (ASX:LSF) since inception on 24 Apr 2018. Prior to this date, data is that of the L1 Capital Long Short Fund – Monthly Class since inception (1 Sep 2014). [5] The NTA before tax is calculated before the provision for deferred tax on unrealised gains and losses on the investment portfolio. The NTA after tax is calculated after all taxes.

Investment Guidelines

Geographic exposures	Max 30% gross outside of Aust/NZ
Net exposure limits	Max 150% of NAV; typically 30-100%
Gross exposure limits	Max 300% of NAV; typically 150-300%
Typical no. of positions	50-100 securities

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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Registry	Link Market Services Limited 1300 554 474 registrars@linkmarketserverices.com.au

L1 Capital (Investment Manager) Overview

L1 Capital is a global investment manager with offices in Melbourne, Sydney, Miami and London. The business was established in 2007 and is 100% 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 only Australian equities, long short 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 versus both benchmarks and peers. 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, financial planning groups, family offices, high net worth individuals and retail investors.

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Information contained in this publication

L1 Long Short Fund Limited, managed by L1 Capital Pty Ltd, 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.