L1 Capital International Fund

Quarterly Report | DECEMBER 2020

Introduction

In this quarterly report we have outlined:

- **Our 2020 reflections as well as key portfolio decisions and outcomes.**
- **Portfolio positioning for 2021 and beyond.**
- **An overview of Eagle Materials, a high quality but below the radar building materials and products company which we believe provides a compelling investment opportunity.**

Fund Performance

Performance*	FUND (%)	INDEX** (%)	EXCESS (%)
1 Month	-0.3	-0.5	0.2
3 Month	2.0	5.9	-3.8
1 Year	3.8	5.6	-1.8
Since Inception – 1 March 2019	19.9	21.9	-2.1

* *Rounded to one decimal place. Numbers may not add due to rounding. Past performance should not be taken as an indicator of future performance.*

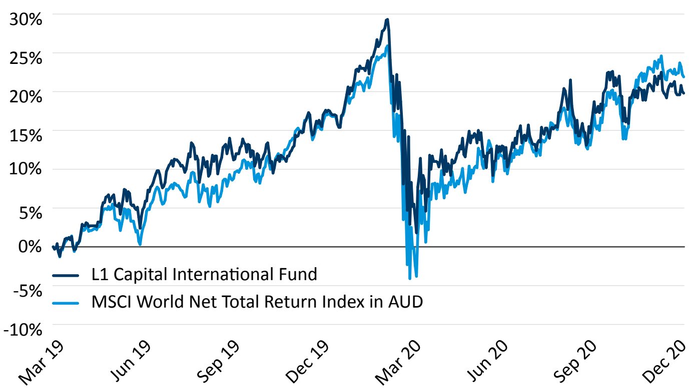
** *MSCI World Net Total Return Index in AUD. Return measured from Index close on 1 March 2019.*

Largest 3 Contributors*	Largest 3 Detractors*
Airbnb	**Alibaba Group**
Labrador Iron Ore Royalty	**Amazon.com**
Tyman	**Fidelity National Information Services**

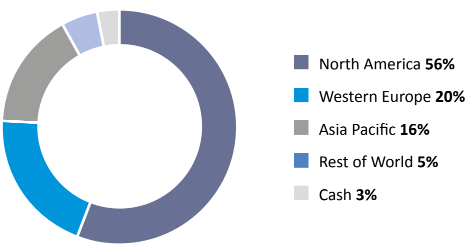
* *Contributors and detractors over the quarter in alphabetical order.*

Top 10 Holdings (in alphabetical order)	Sector
Alibaba	Internet
Alphabet	Internet
Amazon	Consumer Discretionary/Internet
Eagle Materials	Materials
Facebook	Internet
Graphic Packaging International	Industrials
Intercontinental Exchange	Exchanges
Mastercard	Payments
Microsoft	Software
Visa	Payments

Fund and Benchmark Performance Since Inception

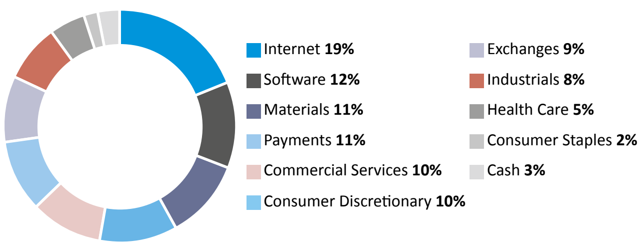


Revenue Exposure By Region*



* *Revenue exposure by region is internally estimated on a look-through basis based on the underlying revenues of the individual companies held in the portfolio.*

Sector Exposure**



** *Industry classification is defined by L1 Capital International to best describe the nature of the underlying businesses.*

2020 Reflections

In the elevator of the building that houses L1 Capital International there is a video artwork by TV Moore entitled "The way things grow". The artwork captures a sequence of events that once set in motion starts a chain reaction. The video shows numerous mechanisms that activate a sequence of moving things, triggering a process of cause and effect, highlighting the construct that despite our best predictions only time will tell us the outcome.

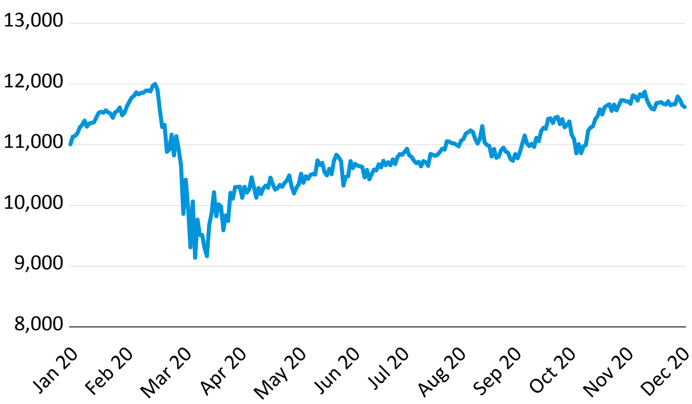
At L1 Capital International we pride ourselves on **transparency** and believe it is important that we clearly outline our investment philosophy and process and provide insights to our investment decisions and portfolio construction.

On 1 January 2020, no-one could have predicted the geopolitical, health, economic and share market events of the year 2020. What was even more unpredictable was the combination of the actual outcomes for these events and their impact on the market.

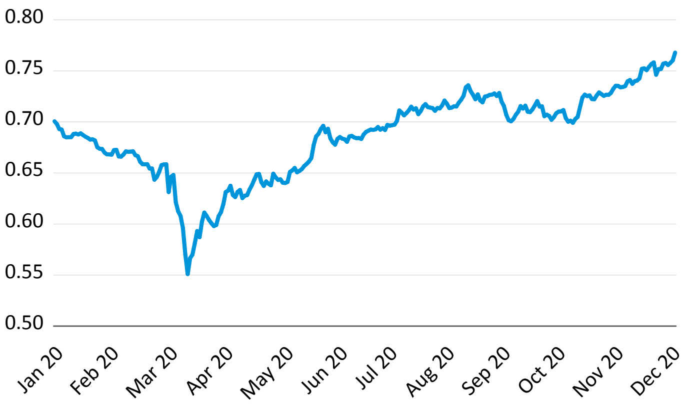
For the year, the Index increased by 5.6% while the Australian dollar appreciated by 9.8% compared to the U.S. dollar. The L1 Capital International Fund returned 3.8% (net of fees) for 2020. The Fund is currency unhedged.

The MSCI World Net Total Return Index in AUD (the Fund's Benchmark) fell by 17% from 1 January 2020 to mid-March. During this period, the fall in the Index was mitigated by a 13% depreciation of the Australian dollar. Subsequently, the Index rallied 27% by year end, this time with Australian dollar Index returns constrained by the appreciation of the Australian dollar which increased by 26% against the U.S. dollar over the same period.

MSCI World Net Total Return Index (in AUD)



AUD: USD Exchange Rate



Source: Bloomberg

Looking back over 2020, while some of the causes and effects of the year can be sensibly rationalised, we are cognizant to avoid both **hindsight bias** (convincing ourselves certain outcomes should have been predicted accurately) and **outcome bias** (making decisions based on a particular outcome, rather than analysing the factors that led to that outcome).

After a challenging and volatile year, we believe the L1 Capital International portfolio is currently the highest quality and the best structured that is has been since inception of the Fund. We are almost fully invested, with a cash balance of 2.6% at 2020 year end.

We have briefly outlined some of our key investment decisions in 2020 and their impact on our portfolio's performance and more importantly why we made those decisions. Some of our analytical assessments and predictions are so far proving correct. Others were too conservative. **One year is also an inappropriately short time horizon to assess the validity or otherwise of an investment.**

2020 Portfolio Decisions and Outcomes

Contributions to the positive performance of the Fund during 2020 were highly diversified with **Activision Blizzard, Airbnb, Alphabet, Facebook, Intercontinental Exchange, Intuit, Labrador Iron Ore Royalty Corp, Microsoft, Nike, Tencent and Thermo Fisher Scientific** all contributing at least 0.5% to the Fund's Australian dollar returns, while only **Booking Holdings, Discover Financial Services and U.S. dollar cash** negatively impacted the Fund's Australian dollar returns by greater than 0.5%.

Most of us have spent far too much time becoming armchair experts on the U.S. President election system or watching the U.K.-EU Brexit negotiations like a slow-moving car accident. Yet despite what was no doubt a more eventful year than most, from an investment perspective COVID-19 and associated Government, regulator and population responses dominated financial markets.

It is incredible how right and wrong our initial assessments were in our March 2020 Report. We commented that COVID-19 was first and foremost a health issue with economic implications, and that the U.S. health policy response to COVID-19 was lagging behind what was necessary to manage the disease. We also stated that the crisis will not last forever and that markets will prioritise the recovery well before infection rates reduce to low levels or a vaccine becomes available.

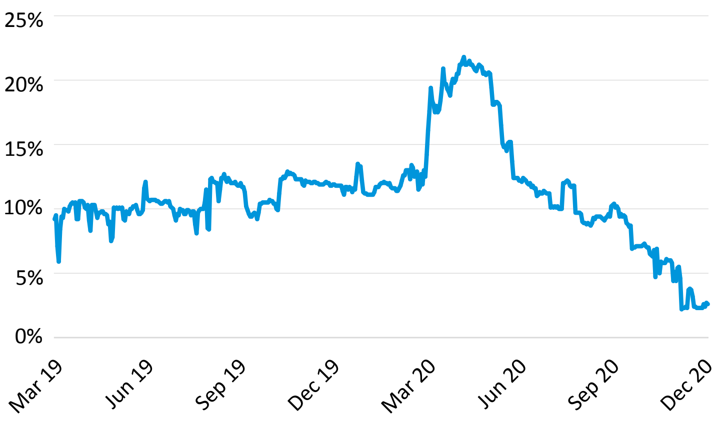
We knew COVID-19 would require a trade-off between wealth and health. We did not envisage such a lop-sided outcome where the health of so many would be sacrificed to sustain the wealth of others. From a health perspective, despite being the world's leading economic power and spending more on health care as a percentage of GDP than any other country, the U.S. has been devastated by COVID-19. Officially over 22 million Americans have been infected, over 360,000 Americans have died, and infection levels and daily death rates are at or near peak levels. Yet from an economic perspective, most industries have achieved a V shaped recovery and most consumers, particularly outside of the lowest socio-economic groups, are in a relatively strong financial position. Economically this has been achieved through exceptionally accommodative monetary policy and unprecedented levels of fiscal support. Investors are also focusing on the highly successful vaccine results which has seen several vaccines approved and widespread vaccination rollouts commence globally.

Capital preservation is a key tenet of our investment philosophy. It is easy to forget how uncertain the world looked in March and April last year, with temporary morgues being built in Central Park, New York and limited progress on the prevention or treatment of COVID-19.

Our investment decisions during this period, while arguably conservative, were consistent with our **objectives to both preserve capital as well as deliver attractive risk adjusted returns to Fund investors**. Some of the decisions around capital preservation proved to be too conservative given the way the economy (and financial markets) subsequently developed. This included **holding elevated cash levels, which was by far the largest negative contributor to the performance of Fund relative to the Benchmark**.

We made limited changes when the market was bottoming in March, but we did sell or reduce some investments in the April and May period when the market initially bounced strongly, with the Fund's cash holdings peaking at around 22%.

L1 Capital International Fund Cash Holding



Source: L1 Capital International

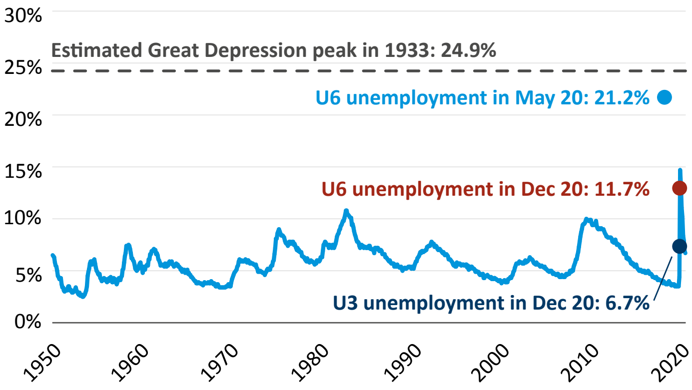
These decisions proved costly to the Fund's returns, with the cash not only missing out on the continued rebound in the share market, but also as the cash was held in U.S. dollars, Australian dollar returns were reduced by the appreciation of the Australian dollar against the U.S. dollar.

Our decision to divest **Discover Financial** and realise a permanent capital loss, particularly at the price we sold, was an investment mistake. Discover Financial is a well-run provider of unsecured credit (predominately credit cards) to middle America. We invested in this business with the expectation that employment, the key driver of consumer financial strength, would remain strong and therefore consumer credit defaults would remain low.

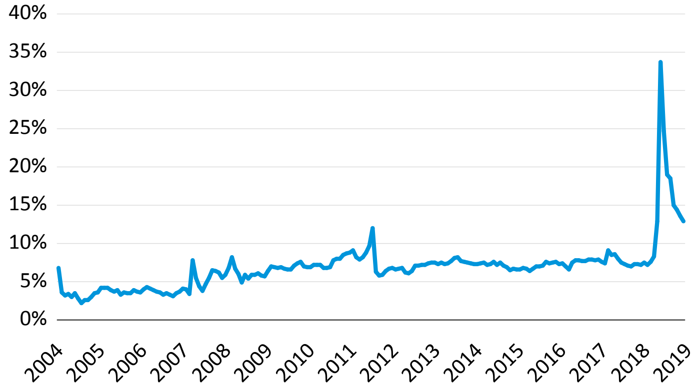
The investment thesis was unexpectedly derailed by COVID-19. At the time of the decision to divest Discover Financial COVID-19 was just beginning to take hold in the United States, businesses were rapidly shutting down and a spike in unemployment was inevitable. Unemployment levels spiked to levels even higher than we feared. However, because the economy was prioritised over social health, stringent business shutdowns proved fleeting, if they occurred at all. Together with policies to support businesses maintain their employees, unemployment rapidly reduced, albeit well above unemployment levels pre-COVID-19.

Discover Financial's performance was further supported by an increase in U.S. household savings rates. Not only have people spent their money differently during COVID-19, but they have also saved more and repaid debt, particularly people with higher wealth.

U.S. Unemployment



U.S. Household Savings Rate



Source: Bureau of Economic Analysis, Bureau of Labor Statistics and Bloomberg

Discover Financial's credit default levels are now lower than they were before COVID-19, more than offsetting any financial pressure from reduced credit card borrowing levels. As a result, Discover Financial's share price has rebounded strongly to levels higher than pre COVID-19, reinforcing our confidence in our investment process and original decision to invest in this business.

In the second half of 2020 it became clearer that the world's economy was recovering, notwithstanding the continued spread of COVID-19 and that Central Banks and Governments around the world would continue to take unprecedented action to support their economies.

Investors prioritised greater exposure to businesses and industry sectors that had been more acutely impacted by COVID-19 or were more economically sensitive. We consider many businesses in some of these economically sensitive sectors such as financials, materials and fossil fuels to be secularly challenged. While share prices for these companies have increased significantly from arguably oversold levels earlier in the year, these businesses lack the quality attributes that underpin our investment philosophy.

During this period, we invested the Fund's cash holdings in high quality businesses positioned to perform strongly, even if there are future economic pressures.

Microsoft and Amazon are two of the highest quality businesses in the world and are trading at attractive valuations. They are also two of the largest holdings in the Fund and while they have underperformed the Index during the latter half of 2020, we are unconcerned and believe it reflects flows of capital and the **focus of many market participants on the short term**. We expect to achieve strong risk adjusted returns from holding investments in these businesses for many years to come.

Alibaba is a top 10 investment for the Fund. In mid-October the share price of Alibaba reached record highs due to optimism over the upcoming IPO of Ant Financial, 33% owned by Alibaba, and the continued strength in the Chinese domestic economy. Subsequently, Alibaba's share price fell by nearly 30% due to the Ant Financial IPO being postponed and the Chinese Regulators announcing new regulations and potential intervention in Ant Financial and Alibaba's business. The lack of public appearances by Jack Ma over the past two months has not helped sentiment either.

Alibaba remains a compelling investment in our view, with a leading position in eCommerce and cloud computing in China, as well as many other growth initiatives in China and elsewhere in Asia. Often periods of uncertainty are the best times to invest in high quality businesses with enduring competitive advantages. Regulation was the clear risk in investing in Alibaba. We believe the current issues are more acute for Ant Financial than Alibaba, although both companies will need to pay increased "national service" to maintain Government support. We have previously seen periods where Chinese companies and their management are in the spotlight of the Government and regulators, and temporarily need to take a step back and make certain business adjustments.

Other key 2020 reflections that inform our positioning for the future include:

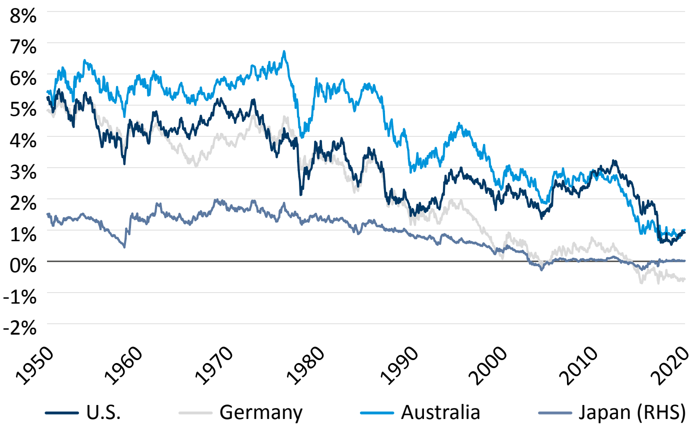
- Governments around the world have shifted away from austerity policies and in one form or another embraced "helicopter money" and other accommodative fiscal policies, e.g. direct hand-outs, non-repayable loans that support businesses to keep people employed and other tax concessions. The recent U.S. election outcomes are likely to see increased fiscal support and stimulus.
- Many of the financial risks caused by COVID-19 have been socialised, and without getting political, sensible Governments should be better placed to manage the economic ramifications of COVID-19 than individuals.
- The wealth divide continues to accelerate, and the middle consumer has been better protected from the fall-out of COVID-19 than we expected in the early stages of the crisis.
- Despite resolution of the U.S. elections, geopolitical tensions will remain.
- Regulation will continue to be a key issue for the world's large technology companies to manage. Recent U.S. political developments could see increased regulatory pressures and we expect these companies to face increased taxation in the U.S. and internationally. However, we believe these issues are more than reflected in the share price of many of these companies and remain very comfortable with our portfolio holdings in this sector.
- We see bubbles forming in some market sectors, where "fear of missing out", record margin loan debt and the allure of a good investment story is causing share prices of some companies to disconnect from fundamental valuation metrics.

Portfolio Positioning for 2021 and Beyond

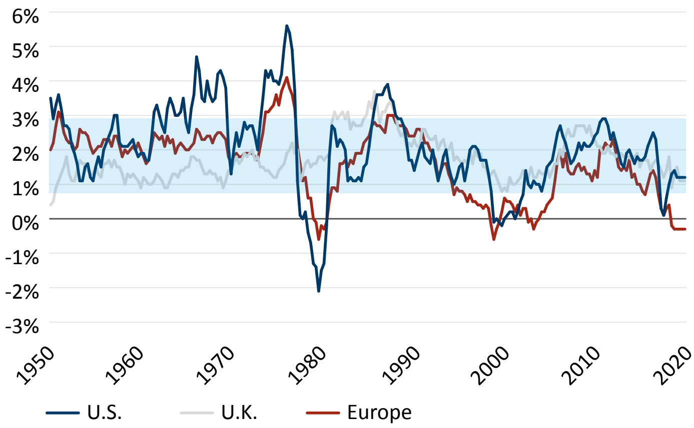
Reflections can be helpful, but our focus is using these reflections to help inform our positioning of the Fund.

At L1 Capital International we continue to focus on bottom-up company investing. However, our view remains that interest rates will be a key driver of valuations. The "Don't fight the Fed" mantra was clearly applicable in 2020, and we believe Central Banks around the world will continue very accommodative policies. There are pockets of inflation that are clear to see (steel, lumber and private school fees!) but most areas of inflation are small, cyclical and generally these areas of increased demand will be met with supply responses in time. Structurally, we see continued deflationary pressures such as technology, aging populations, automation and its impact on labour demand as well as consumer trends away from physical goods to digital goods and experiences continuing to keep inflation relatively low. There have recently been market headlines about the U.S. 10-year bond rate exceeding 1.0%, but this is still an exceptionally low level and only reflects a gradual normalisation from distorted levels caused by COVID-19.

Globally interest rates remain very low...



...and inflation remains benign



Source: Bloomberg

As we enter 2021, we continue to consistently implement our investment philosophy and process which we have outlined in detail in prior quarterly reports **www.L1international.com/reports/**.

We are not traders and portfolio turnover is low.

Our usual investment horizon is 3 to 5 years on a rolling basis, with our strong preference to remain invested in a business unless there is a change to the investment thesis, the share price exceeds our view of fair value, or there are more attractive investments.

Many of the companies currently in the Fund have been holdings since inception. However, close observers will notice there have been a couple of changes to the top 10 holdings compared to the prior quarter and there have also been portfolio adjustments outside of the top 10 holdings.

At a sector level, **Industrials and Materials (predominantly building materials) accounted for 19% of the Fund** at the end of 2020 compared to 5% at the start of the year. We believe some cyclical businesses will do well over the next few years, but we remain very selective, focusing on high quality, albeit cyclical, businesses which meet all our investment criteria.

Portfolio Investment – Eagle Materials

Eagle Materials (Eagle) operates through 2 divisions:

1. **Heavy Building Materials** (55% of Group operating profit) – regional cement business with small aggregates and concrete operations.
2. **Light Building Products** (45% of Group operating profit) – wallboard (called plasterboard in Australia) and paperboard used in the production of wallboard.

Eagle meets all our criteria for a high quality, albeit cyclical, business:

- Well-structured industry, particularly the regional markets in which Eagle Materials operates.
- Favourable business drivers, including essential public infrastructure spending which will likely benefit from recent U.S. political outcomes, growth in the new residential housing market and resilient repair and renovation activity.
- Experienced and aligned management, who act and are remunerated like business owners.
- Consistently strong financial metrics providing an attractive risk adjusted return in our base case scenario, with significant upside optionality.

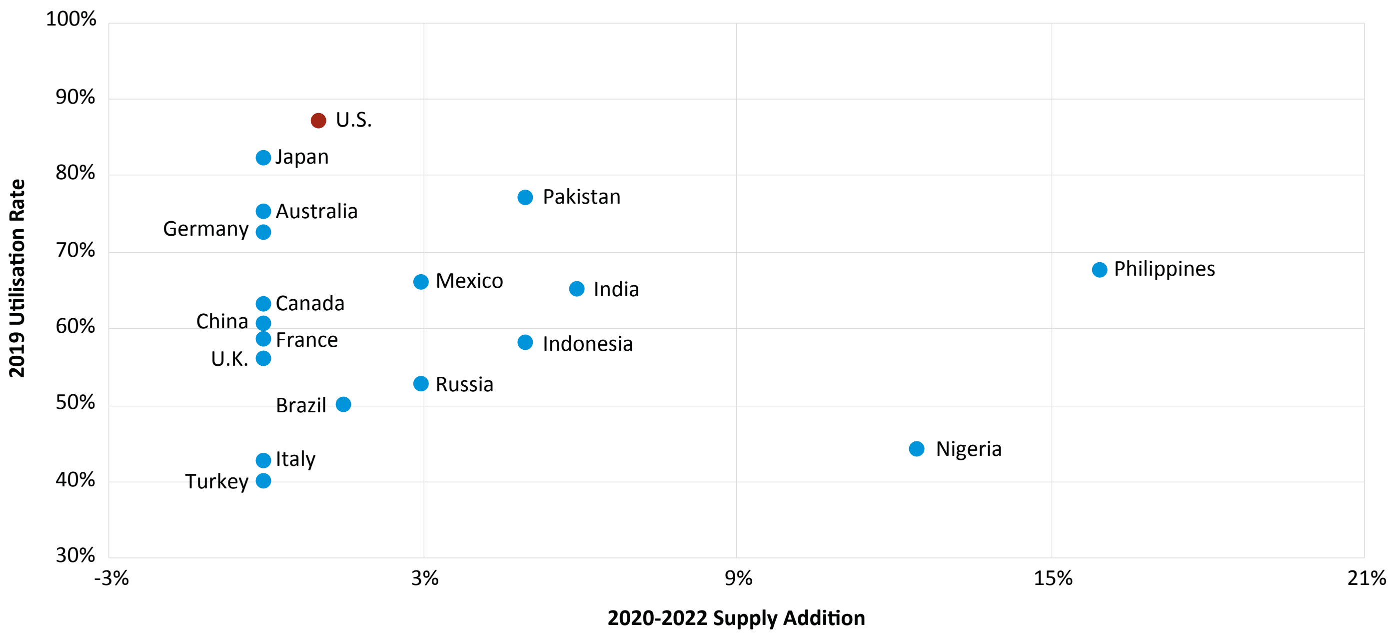
Industry Structure – Cement [1]

Cement is considered a commodity. We would normally not invest in a business that produces a commodity, as barriers to competition are usually limited and it is difficult to sustain high returns on capital.

However, we have been assessing the building materials industry for well over 20 years and **appreciate that not all building materials businesses are commoditised**. Regional and other factors impact industry structure, creating significant barriers to competition and the ability to sustainably achieve strong financial returns.

At a country level, the **U.S. cement industry already stands out as being unique**, with world-leading utilisation levels and limited increases in supply.

Global Cement Industry



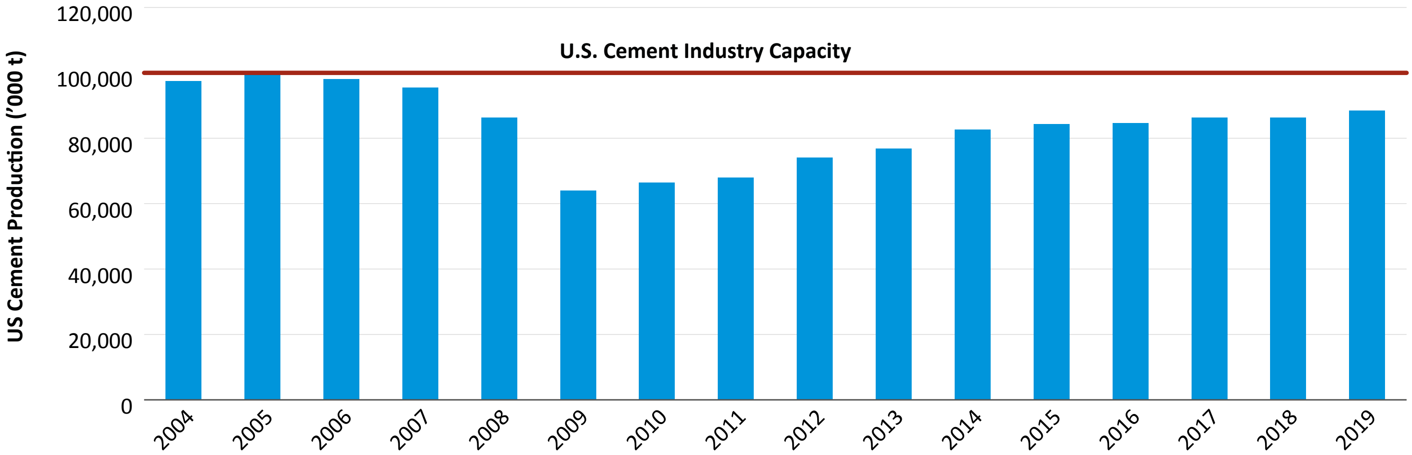
Source: J.P. Morgan

1 *Data from the U.S. Geological Survey.*

Total U.S. cement industry capacity is approximately 100 million tonnes. To put that in context, China's cement production capacity is around 2.2 billion tonnes, or over 20x the size of the U.S. market.

U.S. cement production peaked in 2005 during the last housing boom. There are no new cement plants being built in the U.S. due to stringent environmental restrictions and therefore cement capacity expansion is very limited. Unlike most commodities, increased demand for cement in the U.S. cannot bet met with increased domestic supply. At a national level, cement producers are already operating at near capacity with imports accounting for around 15% of U.S. consumption.

U.S. Cement Industry

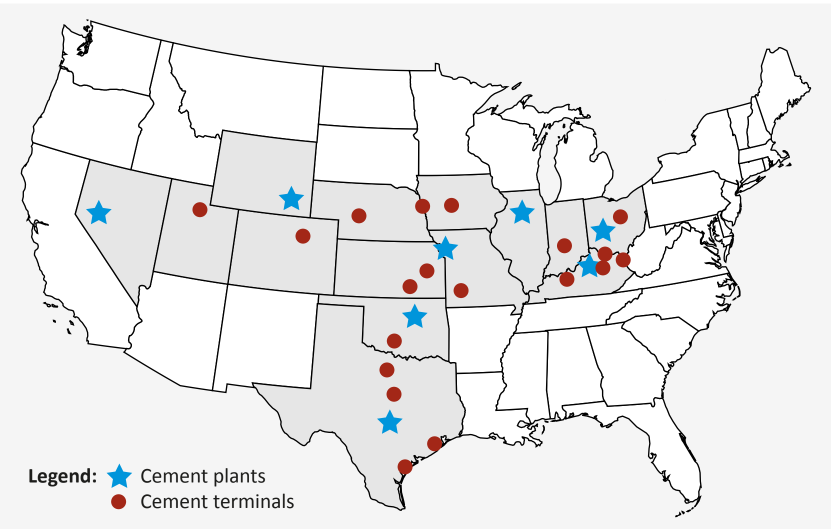


The industry structure and supply/demand structure for Eagle is even stronger than analysis at the national level would indicate.

Cement is heavy and of low value relative to its weight. Cement can be efficiently shipped long distances and the U.S. imports cement to coastal regions, but the cost of transporting cement long distances over land is expensive.

Based on national market share, Eagle is a second-tier cement producer. Eagle's total cement production capacity is around 8 million tons or 8% of total national capacity. However, Eagle has strategically built up a network of cement plants solely operating in the middle of the United States. **Competition is restricted** to limited local cement plants as the cost of transporting imports of cement from other regions of the U.S. is prohibitive.

Eagle Materials Cement Operations

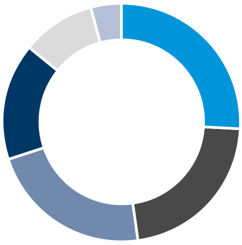


Source: Eagle Materials and L1 Capital International

Industry Structure – Wallboard [2]

The U.S. wallboard industry is reasonably consolidated, with a total of 6 producers and the top 4 companies accounting for 85% market share.

U.S. Wallboard Industry Market Share



Source: Citi and L1 Capital International

The U.S. wallboard industry structure is less favourable than the U.S. cement industry as the industry is operating at lower occupancy levels (around 75%) and barriers to new construction are lower (Georgia Pacific recently announced construction of a new plant in Texas).

Recently, there have been several key developments that have materially improved the structure of the U.S. wallboard industry, and Eagle's strategic position in particular:

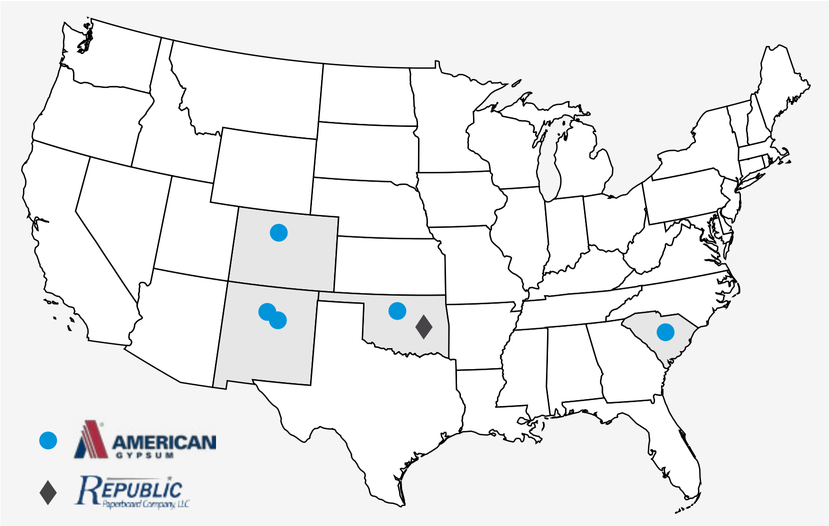
- Knauf entered the U.S. industry through the acquisition of USG and overnight became the industry leader. Knauf is the largest participant in the global wallboard industry and has a track record as a rational competitor, whereas USG had an industry reputation for lacking pricing discipline.
- Saint-Gobain consolidated its position in the industry by acquiring Continental Building Products, increasing its market share from around 10% to over 20%. Saint-Gobain is the number 2 global industry participant and has already demonstrated industry pricing leadership by seeking to increase U.S. wallboard prices in late 2020 and again in early 2021.
- Wallboard can be produced 2 ways – using natural gypsum (rock) and using synthetic gypsum (a bi-product of coal power plants). As coal plants shut down synthetic gypsum is becoming scarcer and less cost efficient. Eagle has strategic long-lived reserves of natural gypsum for most of its production, and a favourable contract for the supply of synthetic gypsum for one of its plants.

Eagle's operations are also in higher growth regions of the U.S.

Additionally, Eagle has a highly efficient paperboard plant which supplies paper used in the construction of wallboard to its own operations, as well as to Saint Gobain.

2 *Data from U.S. Gypsum Association*

Eagle Materials Wallboard and Paperboard Operations



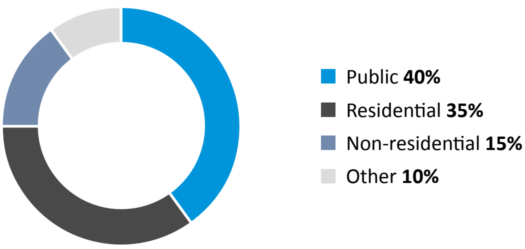
Source: Eagle Materials and L1 Capital International

Favourable Business Drivers

The building products industry is inherently cyclical, and therefore when investing in this sector the demand cycle is a key business driver.

Eagle is diversified across the different end market segments. Public infrastructure accounts for around 40% of cement demand, while residential applications (both new build and repairs/renovations) accounts for approximately 35% of cement demand and 85% of wallboard demand, or around 60% of Eagle's total segment exposure. Non-residential accounts for around 15% of demand for each of cement and wallboard.

Cement Demand



Wallboard Demand

Source: L1 Capital International estimates

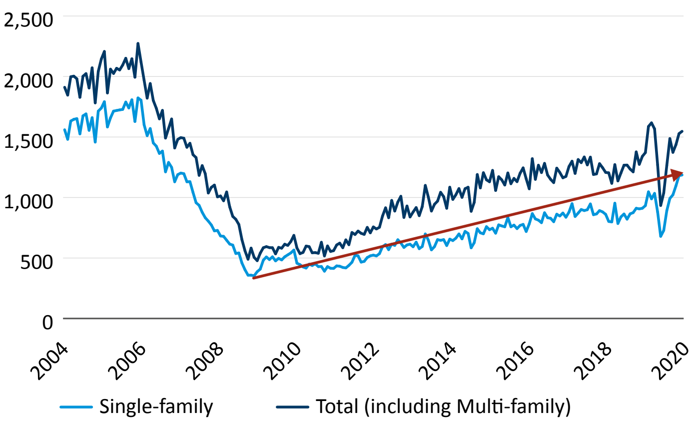
We expect steady demand from the Public infrastructure sector. There is bipartisan support in the U.S. for building and repairing public infrastructure such as roads and bridges, as well as the associated job creation. At a minimum, we expect the current level of spending to be maintained when the next major Federal Highway spending legislation is enacted and see the possibility for a meaningful step-up in spending at both the Federal and State levels.

We remain extremely positive on the outlook for the U.S. Residential Housing sector, both new construction and renovation and repair activity. New residential construction is benefiting from low interest rates supporting affordability and increased demand for single family housing. While the number of housing starts has more than doubled since the trough levels of 2009 to 2011, activity is still only around mid-cycle levels.

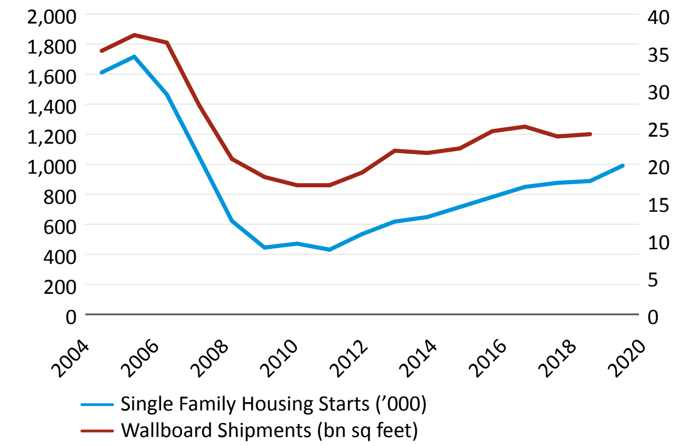
Demand for wallboard is highly correlated with single family housing starts. We expect strong growth in demand for Eagle's wallboard and paperboard as residential housing construction continues to increase.

In additional, people have been spending more time in their homes and have been undertaking increased levels of renovation projects which will also support growth in wallboard and paperboard demand.

U.S. Seasonally Adjusted Housing Starts ('000)



Housing starts and Wallboard Shipment Volumes



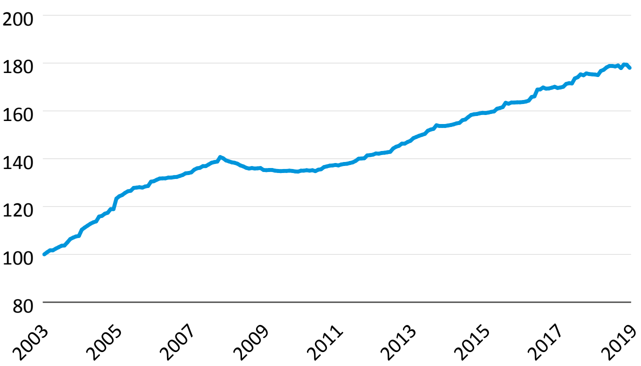
Source: U.S. Census, Gypsum Association

Favourable demand drivers for both cement and housing as well as well-structured industries should **support improved pricing**.

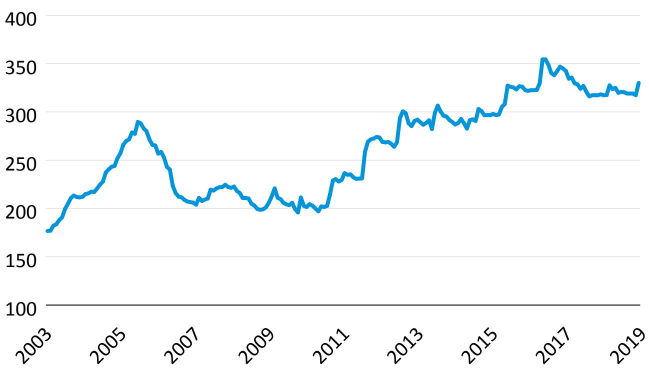
U.S. cement prices have consistently increased over time and we expect this trend to continue, particularly in the regions in which Eagle operates.

While just a blip on the chart below, reported average wallboard prices increased 4% in November 2020 and we believe this is the start of a sustained period of increasing prices as the industry demonstrates greater pricing discipline against a backdrop of strong demand.

Cement and Concrete Products Price Index



Wallboard Price Index



Source: U.S. Federal Reserve, U.S. Bureau of Labor Statistics, L1 Capital International

Aligned Management

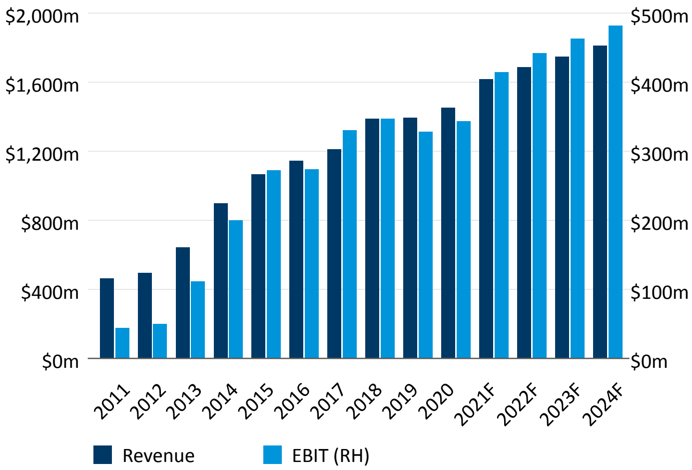
Eagle has a highly experienced management team who have demonstrated industry leading operating skills. Capital has been well-allocated through a mix of strategic, value accretive acquisitions, internal investment and return of capital to shareholders, excluding a failed attempt to diversify into the provision of sand for oil and gas drilling. This non-core business has recently been fully exited.

Annual incentive compensation is structured such that the senior management share 1.2% of the operating profit of Eagle, while long term incentive compensation is linked to return on equity generated by the business. These compensation structures align management with shareholders and reinforce our view that the **Eagle management team thinks and acts like owners of the business**.

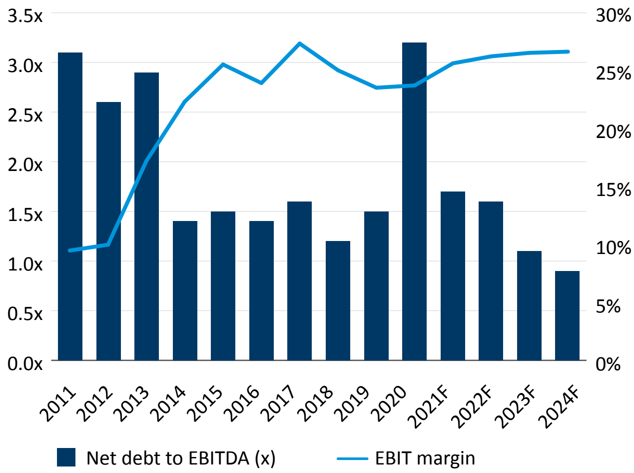
Attractive Financial Metrics and Valuation

A combination of a well-structured industry, advantaged market positions, favourable business drivers and experienced, aligned management position Eagle to materially increase earnings and cashflow over the coming years:

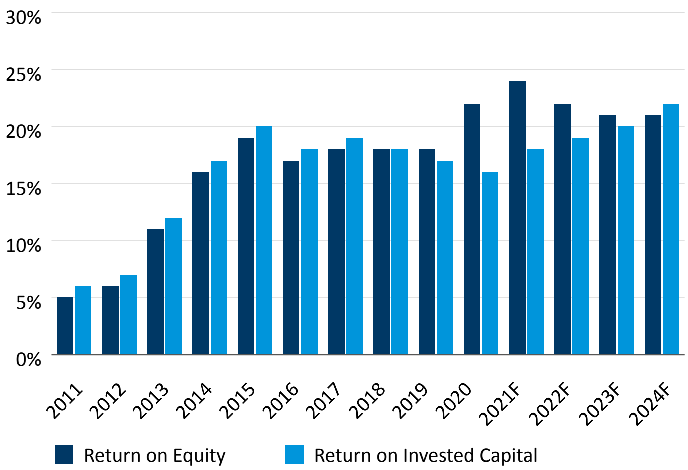
Significant revenue and EBIT growth



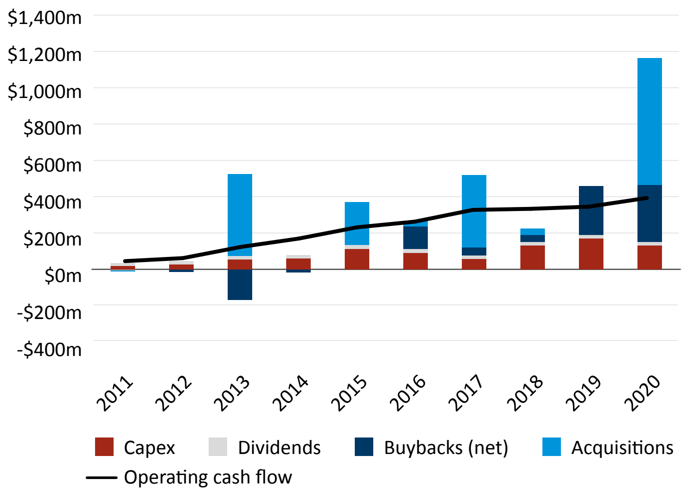
Margins increasing, debt reducing



Strong, improving return on equity and capital



Strategic, value accretive acquisitions



Source: L1 Capital International

We assign a rating of 3 based on L1 Capital International's quality rating system, principally due to the inherent cyclicality of Eagle's businesses. Eagle's share price has already increased over 25% from our average investment price and is trading on a forward PE of around 16x and free cash flow yield of 8%. Following the recent increase in Eagle's share price, Eagle is now trading within our fair value range, but we still expect to achieve a double-digit return per annum in our conservative base case.

Upside Optionality – Potential Acquisition Target

Management has announced that they intend to separate the Heavy Building Materials division from the Light Building Products division. This is logical as there are limited synergies between the operations.

Previously each business lacked sufficient scale to be separately listed. However, the Heavy Building Products division has been expanded through acquisitions and the profitability of the Light Building Products division has increased substantially due to the improved residential housing construction market.

There will be incremental corporate costs in managing two separate listed companies. However, we expect that these costs will not last long as both companies will be very logical bolt-on acquisitions for their larger competitors. Competition issues should be manageable.

The separation has been delayed due to the uncertainties caused by COVID-19, but we expect the separation will be completed in 2021.

The investment base case is sufficiently attractive to make a significant investment in Eagle. We **consider the takeover potential has a high degree of probability of occurring** for one or both divisions and adds material **"free" upside optionality** for this investment.

L1 Capital International Fund

Quarterly Report | DECEMBER 2020

L1 Capital International Overview

L1 Capital International is an independent active manager of global equities established as a joint venture with L1 Capital. We apply a detailed investment process built on a fundamental assessment of quality and value. We aim to deliver attractive risk-adjusted returns by investing in high quality companies that have favourable cashflow-based valuations in well-structured industries that we understand. Capital preservation over the investment horizon is central to our investment philosophy and process. We view risk as the potential for a permanent loss of capital as opposed to volatility in share prices. Additional information on L1 Capital International is available at **www.L1international.com**.

L1 Capital is a global investment manager established in 2007 with offices in Melbourne, Sydney, Miami and London. L1 Capital manages money for a range of clients including large superannuation funds, endowment funds, pension funds, financial planning groups, asset consultants, family offices, high net worth individuals and retail investors. Additional information on L1 Capital is available at **www.L1.com.au**.

Fund Information

Name	L1 Capital International Fund
Portfolio Management	David Steinthal (Chief Investment Officer) David Khaw (Portfolio Manager)
Types of investments	Listed securities globally. Developed market focus. No shorting, no leverage
Number of investments	20 to 40
Cash weighting	0% to 25%
Minimum initial investment	$25,000
Hedging	Unhedged
Structure	Unit Trust
Domicile/Currency	Australia/AUD
Inception	1 March 2019
Management Fee	1.2% p.a inclusive of GST and RITC
Expenses	Nil (included in Management Fee)
Benchmark	MSCI World Net Total Return Index in AUD
Performance Fee	15% over Benchmark, subject to any underperformance being recouped. There must be positive absolute performance (adjusted for distributions) in the performance period*
High Watermark	Yes
APIR	ETL1954AU

* *Otherwise positive relative performance is carried forward to the next Performance Period.*

Service Providers

Responsible Entity	Equity Trustees
Fund Administrator	Mainstream Fund Services
Fund Auditor	EY
Fund Custodian	Mainstream Fund Services
Legal Advisor	Hall & Wilcox

L1 CAPITAL INTERNATIONAL

Level 13, 139 Macquarie Street
Sydney NSW 2000 Australia

Phone +61 2 8067 7090
Email info@L1international.com

www.L1international.com