L1 CAPITAL

August 2020

L1 Long Short Fund Limited

(ASX Code: LSF)

Key Details	
ASX code	LSF
Share price	$1.365
Market capitalisation	$869m
Shares on issue	636,639,144
Listing date	24 April 2018

Net Performance*	NTA pre-tax
One month	9.99%
Three months	5.84%
One Year	4.08%
Two Years (p.a.)	1.78%
Total return since inception	(11.80%)

*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 10.0% in August (ASX200AI 2.8%).

Reporting season proved to be a major positive catalyst for many of the Fund's stocks, with a broad range of our companies delivering better results and outlooks than consensus expectations.

Despite the Fund's strong recent performance, we believe the portfolio remains exceptionally attractive at present given larger than usual valuation anomalies.

We continue to believe the likelihood of a safe and effective COVID-19 vaccine is higher than market expectations and this event should trigger a long-awaited rotation into value and cyclical stocks, which the Fund is well positioned to benefit from.

Global markets recorded solid gains in August (S&P500 +7.2%, FTSE100 +1.8%, Euro Stoxx 50 +4.5%, Hang Seng +2.4%) driven by a continued easing of lockdown restrictions and continued benefits of fiscal and monetary policy support. The ASX200AI returned 2.8% in August – the strongest sectors were Information Technology (+15.5%), Consumer Discretionary (+8.7%) and Property (+7.9%), while Utilities (-4.8%), Communication Services (-3.8%) and Consumer Staples (-0.4%) lagged.

The Fund performed very strongly in August, with a high proportion of 'beats versus misses' during reporting season. It was a particularly pleasing month, given the continued strong outperformance of high P/E 'growth' stocks both domestically and offshore.

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

News Corp (long) (+17%) shares rallied after reporting a strong FY20 result with all key divisions materially ahead of market expectations. News Corp provided additional disclosure around the Dow Jones assets (including the Wall Street Journal) bringing further visibility to the significant value of these assets as compared to listed peers such as the New York Times. If we apply the New York Times' earnings multiple to the Dow Jones assets it would imply a stand-alone valuation of ~US$7b. We continue to believe News Corp is materially undervalued with the REA interest combined with their net cash position exceeding their current market cap of ~US$8.9bn. This implies the remaining media, publishing and real estate assets, including the above-mentioned Dow Jones assets are currently valued at roughly zero. News Corp management are taking progressive steps to better highlight the underlying value of the assets and simplify the corporate structure which we believe will continue to unlock value going forward.

Chorus (long) (+12%) shares rallied after reporting FY20 results that demonstrated good cost control and continued take up of fibre services. The fibre build has been consuming the majority of Chorus' cashflow for many years and has prevented the company from paying out its true underlying earnings in dividends. With the peak capex period now past, we are hopeful shareholders should finally see the returns on this 10 year investment program.

Worley (long) (+17%) shares rose after reporting resilient FY20 results that highlighted the more diversified nature of the business post the ECR acquisition. Worley proactively managed costs and staff utilisation levels to deliver second half earnings in line with the first half, along with a large improvement in cash generation, despite the impacts of the oil downturn and COVID-19 disruptions across the business. Worley initiated a $275m operational cost out program, with $165m of this program already delivered on a run-rate basis. While the near-term outlook may be more subdued, the significant cost action taken by Worley provides a material buffer for any potential revenue weakness. Worley management have done an outstanding job of navigating the downturn, streamlining operations and positioning the business to capitalise on an improvement in the capex cycle. We continue to believe Worley is materially undervalued with the market underappreciating the flexibility of its engineering consulting business model and the diversified and resilient nature of its operations.

Qantas (long) (+22%) shares performed strongly on the back of improved vaccine prospects and falling COVID-19 case numbers in Victoria. Qantas announced a ~$1.9b capital raising in late June together with a significant restructuring and right-sizing program that will see the company deliver $1b in ongoing cost benefits. The loyalty program continues to perform strongly and the shift away from cash towards more online transactions should see sustained benefits going forward. We expect the competitive environment to remain rational and favour Qantas, given that Virgin has announced the closure of Tiger and has flagged reducing capacity to focus on positive cashflow and profitability. We believe Qantas can re-emerge in a stronger position post the COVID-19 disruption due to the significant cost out actions taken, the improved industry dynamics that will likely support higher market share going forward and its considerable balance sheet capacity providing flexibility to weather near-term volatility. Qantas management have also reiterated their FY23 operating targets, which we view as an affirmation of their ability to bounce back strongly as conditions allow. Alan Joyce (Qantas' well-regarded CEO) also extended his contract out to FY23, which we view as another clear positive.

Star Entertainment (long) (+16%) shares rallied after reporting a strong FY20 result despite an incredibly difficult trading environment. Star's management team delivered strong operating margins and positive cashflows by managing costs extremely well through a wave of varying lockdown restrictions. Re-opening trends have been very positive to date, with Star's domestic businesses generating revenues at greater than 75% of pre-COVID levels for the first eight weeks of FY21. Star has navigated the COVID-19 crisis with minimal cash burn to date and is proactively exploring value maximisation options such as the sale of the car park concession at its Sydney casino which could generate in excess of $200m. Star has an attractive outlook given the scarcity value of its casino licenses and the transformative impact of the Queen's Wharf development in Brisbane, which we believe is an underestimated driver of medium-term earnings growth for Star. Star continues to have corporate appeal, with Far East and Chow Tai Fook owning a 10% stake in the company and also seeking regulatory approval to increase their holding. We continue to believe Star's market cap of $2.8b hugely undervalues the asset base, licenses and likely cash flow generation of the company. While the market is very focused on the short-term risks around COVID-19 disruption, we believe the medium-term outlook for Star looks exceptional and we significantly increased our holding at below $2.00/share in March and again around $2.30 in April.

We believe each of the companies discussed above represents a compelling combination of quality and value and we continue to see significant further upside in each of them.

In August, 16 positions contributed more than 0.4% to Fund returns, while only two stocks detracted more than 0.4%.

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	94
Number of long positions	71
Number of short positions	23
Gross long exposure (%)	194%
Gross short exposure (%)	85%
Gross exposure (%)	279%
Net exposure (%)	109%

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 31 August 2020)*

NTA pre-tax	$1.7640
NTA post-tax	$1.8558

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