Daily Class

L1 Capital Long Short Fund

Quarterly Report | DECEMBER 2022

- **The L1 Capital Long Short Fund returned 18.4%[1] for the December quarter (ASX200AI 9.4%).**
- **Over the past 3 years, the portfolio has returned 21.7%[1] p.a. (ASX200AI 5.5% p.a.).**
- **Global markets recovered over the quarter on optimism that inflation had finally peaked and on early signs that China was moving away from its strict 'zero COVID' policy.**

Equity markets were generally stronger over the quarter (MSCI World 9.8%, S&P 500 7.6%, Nasdaq -0.8%), with a rebound in October and November partially offset by a sharp decline in December.

Markets rallied over the first two months of the quarter on the back of falling bond yields and hopes that inflation pressures may have peaked.

Early signs of China moving away from its strict 'zero COVID' policy saw strong gains in Chinese and Hong Kong listed stocks, and those companies most exposed to a potential China re-opening.

Markets were also supported by Fed Chair Jerome Powell's comments in November that the pace of interest rate increases could moderate as early as the Fed's next meeting.

In December, the Fed reduced the pace of interest rate increases, however, the committee maintained its hawkish tone and affirmed its resolve to bring down inflation through sustained higher interest rates. This led to a sharp decline in markets with investors increasingly concerned that Central Bank tightening would persist despite clear signs of a global economic slowdown.

The portfolio performed very strongly over the quarter, driven by broad-based stock gains (26 individual stock positions contributed 0.5% or more to returns) along with tailwinds from positive China re-opening sentiment and the strong performance of our short book.

Returns (Net)[1] (%)	L1 Long Short Fund	S&P ASX 200 AI	Out-performance
3 months	18.4	9.4	+9.0
6 months	10.0	9.8	+0.1
1 year	9.4	(1.1)	+10.5
2 years p.a.	19.4	7.7	+11.7
3 years p.a.	21.7	5.5	+16.2
5 years p.a.	10.8	7.1	+3.7
7 years p.a.	15.9	8.4	+7.5
Since inception p.a.	20.5	7.0	+13.5
Since inception cumulative	374.9	76.3	+298.6

Returns Since inception (Net)[1] (%)	Cumulative Return	Annualised Return p.a.
L1 Capital Long Short Fund	374.9	20.5
S&P ASX 200 Accumulation Index	76.3	7.0
MSCI World Net Total Return Index (USD)	72.7	6.8
HFRX Global Hedge Fund Index	9.5	1.1

We are proud to have received several awards and recognition for the Long Short strategy:

- **Best performing long short fund in Australia (since inception in 2014[2])**
- **Hedge Funds Rock – Australian Alternative Investment Awards**
  - **Winner:** Best Listed Alternative Investment Product for L1 Long Short Fund Ltd (ASX:LSF) in 2021 and 2022
  - **Winner:** Best Alternative Investment Manager of the Year in 2021
- **Zenith Fund Awards**
  - **Winner:** Australian Equities – Best Alternatives Strategy in 2022[3]
- **Ranked in the top 20 performing hedge funds globally by HSBC for calendar year 2021[4]**

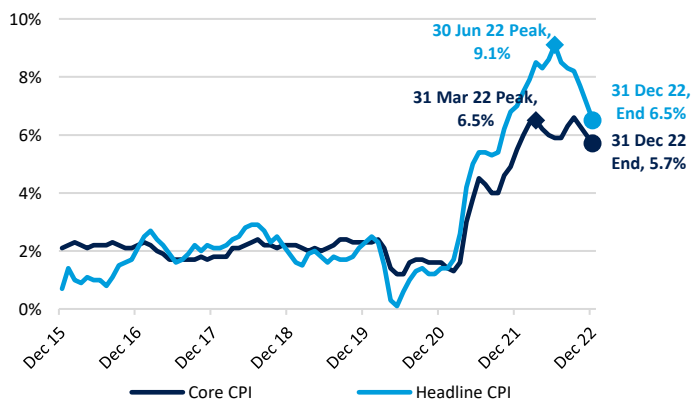
1. All performance numbers are quoted net of fees. Figures may not sum exactly due to rounding. Past performance should not be taken as an indicator of future performance. Strategy performance and exposure history is for the L1 Capital Long Short Fund – Daily Class since inception on 3 Oct 2016 (being the date that the first Daily Class units were issued). Prior to this date, data is that of the L1 Capital Long Short Fund – Monthly Class since inception (1 Sep 2014) which is subject to a different fee structure. 2. Ranking in FE Analytics Australian Shares universe. 3. See Zenith Fund Awards disclaimer at back of the document. 4. Based on full year Fund performance versus published universe of ranked funds as at 14 Jan 2022. NOTE: Fund returns and Australian indices are shown in A$. Returns of U.S. indices are shown in US$. Returns are on a total return basis unless otherwise specified.

Reflections: 2022 in review

2022 was a tumultuous year for global markets with significant economic and geopolitical headwinds weighing on market sentiment and driving significant volatility. The VIX Index, which is a measure of implied market volatility and is anecdotally referred to as the markets' 'fear gauge', remained above 20 for most of the calendar year. This indicates a high level of volatility with increased uncertainty and elevated risk. Markets had to contend with a myriad of issues, including substantial interest rate increases, a sharp reduction in Central Bank liquidity, fragile global supply chains, a European energy crisis, the Russia/Ukraine war, and severe COVID-induced lockdowns in China.

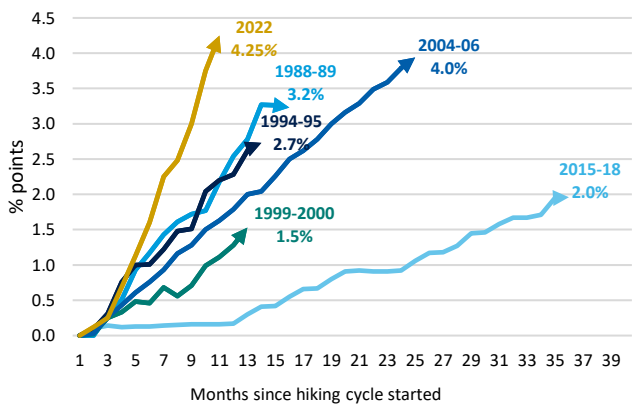
The dominant theme of the year was the surge in inflation, which reached 40-year highs in the U.S., driven primarily by extreme fiscal and monetary stimulus implemented in 2020 and 2021. Figure 1 illustrates the sharp rise in U.S. core and headline CPI, which only started to moderate marginally towards the end of the year. The Fed responded with the most aggressive interest rate hiking cycle seen since 1981 (refer Figure 2). Over the year, the Fed raised interest rates by 425bps relative to market expectations of only 75bps at the start of 2022.

Figure 1: U.S. CPI



Source: Bloomberg

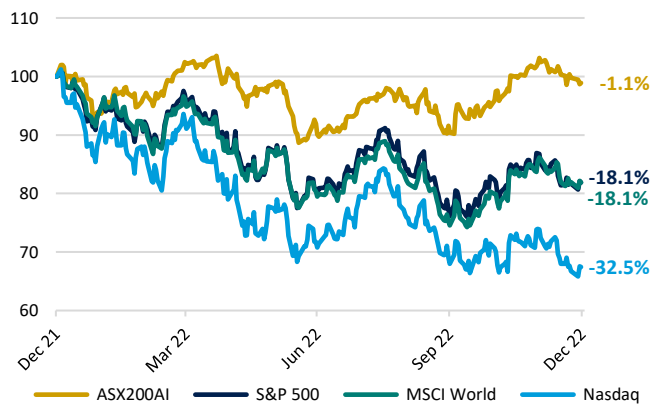
Figure 2: Change in Federal Funds Rate



Source: Bloomberg

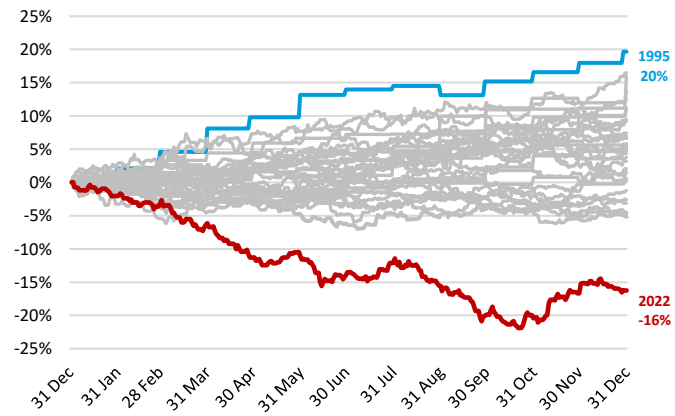
This led to a sharp correction in asset prices, with the Nasdaq falling 33% and the S&P 500 falling 18% in 2022, their worst annual performance since 2008 (refer Figure 3). 9 of 11 sub-sectors of the S&P500 were negative for the year with Utilities marginally positive and only Energy generating a meaningful positive return (+65.7%). Unlike in prior crises, bond markets did not provide a safe haven, collapsing to their worst performance in almost 100 years (refer Figure 4).

Figure 3: Major global equities indices performance CY22



Source: Bloomberg

Figure 4: Bloomberg global aggregate bond index performance



Source: Bloomberg

Given the extreme equity market weakness and elevated market volatility over the year, we are pleased to have delivered robust returns for our investors, with the portfolio generating a net return of 9.4% in 2022 (ASX200AI -1.1%, MSCI World -18.1%, HFRX Global Hedge Fund Index -4.4%).

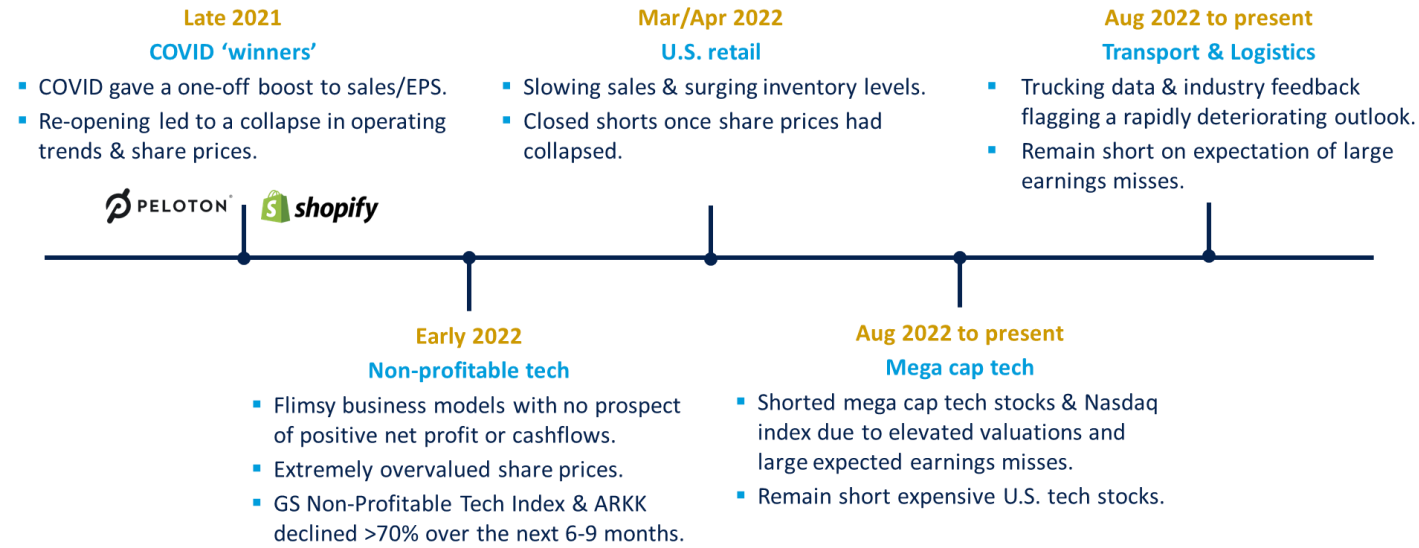
Figure 5 below provides a summary of some of the largest contributors to portfolio performance over the year. 2022 once again demonstrated the investment team's ability to identify 'winners' through rigorous company and industry research across a diverse range of sectors.

Figure 5: Key contributors to portfolio performance in 2022 (in alphabetical order)

Company and sector	Comment
Cenovus Energy *Energy*	Strong operational performance and low all-in cost structure supporting rapid de-gearing at prevailing oil prices.
Chorus *Infrastructure*	Improved regulatory certainty and pleasing operational performance leading to strong growth in dividends and cash flows.
Flutter *Gaming*	Extended leadership position in U.S. sports betting and achieved break-even profitability in the U.S. faster than market expectations.
Madrigal *Biotech*	Exceptional Phase 3 trial results with Resmetirom meeting all primary endpoints and beating efficacy expectations, while maintaining a clean safety profile.
Mineral Resources *Mining services*	Strong lithium prices, potential separate listing of its lithium business and formal sanction of the Onslow iron ore project.
Origin Energy *Energy*	Takeover offer at $9.00 per share from a consortium led by Brookfield Asset Management and MidOcean Energy.
Qantas *Travel*	Two large profit upgrades to H1 guidance driven by strong domestic and international travel demand and exceptional yield management. Net debt reduced below bottom end of target range.
QBE *Insurance*	Premium volumes and rates continued to remain buoyant and investment yields tracking ahead of market expectations. North American business improving after several years of disappointing results.
Shopify (short) *Technology*	Shares collapsed on weakness in the eCommerce market as COVID-19 benefits subsided and from a de-rating across ultra-high P/E stocks due to the sharp rise in bond yields.
Teck Resources *Mining*	Robust operating performance along with strong coking coal price. Exited the stock in early March and reinvested at the end of June post market sell-off.

In addition, 2022 illustrated the benefits of the strategy in protecting investors' capital in falling markets. The short book was a strong positive contributor to performance over the year comprising both index and company-specific shorts. As illustrated in Figure 6 on the next page, we evolved the positioning of the short book throughout the calendar year as various catalysts played out. At present we remain short mega-cap tech stocks in the U.S. such as Apple, where we continue to see downside risks to earnings expectations, as well as U.S. transport and logistics companies, where we expect a deteriorating outlook to lead to a fall in freight and flatbed truck rates.

Figure 6: LSF Short positioning – past 12 months



Source: L1 Capital

Outlook: Equity markets likely to remain volatile

We believe equity markets are likely to remain in a more uncertain period. This is due to the lagged impact of aggressive Central Bank policy tightening, deteriorating leading economic indicators, increasing pressure on corporate earnings into 2023 and tail risk from geopolitical events, which have significant downside potential and are much harder to predict.

On the positive side, we expect inflation to continue to trend down relatively quickly in 2023, which will enable the Federal Reserve and the RBA to imminently pause their interest rate hikes.

In terms of some of the key themes that we believe will influence markets in 2023:

- We expect a continued rotation in sector leadership, with old economy sectors, such as Energy and Materials, outperforming new economy sectors, such as Technology.
- We expect inflation to fall significantly over the year given the aggressive rise in interest rates. We are already seeing clear signs of goods inflation falling rapidly, while services inflation is likely to moderate but stay relatively more elevated given the strong linkage with wage rates.
- We remain optimistic about the impact of China re-opening and expect much stronger economic growth in China in 2023 along with a surge in operating trends for Chinese travel and consumer-related stocks.
- Conversely, we are cautious on Australia and the U.S. where we expect a difficult economic environment ahead with consumer spending trends likely to peak in 2023. We believe further negative revisions to earnings estimates are likely over the course of 2023 as consensus estimates align with key economic indicators which are showing deteriorating trends.

Despite our cautious view on the macro environment, we believe the 2022 sell-off has been quite erratic and is providing us with a better than usual set of long and short opportunities. LSF has the advantage of being able to adjust our exposure to reflect the prevailing risk-reward of the market, to benefit from falling share prices through shorting and to exploit our research insights offshore, not just domestically. Importantly, as 2022 demonstrated, we do not need the stock market to go up to generate positive returns for investors.

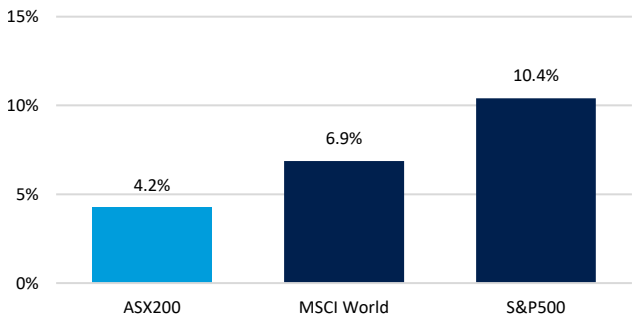
Australian companies are facing several new headwinds that will make strong earnings growth more difficult over the next few years.

One of the key benefits of the Long Short Strategy is our ability to invest not just domestically in Australia, but also offshore. This enables us to capitalise on our sector insights by gaining exposure to the best opportunities globally.

Since the inception of the Long Short Strategy in 2014, we have seen compelling offshore investment opportunities become increasingly abundant relative to domestic ones. This is not just due to the inherently greater volume of choice available in the broader universe, but due to the more attractive growth characteristics of those opportunities. We attribute a strong part of this trend to the relatively lower growth nature and greater maturity of most large Australian companies. We see this trend accelerating with anti-business policy exacerbating the potential impact going forward.

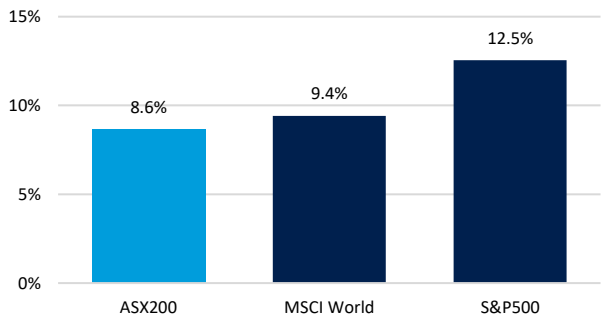
When comparing the ASX200 versus major global indices, Figures 7 and 8 below illustrate the importance of dividends in supporting returns for the ASX200 over the past decade. On a price returns basis (i.e. without dividends), the growth rate of the ASX was less than half that of the S&P500. On a total return basis (price returns plus dividends), this difference narrows considerably due to the high dividends paid by ASX listed companies.

Figure 7: Index price returns – last 10 years p.a.



Source: Goldman Sachs at 31 Dec 2022

Figure 8: Index total returns – last 10 years p.a.

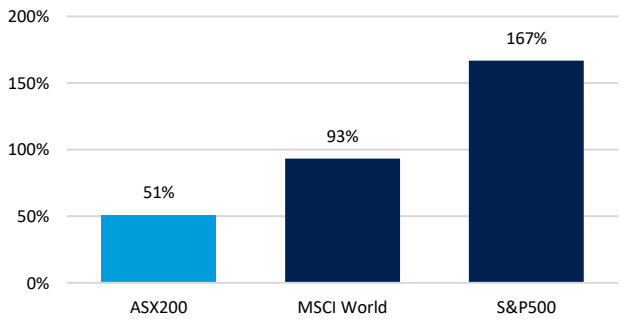


Source: Goldman Sachs at 31 Dec 2022

The underlying reason for the ASX200's lower price returns has been lower earnings growth. Figure 9 outlines the cumulative EPS growth of the ASX vs. major indices over the past 10 years. The chart demonstrates that the ASX200 has delivered cumulative earnings growth well below the MSCI World and the S&P500. While some of the difference has been driven by a greater level of re-investment and capital management in offshore markets, which tend to pay lower dividends, this does not fully explain the wide divergence in growth.

The analysis above indicates that ASX200 returns over the past decade have been predominantly supported by dividend returns, whereas offshore market returns have been more driven by earnings growth.

Figure 9: EPS Growth – last 10 years (Cumulative)



Source: Goldman Sachs at 31 Dec 2022

As we think about the implications of this going forward, we believe the trends noted over the last decade are likely to continue, leading to lower prospective returns for domestic index investors. There is arguably limited scope for P/E multiple expansion in a higher rate environment or for further increases in dividend yields given payout ratios are already relatively high and leave little room for significant business reinvestment. Generally, the largest 20 companies in Australia (which account for over 60% of the ASX200 Index) are relatively mature, low growth businesses. They dominate their respective industries (offering limited further market share opportunities) and in many cases have new competitors or tail risk in their business (e.g. the big four banks, two major supermarket retailers, Telstra etc). According to consensus estimates, the median EPS growth CAGR for the ASX top 20 over the next three years is expected to be ~5% which is less than half that of the S&P500 (+11.5%).

Furthermore, we see several structural risks going forward that could reduce the competitiveness of the Australian market relative to developed market peers and add further headwinds to the growth outlook as outlined below.

1. Implementation of uneconomic energy policy

The Federal Government has passed a revised energy policy that caps the domestic wholesale gas price at $12 per GJ for 2023 and gives the government unprecedented powers to control the Australian Energy sector through a new code of conduct. The Government has claimed that the measures are necessary to prevent energy companies from "war profiteering" as energy prices increased post the invasion of Russia into Ukraine. However, oil prices are currently ~10% below the levels of January 2022, before Russia invaded Ukraine, and gas prices (on an export parity basis) are in line with levels from a year ago. Furthermore, if we analyse returns for Australian oil and gas companies since 2009, the companies have generated a less than 10% return on invested capital on average which clearly does not reconcile with claims of 'excessive returns'. We believe these extraordinary interventionist measures are misdirected, will result in a decline in energy investment at a critical time for Australia and may precipitate more gas shortages in the medium term.

2. Increasing labour market disruption from workplace legislation

The Federal Government has recently passed the Secure Jobs, Better Pay Bill. This is the most extensive industrial relations reform since the introduction of the Fair Work Act around 13 years ago. The Bill will result in greater power for trade unions and employees, increase the likelihood of many businesses being forced into multi-enterprise bargaining and result in industrial action being potentially much more damaging and more difficult to mitigate. In many cases, businesses will be forced to raise wage levels (to the highest common denominator across an industry) with no offsetting improvement in productivity, thereby placing pressure on profit margins. These changes will only seek to further reduce the competitiveness of the Australian labour market relative to offshore peers.

3. Reduced benefit of Chinese growth

In the two decades preceding the COVID-19 pandemic, Australia was an outsized beneficiary of the rapid economic growth and sharp increase in the rate of urbanisation of the Chinese economy. This led to a tripling in Australian exports to China between 1999-2019. China became Australia's largest export trading partner by a significant margin and accounted for nearly 40% of all Australian exports by 2019.

While China remains Australia's largest export partner, we believe the historic growth benefits the Australian economy enjoyed pre-pandemic are unlikely to be repeated going forward. Chinese urbanisation rates, while remaining supportive, are unlikely to match the exponential growth levels in prior years. In addition, the political landscape has changed considerably with the rapid deterioration of economic ties between the two countries during the depths of the COVID-19 pandemic. Australia has looked to actively diversify its exports away from China in response to a wave of trade restrictions imposed on several products, including, barley, beef, wood, wine and coal. While the trading relationship appears to be improving in recent weeks and some restrictions may be relaxed, we believe it is very unlikely that the broader trade relationship will fully revert to the pre-pandemic period. This will make it incrementally harder for Australia to leverage the growth benefits of the Chinese economy.

4. Proposed ban on off-market buybacks

The Treasury has released draft legislation aimed at banning the ability for companies to stream franking credits to shareholders as part of off-market share buybacks. Historically, these buybacks have been used by many large, listed companies including BHP, Rio Tinto, Commonwealth Bank of Australia, Westpac and Woolworths as a means to return capital to shareholders in a tax-efficient manner. The proposed ban will have an outsized impact on superannuation funds, charities and self-managed retirees who benefit the most from franking credits. It also raises the risk that the franking system as a whole may be targeted in future which has been a key pillar in supporting total after-tax returns for domestic investors.

5. State governments increasing taxes and royalties

State Government balance sheets have deteriorated over the last few years due to the impacts of the COVID-19 pandemic and a significant increase in infrastructure spending. In response, State Governments have looked to raise additional funding by increasing various taxes on businesses. Many of these proposed changes have come with little to no industry consultation and are in contrast to recently signed agreements or election assurances. In Queensland, coal royalties were changed in 2022 from a 15% flat to rate, to a range of 15% to 40% at varying coal price levels. This effectively caps the potential returns for coal companies and is in spite of an election promise not to increase any taxes during the election term. In response, mining leaders have indicated job cuts may be implemented at existing projects and investment plans in Queensland across a number of commodities (not just coal) are now under review.

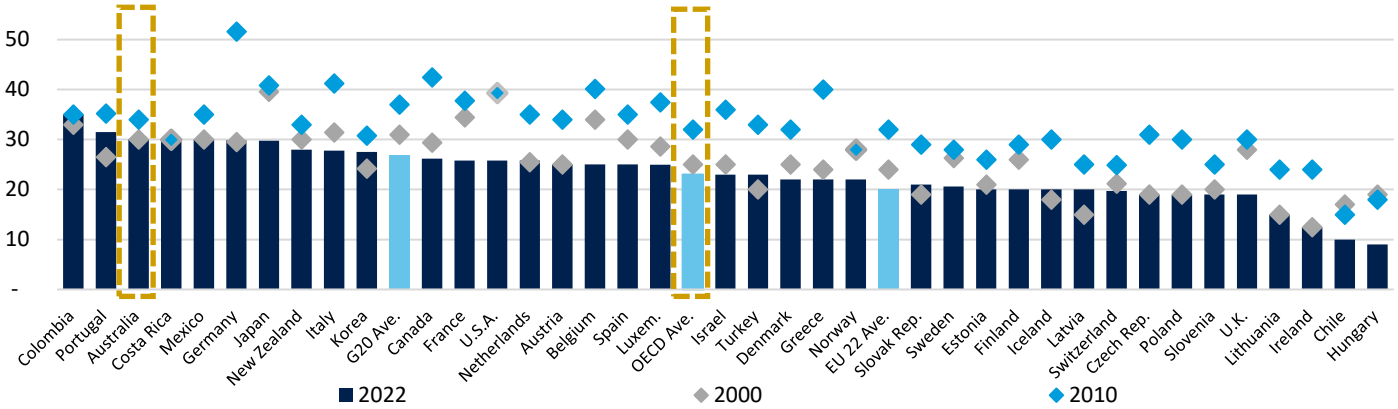
In New South Wales, the State Government has proposed a ~$120m p.a. increase in gaming duties for casinos. This would amount to a ~40% uplift in current taxes and is contrary to the State Government signing a 20-year agreement with the largest casino operator in the State in 2020 at a fixed tax rate. In Victoria, there is a proposal to bring back the Government owned State Electricity Commission ('SEC'), with the SEC potentially making direct energy investments and becoming an energy retailer. This would reverse the decades-long privatisation of the Australian energy market.

All of the above examples have added incremental uncertainty for many companies in the affected sectors and impaired their ability to make long-term, capital-intensive investment decisions until there is greater confidence in the fiscal regime.

6. High corporate tax rates

Over the past two decades we have seen a reduction in corporate tax rates across many developed nations as countries look to protect capital from flowing to other markets. However, as Figure 10 below demonstrates, Australia has kept corporate tax rates broadly flat at 30%. This places Australia as the third highest tax jurisdiction across Organisation for Economic Co-operation and Development (OECD) members, with a tax rate ~700bps higher than the OECD member average. Australia's corporate tax rate is also well above Asian markets such as Hong Kong (16.5% tax rate) and Singapore (17% tax rate) which directly compete for international investment. Planned cuts to the corporate tax rate were shelved by the current Federal Government which we believe will handicap Australia's ability to attract business investment and drive economic growth and job creation.

Figure 10: Statutory corporate income tax rates across OECD countries



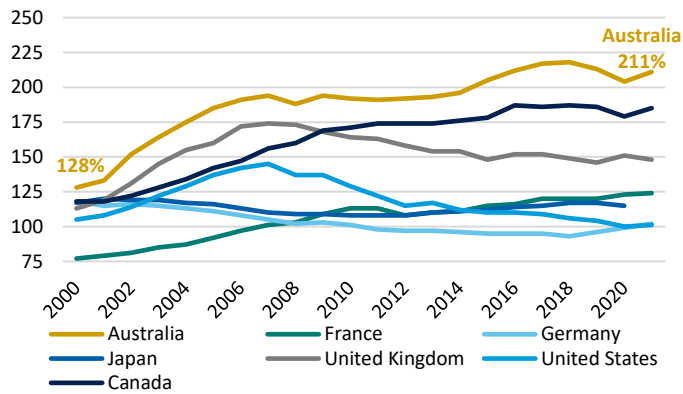
Source: OECD (2022) – OECD Tax Database

7. Sharp increase in household debt levels

Australia has seen a sharp rise in household debt levels over the last two decades which has been accompanied by surging home prices and improved credit availability. Household debt levels rose to 211% of disposable income in 2021 relative to only 128% in 2000 (refer Figure 11), placing Australia at the top-end of its developed markets peer group.

In an environment where interest rates have been rising significantly, and dwelling prices are now falling, this could create a perfect storm for mortgage stress levels. Even assuming a more benign economic outcome, this quantum of debt at higher interest rates will result in a lower level of discretionary spending going forward. The impact will be exacerbated by the rolling-off of very low fixed mortgage rates over the course of 2023.

Figure 11: Household debt to disposable income levels (%)



Source: OECD (2022)

Given the above headwinds to growth in the Australian market, we expect potential offshore investment opportunities will be more abundant and attractive than domestic opportunities for the next few years.

Key stock contributors for the quarter

Qantas (Long +20%) shares rallied over the quarter after the company upgraded its first half profit before tax expectations in October and subsequently upgraded them again by $150m, six weeks later. The upgrades were driven by strong domestic and international travel demand and exceptional yield management. Per the most recent update, Qantas expected first half profit before tax in the range of $1.35-1.45b and a reduction in net debt by $900m to $2.3-2.5b by 31 December 2022. The company also noted that it is actively considering further shareholder returns given its low levels of net debt.

We continue to view Qantas as having emerged 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, which we expect will persist despite macroeconomic headwinds. If Qantas management can achieve its FY24 targets, there is potential to deliver close to $1 of earnings per share, with Qantas currently trading on only ~6.5x P/E on that basis. We believe there is significant share price upside through earnings growth and a P/E re-rating as the company's earnings mix shifts towards its more predictable domestic and loyalty businesses.

Capstone Copper (Long +52%) shares rose on the back of a recovery in copper prices and an update on the integration plan of its Mantoverde (MVDP) and Santo Domingo assets where it is has the potential to become one of the largest and lowest cost battery grade cobalt producers in the world. Capstone has an exceptional growth profile with a pipeline of fully permitted projects that will enable it to more than double production from ~185kt currently, to close to 400kt over the next few years. The company is fully funded to complete the currently approved project pipeline and has a highly capable, focussed and aligned management team. If the management team deliver the MVDP sulphide expansion as planned, we believe there is ~75% upside to the current share price over the next few years. The company also has an attractive suite of copper and cobalt growth opportunities under feasibility studies, which could provide further value creation opportunities. We believe Capstone is significantly undervalued, trading on only 7x consensus FY24 P/E, despite having the most attractive growth profile of its peer group.

Origin Energy (Long +49%) shares rallied after receiving a takeover offer at $9.00 per share from a consortium led by Brookfield Asset Management and MidOcean Energy. The offer represents a 55% premium to Origin's share price prior to the announcement of the proposal and follows two prior rejected proposals at $7.95 per share on 8 August 2022 and $8.70-$8.90 per share on 18 September 2022. The takeover offer recognises the upside potential we saw in the company. We decided to exit the position during the quarter given some risks to completion remain, including, due diligence and regulatory approvals.

Madrigal (Long +347%) is a U.S.-listed clinical stage biotech company. Its key asset is Resmetirom which aims to treat NASH (non-alcoholic steatohepatitis), more commonly referred to as 'fatty liver disease'. NASH is the largest disease group that has no approved treatment with an estimated 10 million sufferers in the U.S. alone. NASH patients typically present asymptomatically but many progress over time to liver cirrhosis and failure. We conducted an extensive due diligence process to evaluate the likelihood of success and risks of Resmetirom. We ultimately invested in Madrigal in 2020 as Resmetirom's Phase 2 results demonstrated strong efficacy in reversing disease with a clean safety profile. It was also the only credible Phase 3 candidate for NASH treatment.

Since we invested, the other companies ahead of Madrigal in NASH trials all failed and COVID-19 prevented new candidates from initiating Phase 3 trials which typically take three years to complete. In December, Madrigal shares surged after the company announced that Resmetirom met all its primary endpoints and beat efficacy expectations while maintaining a clean safety profile. We believe Resmetirom will be approved on these results and will become a blockbuster drug. By being first to market in a massive end market (NASH) and with a multi-year lead over future competitors, we believe Madrigal is now an ideal takeover candidate for large pharmaceutical companies.

Flutter (Long +14%) shares rose with continued strong momentum from its U.S. business through the start of the key NFL season. The U.S. business moved to positive EBITDA in Q2 2022, well ahead of its peers, and its sports betting market share accelerated to 51% from ~40% six months ago, driven by its superior product, efficient customer acquisition strategies and strong operational execution. The U.S. division is now the largest by revenue for the company, with a clear path to profitability in 2023. This shift to profitability, together with the exponential growth of the U.S. sports betting market, underpins the ability for Flutter to significantly accelerate its earnings growth over the next few years. We believe Flutter remains significantly undervalued given its exceptional growth outlook and dominant industry position.

Sandfire Resources (Long +47%) shares rose as copper prices continued to recover and with an easing of electricity prices in Spain where its MATSA operations are based. Energy costs have moderated due to a milder winter than previously expected which should support a meaningful reduction in cash costs for the company. Sandfire also completed its $255m retail and institutional entitlement offer in December which de-risks the company's balance sheet as it completes the development of the Motheo Copper Mine in Botswana. The company also announced a formal sale process for its De Grussa operations after receiving several unsolicited expressions of interest. We continue to see compelling valuation upside in Sandfire with the commencement of Motheo production in FY24 set to deliver a step-change in profits and cash flow for the company. With the acquisition of OZ Minerals by BHP close to completion, we believe Sandfire will become the preferred company for investors to gain copper exposure in the Australian stock market.

Mineral Resources (Long +17%) shares performed strongly over the quarter as lithium markets remained tight, supported by demand for electric vehicle batteries and iron ore pricing recovered supported by a re-opening of the Chinese economy. The company is shortly expected to finalise its joint venture agreement with Albemarle (over their jointly owned upstream and downstream lithium assets). This agreement will give clarity to Mineral Resources' lithium portfolio and support full downstream integration for >100kt of lithium hydroxide production. This will also provide the foundation for any possible separate listing of the lithium business in the future. We continue to believe that all key areas of Mineral Resources' core business (iron ore, lithium and mining services) have favourable medium-term tailwinds.

Seven Group Holdings (Long +24%) shares gained after providing a strong trading update at its AGM in November, including double digit earnings growth expectations for its WesTrac and Coates business units for FY23. These business units account for roughly two-thirds of Group earnings and are well positioned to grow strongly over the medium term as investment in mining, construction and infrastructure continues to grow. Seven also holds a 72.6% shareholding in Boral, one of the largest building and construction materials companies in Australia. Boral earnings have been impacted by surging input costs and significant wet weather delays. Under new leadership, and in a normalised trading environment, we believe Boral has the potential to more than double earnings over the medium-term from current levels.

Cenovus Energy (Long +24%) shares rallied over the quarter with oil prices steadying around US$80/bbl. Given the long-life nature of its oil sands assets and its low cost of production, we estimate Cenovus is free cash flow break-even at an oil price of ~US$40/bbl. With oil prices around double this break-even point, the company is able to generate considerable free cash flow at current levels, with Cenovus trading on a consensus FY22 free cash flow yield of ~15%. Furthermore, we expect the company to reach its target net debt level of US$4b by early CY23 at which point we expect it will allocate all available free cash flow to shareholder returns.

QBE (Long +16%) shares rose during the quarter with premium volumes and rates continuing to remain buoyant and investment yields tracking ahead of market expectations. QBE continues to improve the performance of its North American business which has struggled for many years. The company has also considerably strengthened its reserving which we believe places it in a strong position to deliver consistent earnings growth over the next few years. We have been cautious on QBE for many years, given the clear industry and company-specific issues it was facing. However, after 15 years of clear headwinds, we believe the company is finally at a turning point and is set to deliver stronger margins, dividends and return on equity. We believe this inflection point in business performance is not yet factored into market expectations, with QBE trading on only ~8.4x FY23 consensus P/E (versus a 10-year pre-COVID average of ~13x).

Fund returns (Net)[5] (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2014	–	–	–	–	–	–	–	–	(2.42)	3.03	2.85	1.61	**5.07**
2015	0.59	9.14	2.42	1.71	3.73	(0.86)	3.30	2.06	5.51	8.49	8.11	4.61	**60.52**
2016	5.81	0.59	5.47	2.46	2.78	(0.89)	3.22	3.92	0.46	(0.18)[4]	0.55	2.13	**29.43**
2017	2.48	1.79	2.83	1.01	4.14	1.68	2.61	1.67	1.91	2.50	0.86	3.50	**30.50**
2018	0.54	(0.49)	(1.68)	1.59	(3.77)	(6.31)	0.79	(5.93)	(2.13)	(4.01)	(2.62)	(6.07)	**(26.60)**
2019	4.33	5.14	0.19	2.82	(2.80)	3.84	1.16	0.41	2.59	3.34	0.30	2.19	**25.87**
2020	(7.83)	(7.11)	(23.04)	22.93	10.95	(2.21)	(1.96)	9.97	0.50	(2.64)	30.80	4.33	**26.54**
2021	(0.14)	9.06	(0.14)	4.96	4.08	(0.56)	1.81	5.22	4.79	2.29	(7.20)	3.56	**30.35**
2022	2.72	6.98	1.45	3.28	0.10	(13.69)	(4.66)	5.86	(7.98)	5.08	8.10	4.24	**9.39**

Portfolio positions	Current	Avg. since inception
Number of total positions	89	81
Number of long positions	60	56
Number of short positions	29	25
Number of international positions	30	25

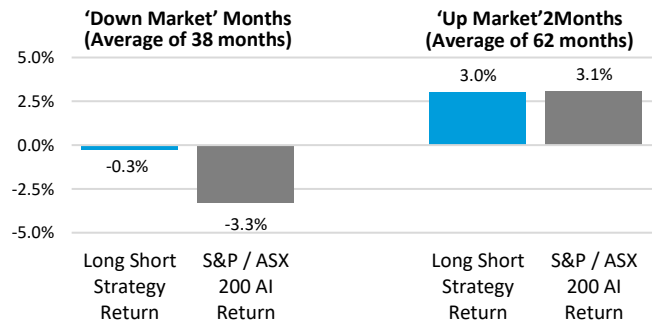
Fund information as at 31 December 2022[6]

Unit Price	$1.3403
Fund NAV	$918m

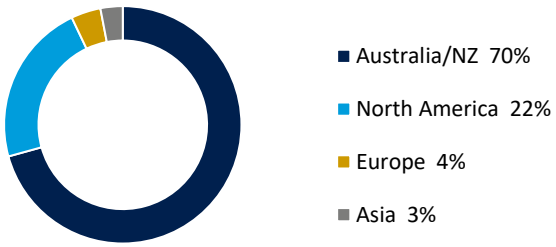
Net & gross exposure by region[5] (%)

Geography	Gross long	Gross short	Net exposure
Australia / NZ	79	78	1
North America	36	14	23
Europe	10	0	10
Asia	8	0	8
Total	**133**	**92**	**41**

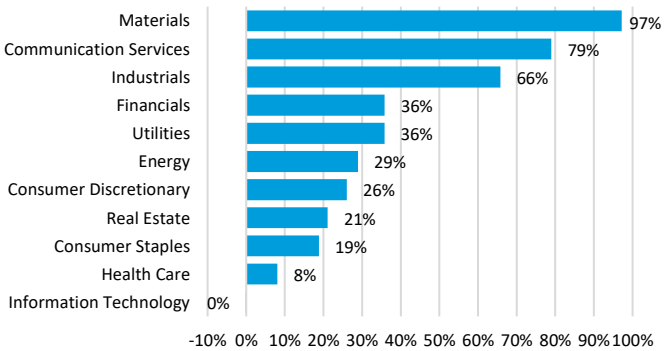
Performance in rising & falling markets[5] (Net)



Gross Exposure as a % of Total Exposure[5]



Sector contribution since Strategy inception[5] (Net)



5. All performance numbers are quoted net of fees. 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 Capital Long Short Fund – Daily Class since inception on 3 Oct 2016 (being the date that the first Daily Class units were issued). Prior to this date, data is that of the L1 Capital Long Short Fund – Monthly Class since inception (1 Sep 2014) which is subject to a different fee structure. 6. The value of the Fund's assets less the liabilities of the Fund net of fees, costs and taxes. The unit price is calculated by decreasing the NAV price by the sell spread (currently 0.25%). The NAV price is the NAV divided by the units on issue.

Fund Information – Daily Class

Class Name	L1 Capital Long Short Fund – Daily Class
Structure / Currency	Australian Unit Trust / AUD
Inception	1 September 2014
Management Fee	1.54% p.a. inclusive of GST and RITC
Performance Fee	20.50% inclusive of GST and RITC[7]
High Watermark	Yes
Buy / Sell Spread	15bps / 15bps
APIR / ISIN	ETL0490AU / AU60ETL04909
Minimum Investment	A$25,000
Subscription / Redemption Frequency	Daily
Platform Availability	Asgard, Australian Money Markets, BT Panorama, CFS FirstWrap, HUB24, IOOF, Macquarie Wrap, Mason Stevens, MLC, Netwealth, North, Powerwrap, Praemium, 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, financial planning groups, family offices, high net worth individuals and retail investors.

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Key service providers for the Fund are: Responsible Entity – Equity Trustees Limited, Prime Brokers – Morgan Stanley, Merrill Lynch and Goldman Sachs, Fund Administrator – Apex Fund Services Ltd (formerly known as Mainstream Fund Services), Fund Auditor – EY, Legal Advisor – Hall & Wilcox. There have been no changes to key service providers since the last report.

7. The performance fee is equal to the stated percentage (inclusive of GST and net of RITC) of any increase in the NAV over any Performance Period (adjusted for applications and redemptions and before the payment of any distribution after the payment of the management fee and expenses) above the high-water mark.

All performance numbers are quoted net of fees. All performance prior to 3 Oct 2016 (being the date that the first Daily Class units were issued) relate to the Monthly Class units which are subject to a different fee structure. Sources of information in this report are Mainstream Fund Services, Bloomberg and L1 Capital.

Information contained in this publication

Equity Trustees Limited ("Equity Trustees") (ABN 46 004 031 298), AFSL 240975, is the Responsible Entity for the L1 Capital Long Short Fund. Equity Trustees is a subsidiary of EQT Holdings Limited (ABN 22 607 797 615), a publicly listed company on the Australian Securities Exchange (ASX: EQT). This publication has been prepared by L1 Capital Pty Ltd (ACN 125 378 145, AFSL 314 302), to provide you with general information only. In preparing it, we did not take into account the investment objectives, financial situation or particular needs of any particular person. It is not intended to take the place of professional advice and you should not take action on specific issues in reliance on this information. Neither L1 Capital Pty Ltd, Equity Trustees nor any of its related parties, their employees or directors, provide any warranty of accuracy or reliability in relation to such information or accepts any liability to any person who relies on it. Past performance should not be taken as an indicator of future performance. You should obtain a copy of the Product Disclosure Statement before making a decision about whether to invest in this product. The L1 Capital Long Short Fund's Target Market Determination is available at https://bit.ly/3a0Kj68. A Target Market Determination is a document which was required to be made available from 5 December 2021. It describes who this financial product is likely to be appropriate for (i.e. the target market), and any conditions around how the product can be distributed to investors. It also describes the events or circumstances where the Target Market Determination for this financial product may need to be reviewed.

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