ASX:LSF

L1 Long Short Fund Limited

Quarterly Report | DECEMBER 2023

- **The L1 Long Short Fund (LSF) portfolio returned 2.9%[1] for the December quarter.**
- **Over the past 3 years, the portfolio has returned 15.3%[1] p.a. (ASX200AI 9.2% p.a.).**
- **Global markets rose over the quarter as more dovish U.S. Central Bank commentary triggered a fall in bond yields and supported a broad-based market rally.**

Equity markets were stronger over the December quarter with a sell-off in October more than offset by a sharp rebound across November and December.

The primary driver of equity market momentum was interest rate expectations. In October, the market narrative was focussed on the need for interest rates to remain 'higher for longer'. In response, bond yields rose sharply, with U.S. 10-year bonds peaking in late October at close to 5%, the highest level since 2007. However, from mid-November, interest rate expectations began to recede quickly across all durations, driven by falling inflation and an increasingly dovish Fed. This supported a broad-based market rally which accelerated into the year end.

Returns (Net)[1] (%)	L1 Long Short Portfolio	S&P/ASX 200 AI	Out-performance
3 months	2.9	8.4	(5.5)
1 year	6.2	12.4	(6.2)
2 years p.a.	8.4	5.5	+3.0
3 years p.a.	15.3	9.2	+6.0
4 years p.a.	18.7	7.2	+11.5
5 years p.a.	20.0	10.3	+9.7
LSF Since Inception p.a.	**11.2**	**8.7**	**+2.5**
Strategy Since Inception[2] p.a.	**19.4**	**7.6**	**+11.8**

Figures may not sum exactly due to rounding.

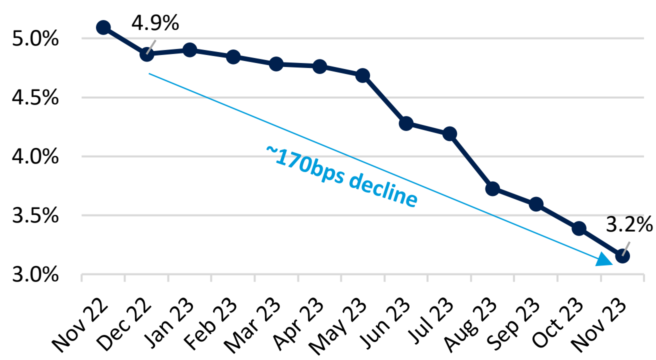
The ASX200AI was up 8.4% for the quarter, driven by Property (+16.6%), Materials (+13.4%) and Healthcare (+13.1%). The weakest sector during the quarter was Energy (-9.1%), reflecting weaker oil prices.

The portfolio performed positively over the quarter but lagged the broader market rally primarily due to weaker oil prices (-21%) which created a headwind for the portfolio's Energy exposures.

Equity market observations

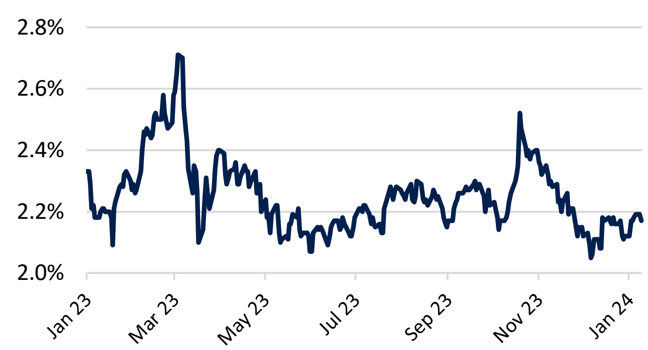
One constant during the quarter was the direction of inflation. The Fed's preferred measure of inflation, the core PCE price index, fell to 3.2% in November, marking its tenth consecutive monthly decline, and an aggregate decline of ~170bps since the beginning of the year (refer Figure 1). This steady decline in inflation boosted the market's confidence that measures taken by Central Banks are having the desired effect in curtailing inflationary pressures.

Figure 1: YoY growth of the core PCE price index



Source: Bureau of Economic Analysis as at 22 Dec 2023

Figure 2: 5-year U.S. Treasury Breakeven Rate



Source: Federal Reserve Bank of St Louis as at 9 Jan 2024

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 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). NOTE: Fund returns and Australian indices are shown in A$. Returns of U.S. indices are shown in US$. Index returns are on a total return (accumulation) basis unless otherwise specified.

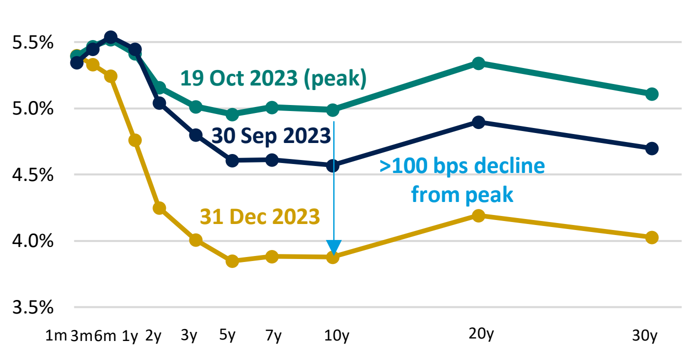
The anchoring of inflation expectations is further illustrated by the movement in the U.S. Treasury Breakeven Rate. This provides a forward view of inflation expectations by calculating the difference between Treasury bonds and Treasury inflation protected securities ("TIPS") of the same duration. Over the quarter, the 5-year U.S. Treasury Breakeven Rate fell to 2.1% (refer Figure 2), only modestly above the Fed's 2% long-term inflation target.

With inflation continuing to re-trace to lower levels and inflation expectations remaining anchored (as illustrated by the Breakeven Rate above), the Fed's commentary became decidedly more dovish at the December FOMC meeting. Fed Chair Jerome Powell gave the strongest indication to date that further interest rate increases are unlikely with an acknowledgement that "we are likely at or near the peak rate for this cycle". Powell further added that with labour markets coming back into balance and inflation moving towards the long-term target, that cutting interest rates had now "come into view".

As illustrated by Figure 3, these comments drove a significant shift in the yield curve, with bond yields across all durations falling sharply. U.S. 10-year bond yields re-traced more than a 100bps from the October peak, to finish below 4% at the end of the quarter.

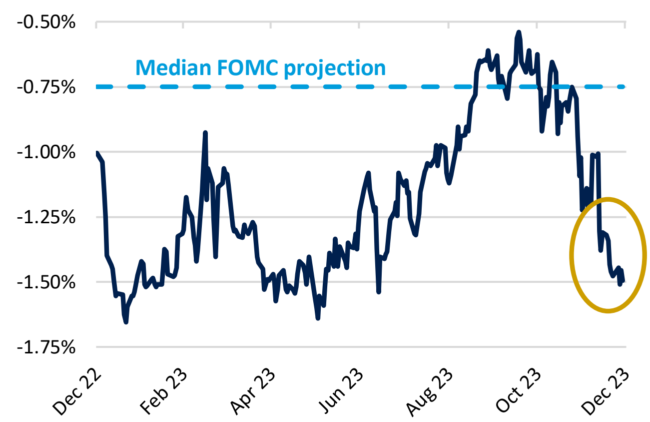
Movements at the short-end of the curve were also substantial, with futures markets pricing in much deeper interest rate cuts than Fed projections, with cuts potentially beginning as early as March this year. Figure 4 illustrates the difference between the median FOMC Committee member 'dot-plot' and futures expectations. The FOMC 'dot-plot' median implies the equivalent of three 25bps interest rate cuts in 2024, relative to the futures market projection which indicates the equivalent of six 25bps cuts.

Figure 3: U.S. yield curve shifts



Source: Chicago Mercantile Exchange, Bloomberg

Figure 4: Futures-implied 2024 Fed Funds Rate Change (%)



Source: The Daily Shot as at 11 Jan 2024

Portfolio positioning

With a greater probability of an economic 'soft landing' and the Fed reinforcing market expectations for rate cuts, equity markets delivered strong gains over the December quarter and over the calendar year. We believe this rally has stretched the valuations of larger index constituents (ASX20, 'Magnificent Seven') in both Australia and the U.S., along with high-multiple (long duration) growth stocks.

From a corporate earnings perspective, we do not expect a high degree of large 'beats' or 'misses' in the upcoming reporting season, with earnings expectations having largely re-calibrated post a COVID-19 disrupted period.

Portfolio positioning of the Fund has remained relatively consistent with the prior quarter. We continue to see numerous compelling opportunities in low P/E, highly cash generative companies, despite relatively fully-priced equity markets. Furthermore, we expect M&A activity to increase significantly in 2024, which should be skewed to undervalued, undergeared and strategic assets, to which the portfolio is very well exposed.

While we build our portfolio on a 'bottom-up' basis from our company and industry research (selecting stocks that represent the best combination of Value and Quality), when we step back and look at the major themes and opportunity sets we see at present, they broadly fall into five key themes as further outlined below.

1. Energy

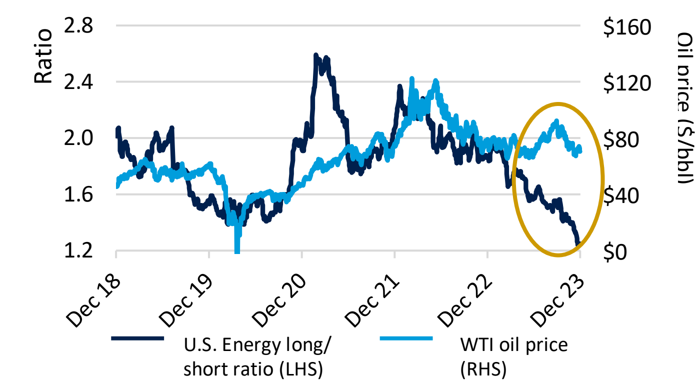
This part of our portfolio has underperformed in 2023 with the market concerned about potential over-supply and scepticism regarding whether OPEC will curtail supply sufficiently to maintain market balance. Investors remain extremely bearish on Energy, with net positioning worse than the levels during the 2020 COVID-19 lockdowns (refer Figure 5). We find this negative positioning very surprising given the oil price today is above US$70 a barrel, geopolitical tensions remain elevated, the supply/demand outlook is improving and oil inventories are at multi-decade lows.

In addition to our positive macro view on Energy overall, we believe our key stock positions have specific catalysts that can drive further shareholder value.

Santos: Share price performance has lagged global peers significantly over the last three years with the company trading at a large discount to U.S. peers despite having a much stronger EBITDA growth profile (refer Figure 6). As outlined in our **September 2023 Quarterly Report**, we believe Santos' asset base has been materially undervalued by the market and that structural options (e.g. demerger, asset sales, etc.) should be explored to close the valuation gap. On the 7th of December 2023, Santos announced that it was engaged in preliminary discussions for a potential merger with Woodside, in addition to examining a range of alternative structural options for unlocking value. We welcome the willingness of the Santos Board to engage with Woodside, demonstrating the company is open to exploring options to unlock shareholder value.

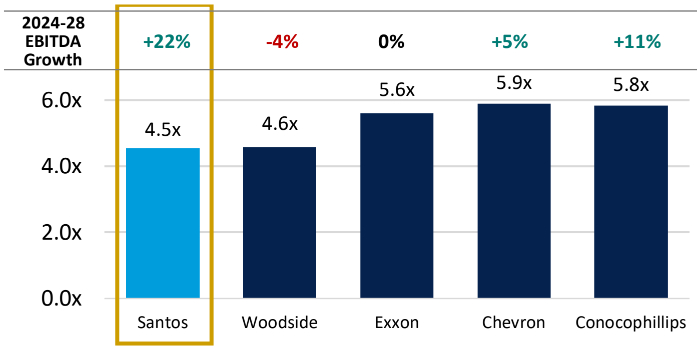
Cenovus: Continues to generate solid free cash flows at current oil price levels and trades on a free cash yield of 14% based on consensus FY24 estimates. Cenovus has seen some impacts from refinery outages, but operational performance has improved in recent periods which will support better downstream performance. We estimate the company can reach its net debt target in CY24, enabling a step-up in shareholder returns through on-market share buybacks. Cenovus has been very clear that as soon as it hits this target, it will return 100% of cash flow to shareholders.

Figure 5: U.S. Energy long/short ratio (MV) vs. oil price



Source: Goldman Sachs Global Banking & Markets data as at 17 Jan 24

Figure 6: Santos' valuation relative to peers (EV/Adj EBITDA)



Source: S&P Capital IQ as at 15 Jan 2024

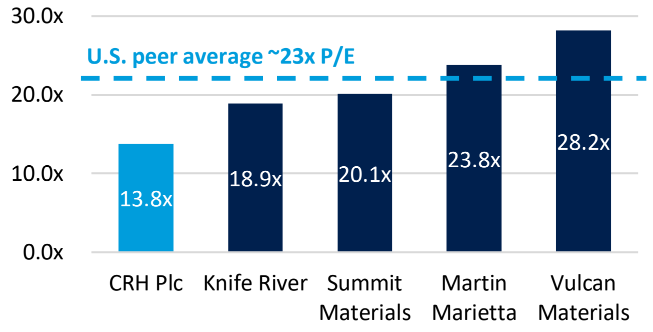
2. Global champions

These companies are industry leaders within their segments, with strong growth outlooks in their end markets and high quality, long-tenured management teams with a strong track record of operational performance.

CRH: As the largest construction materials business in North America, CRH holds the number one positions in several construction materials categories. At its recent investor day, the company outlined a pathway to double-digit annualised earnings growth over the medium term, as well as the potential to deliver ~$35b in financial capacity from operating cash flow generation and bolt-on acquisitions over the next 5 years – amounting to over 70% of its current market capitalisation. Despite this exceptional growth outlook, the company trades on only ~14x consensus FY24 earnings, a huge discount to U.S. Peers (refer Figure 7 on the next page).

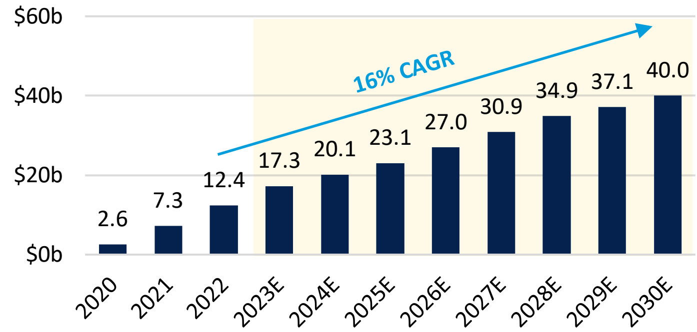
Flutter: 2024 has several catalysts for the company with Flutter due to complete its U.S. Secondary listing at the end of January and with FanDuel's profitability set to accelerate meaningfully after several years of high investment. The U.S. market remains relatively nascent, with many years of growth ahead as additional states continue to legalise sports betting and iGaming (refer Figure 8 on the next page). We believe the business has an exciting growth path ahead for the rest of the decade with Flutter's outstanding management team well placed to maintain the company's leading position.

Figure 7: CRH valuation vs. key U.S. peers – FY24E P/E



Source: S&P CapIQ as at 17 Jan 24

Figure 8: North America online sports betting/iGaming TAM



Source: BoFA as at Oct 2023

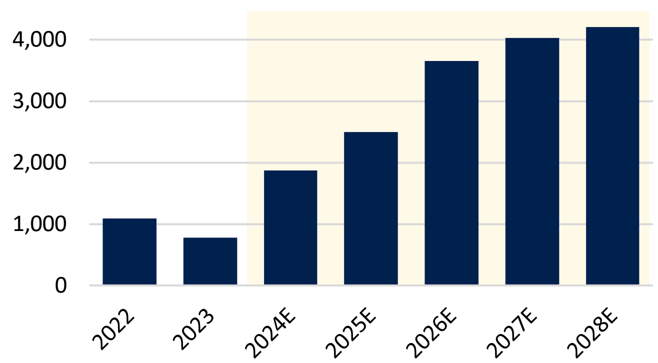
3. Gold

Gold remains an important part of our portfolio as a valuable hedge against geopolitical risk, inflation and potential U.S. dollar weakness. On top of this, the companies we are invested in are forecast to generate strong production growth, with significant leverage to higher gold prices.

Newmont: Post the acquisition of Newcrest, Newmont is now the largest gold producer in the world by a sizeable margin with nearly double the annual production of the second placed company – Barrick Gold. The company has a portfolio of tier one, long-life mining assets with several development-ready growth assets that will support production and free cash flow growth over the next few years (refer Figure 9). In addition, the company has strong exposure to copper, with annual copper production of ~150kt.

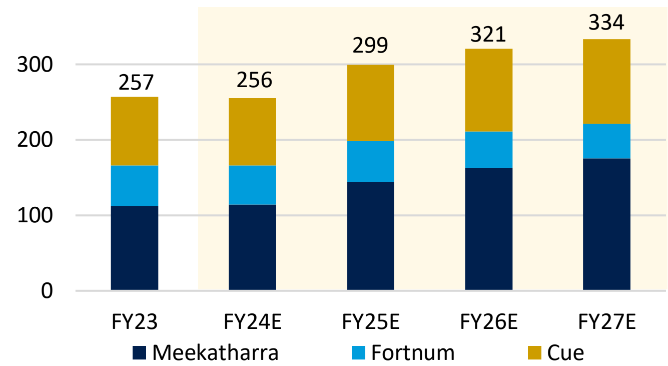
Westgold: We expect production to grow strongly from around 250koz to over 300koz ounces in the next few years (refer Figure 10). If we couple this production growth with a very attractive A$ Gold price which remains above A$3,000/koz we see the potential for exceptional free cash flow growth in the coming years. The new management team continues to execute well and has delivered an outstanding turnaround over the past year.

Figure 9: Newmont free cash flow estimates



Source: Barrenjoey Research estimates

Figure 10: Westgold production estimates (koz)



Source: Macquarie Research estimates

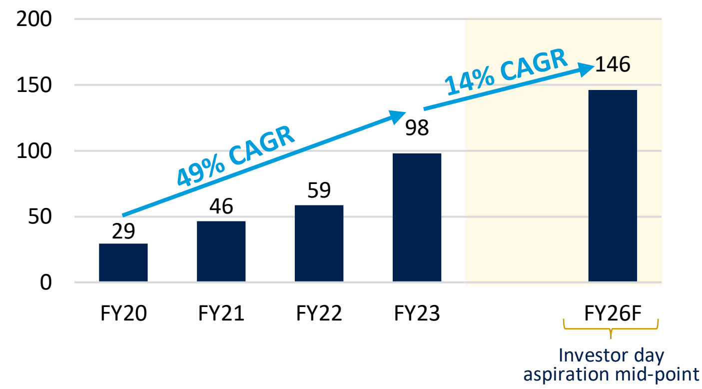
4. Hidden tech

These companies have exciting proprietary technologies that have taken decades to develop and are underappreciated by the market given the high barriers to entry and difficulty in replicating their intellectual property. These technology advantages are in the early stages of being leveraged to drive strong structural earnings growth.

Nufarm: The seed technologies segment within the Nufarm Group has grown EBITDA at a CAGR of 49% p.a. over the last three years to now comprise 20% of group earnings (refer Figure 11 on the next page). The company outlined the aspiration at its last investor day to grow EBITDA within this segment to ~$150m in FY26 and over ~$400m in FY30. A large part of this growth is driven by its proprietary Omega-3 seed technology which we believe provides a sustainable and scalable solution to support growth in Omega-3 demand from the fish farming industry.

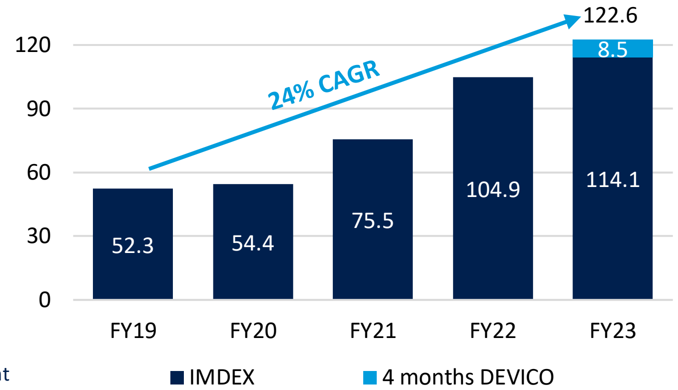
Imdex: With the recent acquisition of Devico, we believe Imdex has extended its global leadership position in mining exploration drilling technology. While the sector is perceived as highly cyclical and somewhat unsophisticated, Imdex has demonstrated how its superior technology can drive enhanced drilling efficiency and underpinned their exciting growth trajectory. The company has grown EBITDA at 24% CAGR over the last 5 years (refer Figure 12). With the best portfolio of products in the market, we think Imdex is very well placed to continue to grow earnings strongly for many years to come.

Figure 11: Nufarm – Seed tech: long-term growth aspiration (EBITDA $m)



Source: Company reports, consensus estimates

Figure 12: Imdex 5-year EBITDA growth



Source: Bloomberg, company reports and L1 Capital

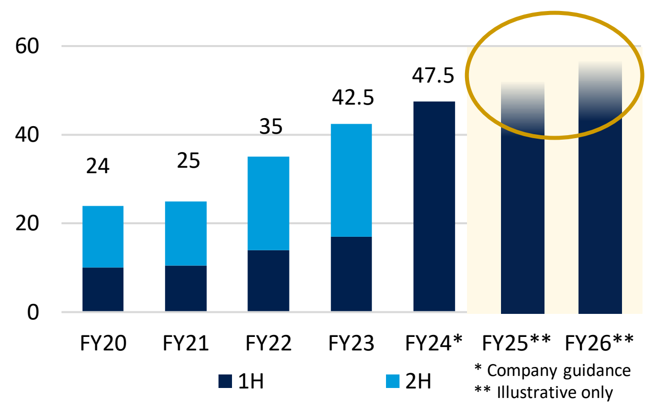
5. Infrastructure

These companies have monopoly positions in highly regulated markets with huge barriers to entry. We are focused on their ability to deliver an attractive and growing dividend stream in the coming years.

Chorus: Owns and operates the majority of NZ's high-speed broadband infrastructure. The company has recently completed the decade-long roll-out of its fibre network at a significant capital cost. While the current consensus FY24E dividend yield of ~6% is attractive, what excites us the most is the potential for these dividends to accelerate in FY25 and FY26 (refer Figure 13).

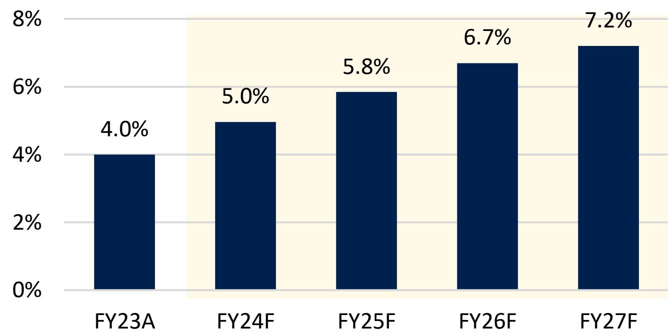
Aurizon: As the leading rail operator in Australia, Aurizon has over 5,000km's of network rail assets and the largest haulage operations in Australia across coal, bulk commodities and containerised freight. We see three key drivers underpinning the earnings outlook for the company (i) step up in its regulatory network earnings as it cycles into a new regulatory period, (ii) growth in volumes from contract wins and less weather-related impacts, and (iii) an ongoing focus on operational efficiencies. This earnings growth, together with a reduction in capital expenditure and an improvement in the payout ratio should drive a steady increase in dividends to shareholders over the medium term (refer Figure 14).

Figure 13: Chorus dividend per share forecasts



Source: Company reports

Figure 14: Aurizon dividend yield profile (%)



Source: Visible Alpha consensus

Key stock contributors for the quarter

CRH (Long +26%) shares continued to rally after upgrading its full year guidance in November and as its investment profile continues to build in the U.S. with the completion of its NYSE primary listing in September. The company is a significant beneficiary of the unprecedented growth in U.S. infrastructure spending which will underpin many years of robust demand. The Infrastructure Investment and Jobs Act ('IIJA'), Inflation Reduction Act ('IRA') and the Chips and Science Act will together add roughly US$2 trillion in investment to ageing U.S. infrastructure. These market tailwinds, together with CRH's ability to drive value-accretive M&A, position the company to deliver consistent double-digit earnings growth over the medium term. The company also made a $2.1b offer together with the Barro Group to acquire ASX-listed building materials company Adbri in December.

Bluescope Steel (Long +20%) continued its strong performance driven by the ongoing strengthening of U.S. steel spreads – U.S. steel prices moved +61% during the December quarter following a resolution to the United Auto Workers strike. The combination of U.S. steel delivery lead times and prices being well above historic averages should provide a strong tailwind for the company's second half earnings. In addition, recent M&A activity in the U.S. market, notably Nippon Steel's agreement to acquire U.S. Steel for ~US$14b, bodes well for the potential future value of BlueScope's U.S. operations. BlueScope continues to focus on growing its U.S. operations through expanding the capacity at the North Star facility in Ohio by 850ktpa, acquiring the U.S.'s second largest metal coating/painting company in Coil Coatings, and establishing BlueScope Recycling following its acquisition of the MetalX recycling business. We continue to believe the market significantly undervalues BlueScope's unique and strategic asset base and the resilience of the largely consolidated U.S. steel sector.

Imdex (Long +21%) shares performed well following the company providing a better-than-expected trading update for Q1 FY24. This news improved sentiment and demonstrated the company's resilience, with volume declines offset by higher average pricing against the backdrop of a weaker market for exploration and junior miner financings. Imdex management indicated increasing optimism heading into FY24, with 'steady growth' anticipated across all regions and an improved business mix supporting better profitability. Market activity for junior explorer financings, especially in the gold sector, picked-up during November, with Imdex being well positioned to capitalise on improved exploration activity.

Westgold Resources (Long +29%) rallied strongly on the back of the ongoing rise in the gold price (+11% in December quarter), as well as the company's release of a positive Q1 FY24 production update. In addition, during the quarter, the company announced the approval of its Big Bell expansion project. We expect this project to add ~93koz per annum once complete and extend the mine life to 16 years. Westgold's new management team continue to execute very well with all-in sustaining costs falling substantially over the past year and net cash growing to over $200m.

Viva Energy Group (Long +16%) shares rose, catalysed by the company's investor day in November in addition to the ACCC's decision not to oppose Viva's acquisition of fuel retailer and convenience store operator OTR Group. Viva is a leading fuel distributor, operating the Geelong Refinery, a fuel network of over 700 retail stores across Australia and a commercial/industrial fuel business. During its investor day Viva outlined its growth strategy, including a target of doubling EBITDA to >$1,250m over the coming five years. Viva's acquisition of OTR is transformational for the company through increasing its Australian fuel and convenience store network to >1,000, growing the more defensive area of non-fuel earnings from ~30 to ~50% of its business mix, realising run-rate synergies of US$60m p.a. and delivering material EPS accretion.

Nufarm (Long +10%) shares recovered after announcing solid FY23 results, considering the difficult weather conditions and de-stocking impacts the company faced during the year. The shares were further supported by an improvement in agricultural conditions and a normalisation in on-farm inventory levels which should support a return to more normalised ordering patterns in the coming year. We believe Nufarm is a much higher-quality business than it was a few years ago. The company is in the process of augmenting its crop protection business with a series of high-margin, high-growth proprietary formulations. In addition, Nufarm's seeds business has commercialised several exciting traits, including Omega-3 and Carinata, that are gaining traction and should deliver strong earnings growth in the Seeds division for many years to come.

Key stock detractors for the quarter

Cenovus (Long -20%) shares declined during the quarter as the WTI oil price dropped by 21% to ~US$72/bbl. The lower oil price reflected stronger-than-anticipated non-OPEC production and growth in global inventories during the quarter, as well as market scepticism over whether OPEC could curtail its supply sufficiently in response to these dynamics. Cenovus continues to generate strong free cash flow at current oil price levels, with the long-life nature of its oil sands assets and its low cost of production providing a break-even oil price at around ~US$40/bbl.

Alibaba (Long -11%) shares declined as the company walked back plans to separately list key business units due to weak capital market conditions. Given substantial macro-economic and geopolitical uncertainty, we believed that the market needed a catalyst to re-rate Alibaba, especially given a muted earnings growth outlook in 2024. With no separate listing forthcoming and our key catalyst no longer applicable, we exited the position during the quarter.

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Strategy returns (Net)[3] (%)

	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)[3]	(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	2.32	(7.36)	3.66	**30.29**
2022	2.79	6.87	1.34	3.44	0.06	(13.39)	(3.34)	5.37	(7.60)	5.24	7.52	4.36	**10.72**
2023	3.65	(2.04)	0.54	1.64	(3.19)	1.70	5.25	(4.89)	0.94	(3.07)	2.39	3.67	**6.20**

Portfolio positions

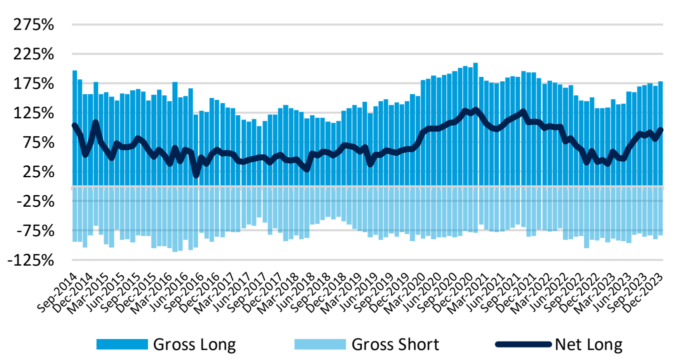
Number of total positions	83
Number of long positions	65
Number of short positions	18
Number of international positions	26

Net & gross exposure by region[3] (%)

Geography	Gross long	Gross short	Net exposure
Australia/NZ	116	74	41
North America	46	9	37
Europe	14	-	14
Asia	3	-	3
Total	**178**	**83**	**95**

Figures may not sum exactly due to rounding.

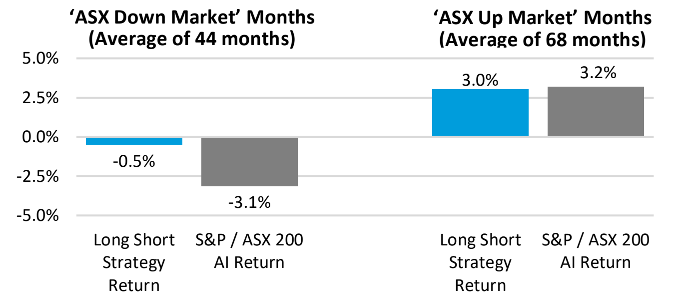
Historical Strategy exposures[3]



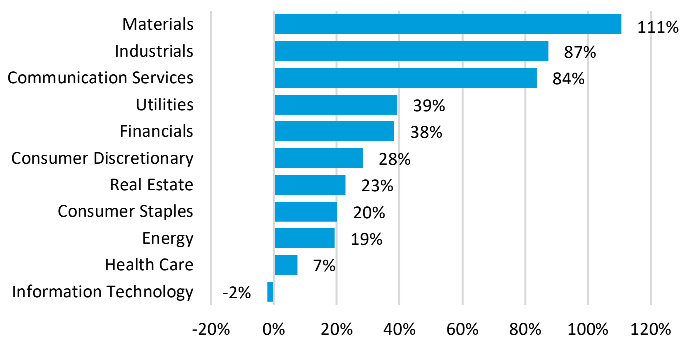
Company information as at 31 December 2023[4]

Share Price	$2.96
NTA before tax	$3.04
NTA after tax	$2.96
Shares on issue	619,457,738
Company market cap	$1.83b

Strategy performance in rising & falling markets[3] (Net)



Sector contribution since Strategy inception[3] (Net)



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Key personnel

Andrew Larke	Independent Chair
John Macfarlane	Independent Director
Harry Kingsley	Independent Director
Raphael Lamm	Non-Independent Director
Mark Landau	Non-Independent Director
Mark Licciardo	Company Secretary
Registry	Link Market Services Limited
Company website	www.L1LongShort.com
Manager website	www.L1.com.au
LinkedIn	Follow us on

Company information – LSF

Name	L1 Long Short Fund Limited
Structure	Australian Listed Investment Company (ASX:LSF)
Inception	24 April 2018
Management fee	1.44% p.a. inclusive of GST and net of RITC
Performance fee	20.5% p.a. inclusive of GST and net of RITC
High watermark	Yes
Platform availability	BT Panorama, CFS Firstwrap, HUB24, IOOF, Macquarie Wrap, Mason Stevens, Netwealth, Powerwrap, uXchange

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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 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 short Australian 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. 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, private wealth firms, financial planning groups, family offices, high net worth investors and retail investors.

L1 CAPITAL

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