L1 Capital International Fund

Quarterly Report | MARCH 2021

L1 CAPITAL INTERNATIONAL

Introduction

In this quarterly report we have outlined:

- **March 2021 Quarterly Review.**
- **Why we consider the typical “Growth vs. Value” debate to be misguided.**
- **L1 Capital International’s approach to unify Growth and Value into a distinct, balanced “Quality” philosophy.**
- **Positioning of the L1 Capital International Fund, a unique portfolio of high-quality businesses.**
- **An overview of TSMC, the global leader in semiconductor manufacturing. TSMC is a business which meets all our stringent quality requirements while also trading at an attractive valuation.**

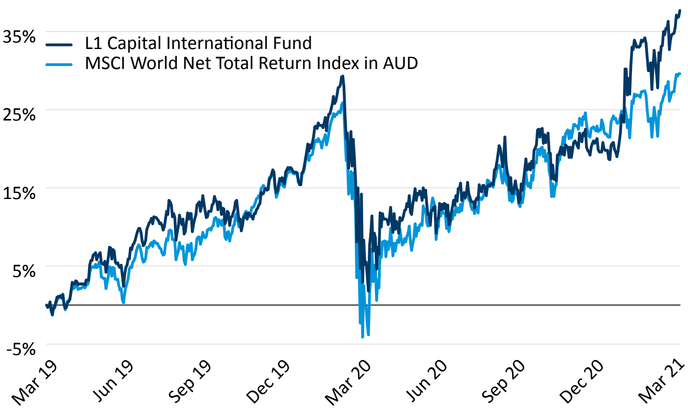
Fund Performance (after fees)

Performance*	Fund (%)	Index** (%)	Excess (%)
1 Month	5.4	5.0	+0.4
3 Month	15.0	6.3	+8.7
1 Year	26.9	23.8	+3.2
2 Years p.a.	16.9	13.5	+3.4
Since Inception p.a.	16.7	13.3	+3.4
Since Inception – 1 March 2019	37.8	29.6	+8.2

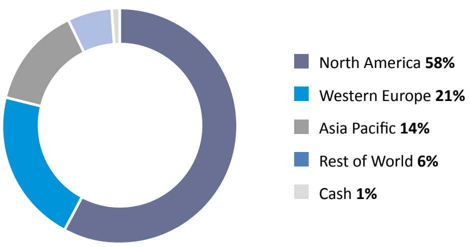
* *Rounded to one decimal place. Numbers may not add due to rounding. Past performance should not be taken as an indicator of future performance.*

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

Fund and Benchmark Performance Since Inception



Revenue Exposure By Region*

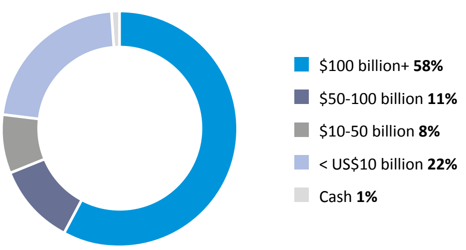


* *Revenue by region is internally estimated on a look through basis based on the underlying revenues of the individual companies held in the portfolio.*

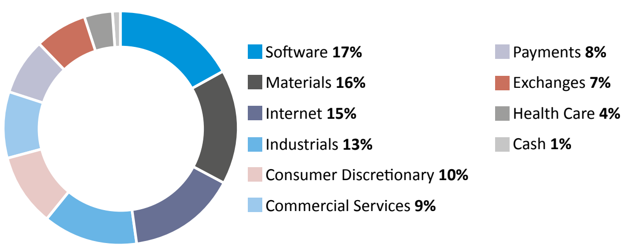
Top 10 Holdings (in alphabetical order)

Top 10 Holdings (in alphabetical order)	Sector
Alphabet	Internet
Amazon	Consumer Discretionary/Internet
Eagle Materials	Materials
Graphic Packaging International	Industrials
Insight Enterprises	Commercial Services
Louisiana Pacific	Materials
Marsh & McLennan	Commercial Services
Mastercard	Payments
Microsoft	Software
TSMC	Industrials

Market Capitalisation Exposure



Sector Exposure**



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

March 2021 Quarterly Review

The L1 Capital International Fund performed well during the March 2021 quarter, returning 15.0% (net of fees) and outperforming the benchmark by 8.7%. Contributors to the gains were broad based, with the decision to selectively increase exposure to more cyclical sectors such as U.S. housing delivering strong returns. **Eagle Materials**, a high quality but below the radar building products company, was featured in the December 2020 quarterly report. Pleasingly, the market began to recognise the quality of this business and its strong cashflow and earnings outlook. Its share price increased by 33% during the March 2021 quarter. Recently, we further increased our exposure to U.S. housing through a new top 10 investment in **Louisiana-Pacific Corporation**. Louisiana-Pacific is a business in transition – rapidly evolving from a commodity-oriented forest products company to a specialty building solutions company. We expect a significant improvement in the quality of earnings over the coming years and near term we believe the market is significantly under-appreciating profitability during highly favourable operating conditions.

Long term followers of the Fund will be aware that we have held investments in some of the leading global technology businesses since inception of the fund. **Alphabet's** (Google) share price increased by 18% during the quarter as advertising continued to recover.

Our flexibility to invest in companies ranging in size means we are not restricted to mega-capitalisation companies. At the end of the March 2021 quarter, companies with a market capitalisation over US$100 billion accounted for 58% of the Fund, while companies with a market capitalisation under US$10 billion accounted for 22% of the Fund. We believe having capacity to invest selectively in smaller companies which meet our stringent quality requirements is advantageous in delivering strong risk-adjusted investment returns over time.

We have leveraged our knowledge of leading software companies to invest in two smaller value-added software resellers, **Insight Enterprises** and **Bytes Technology**. While **Microsoft's** share price drifted up during the quarter (increasing by 6%), the share price of Insight Enterprises and Bytes Technology increased by 25% and 19%, respectively (local currency). These companies facilitate the continued rise of enterprise cloud software spend and are also able to add value through personalised service to companies and Government entities that are below the size targeted by the global technology companies' own salesforces.

The share price of many of our consistent but not flamboyantly growing companies such as **Iqvia** (leading provider of contract research, analytics and technology services to the life sciences industry) and **Graphic Packaging** (largest provider of integrated paperboard packaging to the food and beverages industry in the U.S.) also increased ahead of the market, contributing to the Fund's outperformance.

Negative contributors to the Fund's returns were few and far between, with only **Amazon** (-0.4%) detracting more than 0.2% in Australian dollar terms for the quarter.

"Growth vs. Value" – Why L1 Capital International Considers this Debate to be Misguided

Hardly a day goes by without an article or piece of research comparing **"Growth"** and **"Value"** and predicting which "style" is going to be in favour. The concepts of Growth and Value are so embedded in investment management parlance that to question these concepts seems sacrilegious. However, at L1 Capital International, we consider these near ubiquitous descriptions of investment styles to be fundamentally flawed and unproductive.

Simplistically, a **"Growth Investor"** is used to designate a manager who invests in companies that are growing faster than the overall market, while a **"Value Investor"** is meant to focus on companies priced below their intrinsic worth.

Illustrating that this is not a new debate, Warren Buffett colourfully commented in his **1992** Annual Letter, "… most analysts feel they must choose between two approaches customarily thought to be in opposition: "Value" and "Growth." Indeed, many investment professionals see any mixing of the two terms as a form of intellectual cross-dressing…the two approaches are joined at the hip: Growth is always a component in the calculation of value, constituting a variable whose importance can range from negligible to enormous..."

Growth is just one factor to consider when assessing a business. Investing at attractive risk-adjusted valuations is fundamentally important to all our decisions.

Let's apply the concepts of Growth and Value to cars. Some cars are faster than others. There is no doubt that a Ferrari SF90 Spider is faster than a Toyota Corolla.

If speed were the only factor in deciding which car to buy, there would be a lot more Ferraris on the road and far fewer Toyota Corollas. You don't just buy a car because it goes from 0 to 100km/h really fast. There are numerous other considerations such as brand, aesthetics, safety, comfort, insurance and maintenance costs, as well as the residual value. And then there is the small matter of the price. A Ferrari Spider will set you a back around US$550,000, whereas a shiny new Toyota Corolla can be secured for under US$25,000.

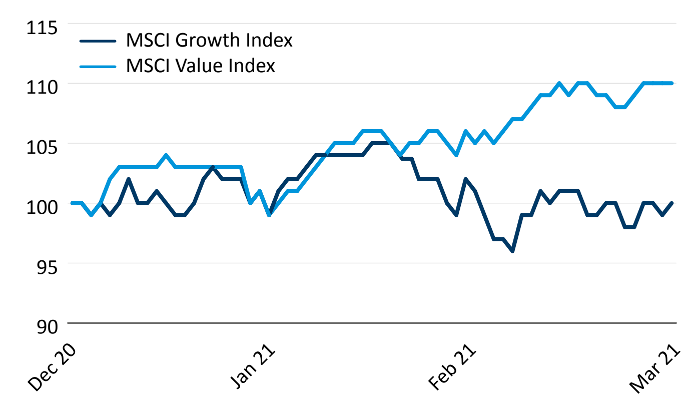
Ignoring the cost of the car and focusing just on its speed is silly. Yet, when it comes to investing, many people toss aside common sense in favour of rigid, pre-established style buckets, including investing in high growth (speed) at all cost.

It is not surprising that the investment world communicates with the simplified, albeit grossly limited concepts of Growth and Value. The world is complicated and there is a flood of information to prioritise and decipher. **People employ many heuristics or mental short-cuts** to solve problems and make judgements quickly and efficiently. It is simple and quick to characterise a business or an investment manager as Growth or Value and to use this designation to explain performance or to make a decision. However, heuristics can also lead to **cognitive biases** which can be very **detrimental to long term investment returns**.

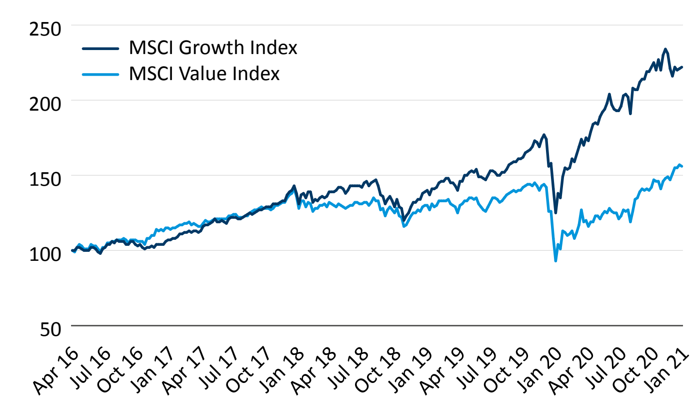
There are a myriad of Investment Indices and Exchange Traded Funds (ETFs) that are positioned as Growth and Value. The charts below show the performance (in USD) of the MSCI World Growth Index (Total Return) compared to the MSCI World Value Index (Total Return) over the past 3 months and 5 years.

Over the past 3 months the Value Index has significantly outperformed the Growth Index, while over the past 5 years the Growth Index has significantly outperformed the Value Index. However, this outperformance of the Growth Index has predominantly been over 2019 and 2020. Between 2016 and 2018 the performance of the Growth Index and the Value Index were similar.

Growth Index vs. Value Index – past 3 months



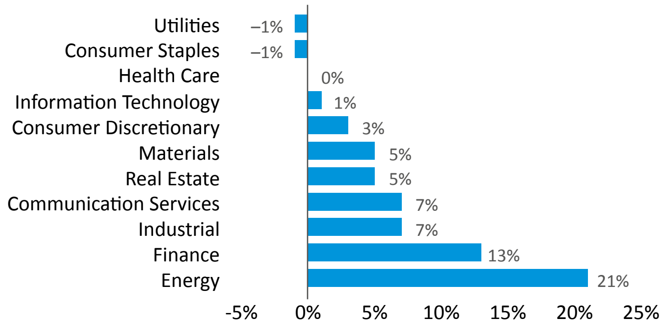
Growth Index vs. Value Index – past 5 years



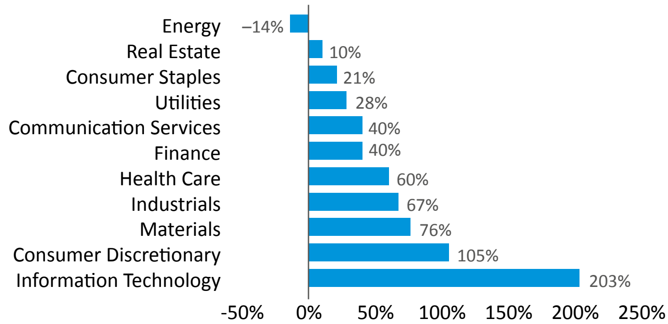
Source: Bloomberg, L1 Capital International

At a sector level, Energy has performed strongly over the past 3 months, while it is the only sector to deliver negative returns over the past 5 years. In contrast, Information Technology has contributed almost nothing over the past 3 months, while significantly outperforming over the past 5 years.

Sector contribution to MSCI World Index (USD) – past 3 months



Sector contribution to MSCI World Index (USD) – past 5 years



Source: Bloomberg, L1 Capital International

Characterising the Energy sector as Value to explain its recent outperformance is over-simplistic, if not misleading. Energy companies have outperformed recently because the oil price has recovered from depressed levels as demand has begun to recover and OPEC has demonstrated supply discipline.

The Impact of Interest Rates on the Performance of Growth and Value

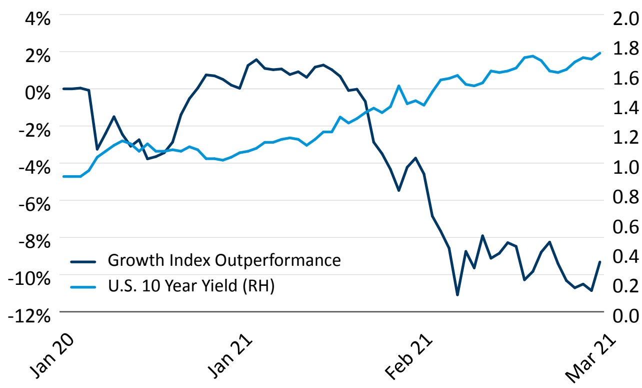
We are often asked, "What is your view of interest rates and how will an increase in interest rates impact your investment performance?"

An increase in U.S. longer term interest rates has been cited as a key driver for the recent underperformance of Growth compared to Value. To paraphrase Sigmund Freud, **there is a grain of truth in every financial markets' heuristic**. An increase in interest rates does have a greater impact on the valuation of companies which are higher growth and trading on higher multiples of current earnings and cashflow or the promise of future profitability, compared to lower growth companies trading on lower multiples of current earnings and cashflow.

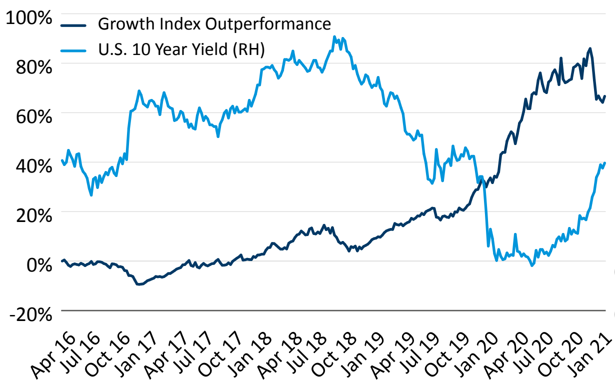
This is because the value of a dollar today is worth comparatively more than a dollar in the future when the "cost of waiting" or discount rate is higher due to increased interest rates.

As can be seen in the graphs below, the recent increase in the U.S. 10-year yield has corresponded with the underperformance of Growth vs. Value.

Outperformance of Growth vs. Value compared to the U.S. 10 Year Bond Yield – past 3 months



Outperformance of Growth vs. Value compared to the U.S. 10 Year Bond Yield – past 5 years



Source: Bloomberg, L1 Capital International

While it is logical that rising interest rates has a greater impact on the valuation of companies trading on higher multiples of near term earnings and cashflow than lower rated companies, it does not follow that the valuation of all companies should be mechanically impacted to the same extent.

We believe valuations of many **"story growth companies"** or companies trading on high multiples of revenue and which today generate little or negative earnings and cashflow have been, and still are, **overvalued**. This is because the share prices were pushed up well beyond fair value due to **lack of valuation discipline**. The share price of **"meme companies"** such as **GameStop** have no correlation with reality – valuation is not a consideration.

The cause of increased interest rates also needs to be considered. The impact on a business and valuations from higher interest rates in a stagflation economic environment is not the same as interest rates increasing as economic growth rebounds strongly.

Not all businesses are impacted equally by rising interest rates. **Financial** companies such as banks generally benefit from a steepening yield curve which is one of the key reasons why this sector has outperformed recently (as well as the expectation of improved economic conditions), although the impact on lending growth and credit quality also needs to be considered.

Companies like **Visa** and **Mastercard** effectively "clip the ticket" of personal consumption expenditure and therefore rising prices generally have a positive impact on their revenue.

We focus on investing in companies which have **pricing power** to offset cost inflation. Companies without pricing power will face margin pressure in a rising interest rate, inflationary environment.

Utility companies generally have significant debt and relatively constrained growth potential, and therefore **rising interest rates has a magnified negative impact on their equity value**. **Consumer Staples** businesses have also traded at high multiples of earnings and cashflow due to their perceived stability, even though their growth has been limited. The **Utilities** and **Consumer Staples** sectors have **underperformed** over recent months during a period of increasing 10-year bond yields, yet they **can hardly be characterised as "Growth"**.

The amount and speed of any rate increases also need to be considered. We expect interest rates to continue to drift higher, but we believe fears of widespread rapid inflation and spiking interest rates are unfounded.

In our view, to conclude any rise in interest rates is good for "Value" and bad for "Growth" is both simplistic and wrong. Deeper thinking is required to adjust an investment portfolio for changing macroeconomic and operating conditions.

L1 Capital International's Approach to Growth and Value

"Factor Investing" or attempting to invest based on chosen common attributes of equities or other asset classes is becoming increasingly popular. Growth and Value are often cited as style "Factors". By now you will appreciate that we consider these generic stylistic definitions to be simplistic and unhelpful to delivering strong risk-adjusted returns over time.

It is now possible to invest in an ETF which is based on large capitalisation U.S. companies *"which exhibit the highest degree of positive investor sentiment and bullish perception based on content aggregated from online sources including social media, news articles, blog posts and other alternative datasets"* – the **BUZZ ETF**.

We are immediately reminded of two quotes – *"When the ducks quack, feed them"* and Benjamin Graham's investment bedrock *"In the short run, the market is a voting machine but in the long run, it is a weighing machine."*

Returning to our car analogy, speed or growth is one factor we consider when deciding which cars will be in our garage or portfolio of businesses.

Some of our cars are quite speedy, with **elevated levels of growth**. Others will never set speed records, but their **growth is dependable and predictable**.

We don't invest in broken down cars that can be parted out for potentially more than their cost. In other words, we do not invest in secularly challenged industries and businesses. We only invest in businesses with **fundamentally positive industry drivers, but that does not necessarily mean high growth**.

It is also important to consider the **sustainability of growth**. Our investment horizon is usually 3 to 5 years on a rolling basis, sometimes longer. A car that can accelerate from 0 to 100 km/h in two seconds isn't very valuable if it blows its engine. **Duration of growth** is highly relevant when considering **valuation**. We believe our **longer duration investment horizon** is an advantage over investors chasing short term returns, although it does mean some of our businesses may underperform the market over the short term. In our view, **chasing short term returns is not a sustainable way to compound attractive risk-adjusted returns**.

Valuation is critical to any investment. A high-quality business with sustainably high growth in earnings and cashflow should be valued at above average multiples of near term earnings and cashflow, but **even the highest quality robustly growing business can be overvalued**.

"Value Investing" or seeking to invest in a company below its intrinsic worth is central to every company we assess, whether it operates in a fast-growing industry, or whether it is a more mundane GDP-plus growth business.

At L1 Capital International we spend considerable effort determining the fair value of the companies in our Portfolio or Bench of potential investments. Even then it is not a precise science and is subjective. When we think of fair value we think in ranges. For example, we can assess a business to be valued at $90 to $110 a share, but we do not conclude the company's shares are fairly valued at $100, cheap at $99 and expensive at $101.

Generally, we will make a position size larger as the company's share price trades at an increasing discount to our assessment of fair value. However, **risk must also be considered**, and therefore higher risk, higher potential return businesses (Quality Ranking of 3 in the L1 Capital International rating system) will generally be smaller positions in our Portfolio.

Positioning of the L1 Capital International Fund

L1 Capital International defines its investment process and universe as only investing in **Quality** businesses. While Quality is often cited as a factor or style of investing, the **L1 Capital International definition of Quality is unique, and much broader than stereotypical Quality Factor investing. We have a subjective, yet repeatable, detailed and differentiated investment process to identify high quality businesses, assess risk, and determine value**.

Our definition of Quality encompasses industries and businesses that are traditionally classified as Growth, and companies that are traditionally classified as Value. The commonality between all companies we invest in is that they meet our definition of Quality, satisfying four key criteria:

- Favourable key business drivers.
- Well-structured, growing industries.
- Aligned management with a strong capital allocation track record.
- Financial strength and advantaged business economics, including high returns on invested capital.

We have structured the L1 Capital International Fund to perform in "all seasons" or a range of market conditions. The Fund has delivered strong returns when Growth companies have been favoured by market flows and sentiment, and more recently when Value companies have been more favoured.

Over the past 8 months we have **deliberately increased our investment** in businesses which benefit from a **strong U.S. residential housing market**, as well as **U.S. infrastructure spending**. We are not "chasing Value", but rather increasing our exposure to key drivers which we believe have a favourable outlook over the medium term. We expect single family new residential construction activity as well as renovation and repair spending to remain robust. There has been structural underbuilding of single-family housing in the U.S. for over 10 years and housing affordability remains high despite recent increases in home prices and a modest increase in mortgage rates. At least for now the migration from city to suburb continues in response to COVID-19. There is bipartisan support for investment in civil infrastructure.

We are very selective in which companies we invest in – just having exposure to U.S. housing and U.S. infrastructure is not enough. For example, we consider homebuilders to be a low-quality industry that does not satisfy our investment criteria. **CRH**, **Eagle Materials and Louisiana-Pacific** meet all our quality requirements, and we believe we have invested in these businesses at attractive valuations.

We are not contrarian for the sake of being contrarian, but capital flows are often driven by sentiment and herd mentality, creating opportunities to invest in high quality businesses below fair value. **We have taken advantage of negative market sentiment to increase our investment in some of the highest quality (and so it happens largest) businesses in the world, including Amazon, Microsoft and TSMC.**

The Fund currently has no investments in Infrastructure companies or Consumer Staples – not because they do or do not meet a generic definition of Quality, Growth or Value. Rather, because we believe the high quality businesses we have identified in these sectors do not offer a sufficient risk-adjusted return compared to the companies in our Portfolio. A low interest rate environment has supported the share price of these defensive, stable companies, lowering future return expectations. We also have no exposure to Energy, with oil in particular being a commodity with structural headwinds.

We invest in a wide range of companies by market capitalisation. **Limiting the investment universe based on size of a business is an artificial and unnecessary constraint on maximising risk-adjusted returns.**

We continue to focus on our objective of delivering attractive risk-adjusted returns by investing in a **unique portfolio of high-quality businesses** that we understand well at attractive valuations, while seeking to preserve capital over the investment horizon.

Portfolio Investment – Taiwan Semiconductor Manufacturing Company ("TSMC")

TSMC compellingly satisfies L1 Capital International's criteria for a high quality, financially attractive investment:

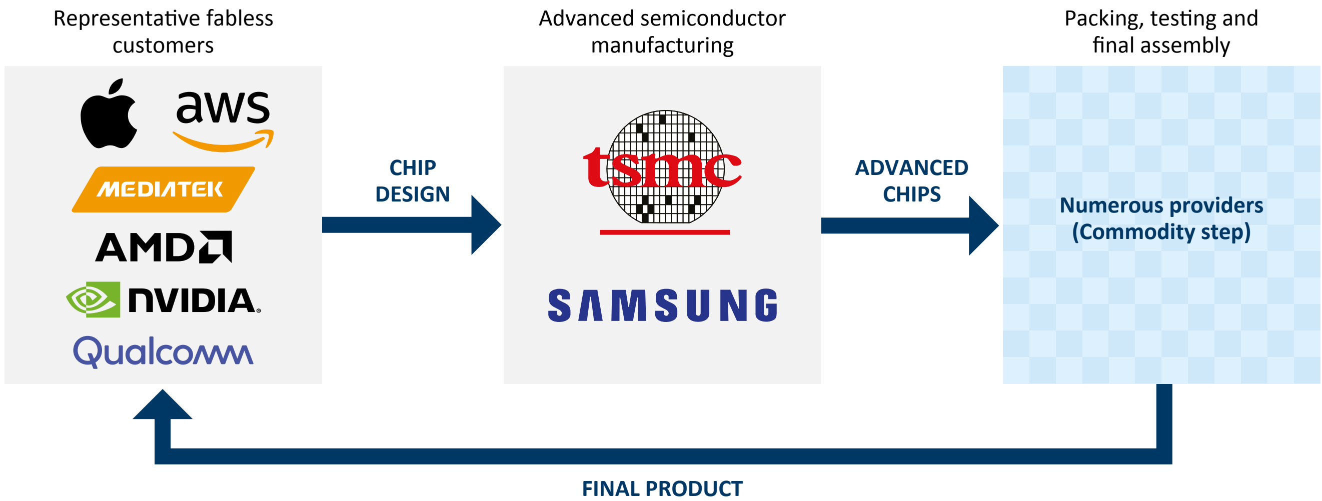
- Occupies the dominant position in an effective duopoly.
- Benefits from long term, structural industry growth tailwinds.
- Provides an essential and difficult to replace service.
- Is well regarded as a critical business partner by its customers.
- Has a highly experienced management team driving a unique, fastidious culture of innovation and long term shareholder value creation.
- Has the opportunity to re-invest large amounts of capital at very attractive rates of incremental return, supporting sustained double-digit earnings growth.

Semiconductor Industry Overview – Highly Favourable Industry Drivers

TSMC is the largest pure-play semiconductor fabrication ("fab" or "foundry") company in the world, a position that is of unique importance to many industries:

- Foundries take the designs of their **"fabless" customers** and produce chips to their specifications on **silicon wafers**.
- Wafers are characterized by their **"node"** which specifies **transistor density**. A 5nm ("nanometer") wafer is much denser than a 10nm wafer. *(For perspective, 5nm is only about 50x bigger than an atom.)*
- The more transistors packed onto a wafer (the higher the density), the more calculations a chip can perform in a clock cycle.
- Alternatively, a chip produced on a 5nm wafer could also perform as many calculations as a chip produced on a 7nm or 10nm wafer but could do so **while consuming far less power**.

Semiconductor fabrication supply chain

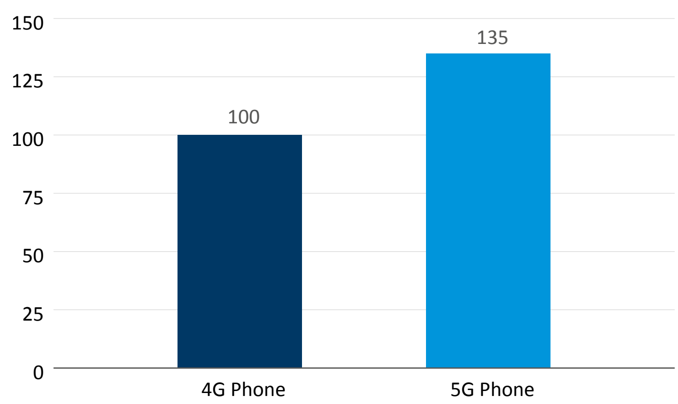


Source: L1 Capital International

While not all applications require the most sophisticated semiconductors, advanced technologies such as 5G and High Performance Computing (HPC) applications including cloud servers, Artificial Intelligence, accelerated compute, driverless/autonomous cars and many others all require access to the most advanced nodes available. Demand for these products has continued to increase and use-cases for the technologies have continued to proliferate. One does not have to be a technologist or a futurist to simply observe that there are more "chips" going into just about everything these days.

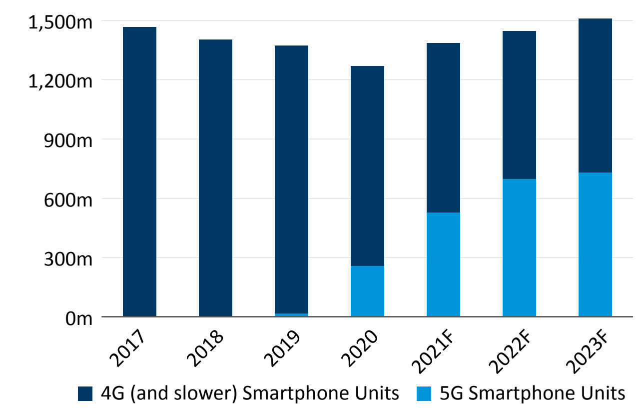
Total semiconductor content in a 5G phone is 30-40% greater than in a 4G phone leading to a dramatic and sustained increase in demand for advanced wafers despite an expected modest increase in total smartphone units.

Smartphone silicon content



Source: TSMC and L1 Capital International

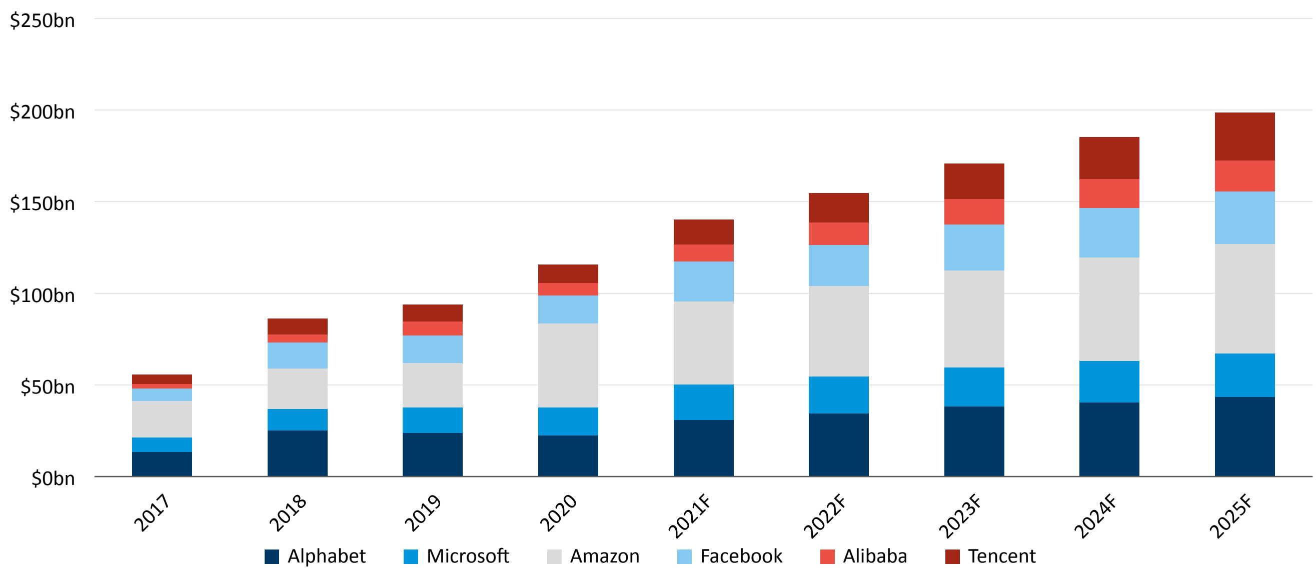
Global smartphone units manufactured



Source: TSMC, Credit Suisse and L1 Capital International

Similarly, capital expenditure ("capex") by the largest cloud providers is expected to continue to increase. Companies like Amazon (AWS) and Microsoft (Azure) spend large amounts of capital on high performance computing solutions which are fabricated by TSMC. In some cases, these computing solutions are designed by TSMC partner, Advanced Micro Devices. In other cases, the cloud providers design their own solutions based on licensed IP from the world's leading semiconductor IP company, ARM. In either case, TSMC is the fabrication partner of choice because the solution needs to be as powerful and energy efficient as possible, necessitating the most advanced manufacturing node.

Total capex (including non-cloud capex) by largest cloud providers



Source: Company filings and L1 Capital International

"Noah's Ark" Industry Structure

As the demand for advanced semiconductor manufacturing has increased, the cost to build advanced foundries has become increasingly prohibitive for all but those with the most efficient scale economies. Fifteen to twenty years ago, the capital cost of building one wafer per month of 65nm capacity was approximately U$70,000. Today, the comparable cost for 5nm wafer capacity is over US$300,000. Building large scale foundries is also not just about availability of capital. It also requires advanced technical know-how and billions of dollars in on-going research and development.

Increase in capex per wafer over the last 15 to 20 years

Node	65nm	40nm	28nm	14-20nm	10nm	7nm	5nm
US$ Capex for 1 wafer/month capacity	$70,000	$83,300	$99,960	$129,948	$175,430	$235,000	$317,250
Node/node increase in cost	+19.0%	+20.0%	+30.0%	+35.0%	+34.0%	+35.0%	

Source: Bernstein and L1 Capital International

Increasing capital requirements combined with high fixed costs lead to industry concentration. As the costs to develop advanced nodes have ***increased***, the number of foundries capable of doing so have ***decreased***.

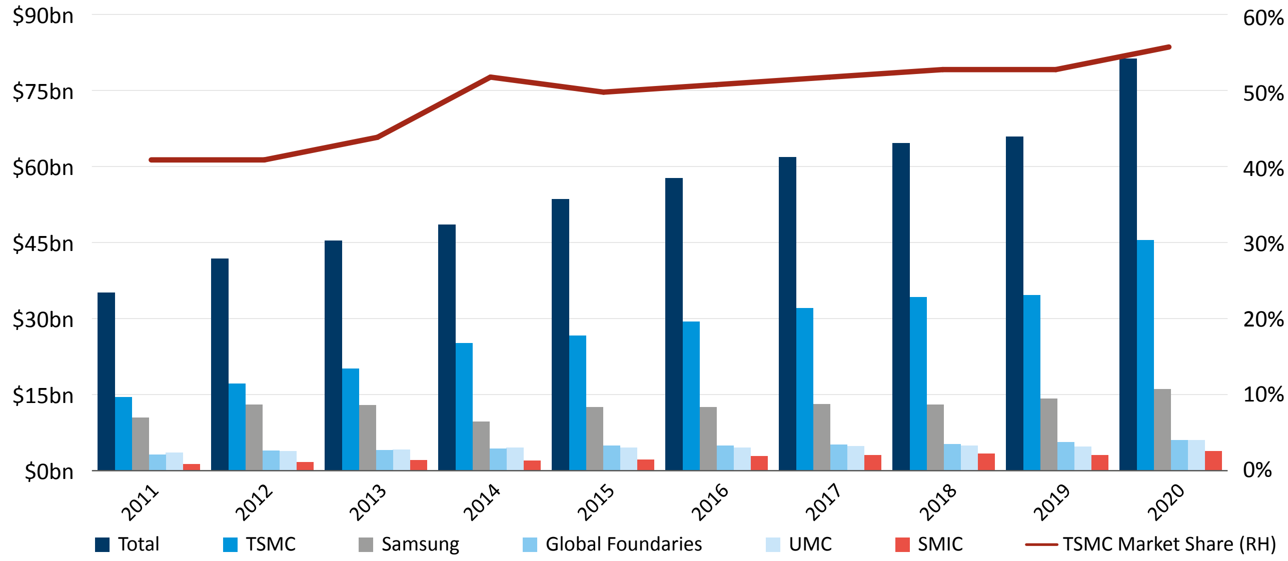
Foundries capable of developing different node capacities

Company	65nm	45/40nm	32/28nm	16/14nm	10nm	7nm	5nm
UMC	Yes	Yes	Yes	No	No	No	No
SMIC	Yes	Yes	Yes	Yes	No	No	No
Global Foundries	Yes	Yes	Yes	Yes	No	No	No
Intel	Yes	Yes	Yes	Yes	Yes	Yes	No
TSMC	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Samsung	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Source: Company filings and L1 Capital International

TSMC is one of only two foundry companies in the world capable of producing the most advanced wafers. In addition, TSMC's market share within the foundry industry has continued to grow steadily and is now around 60%. Furthermore, TSMC's share **within the most advanced nodes is in the order of ~70%**. Even Intel, one of the leading semiconductor fabrication companies in the world, is increasing its outsourcing of leading-edge semiconductor manufacturing to TSMC as it has been unable to keep up with TSMC's technical leadership.

TSMC's growing market share



Source: Bloomberg, Credit Suisse and L1 Capital International

The Golden Rule: If your customers are happy…

Growth for growth's sake is of little value or may be detrimental to the value of a business. Fortunately, TSMC has charted a course that is beneficial to all parties involved: It generates a very attractive return on its invested capital while its customers receive an outstanding product and share in the economics. We believe **TSMC does not fully exploit its pricing power with its customers**, however, the model works and therefore TSMC is **the most sought out partner in the industry**.

Wafer unit economics

The economics illustrated are indicative of an actual customer relationship. It is noteworthy how much of the economics TSMC is "leaving on the table". TSMC's business philosophy is that their customers should be **partners** – and by ensuring the success of their partners, they are ensuring their own success. Likewise, by allowing their partners to be healthy and profitable, they allow them to grow more rapidly and remain loyal to TSMC which creates a virtuous cycle.

Illustrative Unit Economics		
ASP per 7nm Wafer	$10,000	▪ Produced on thin, pizza-shaped slab of silicon called a "wafer"
Diameter of wafer (mm)	300	▪ Translates to 12 inches in diameter
Area of wafer (mm sq)	70,686	
Die Size of chip (mm sq)	110	▪ The wafer is cut into individual chips
# Chips	641	▪ This is how many chips you can make
Yield	70%	▪ Because of defects and circular shape of wafer, not all are viable
Sellable Die	449	
Price per Die to Customer	**$22**	▪ ASP/sellable die
Cost of Chip	$22	▪ Buys from TSMC at this price
Packaging Costs/Other	$30	▪ Cost of the chip typically 40-60% of COGS
Total Costs of Goods Sold	$52	
Sales Price	$168	* Receives ~60% of $280 retail price
Gross Profit	$116	
Gross margin	***69%***	***Attractive gross margin for TSMC customer!***

Source: Company Filings, L1 Capital International

Unique Management and Culture

TSMC founder, Morris Chang, was born in China in 1931 into what he has described in numerous public interviews as middle-class: *"we didn't starve … but our lifestyle was very modest compared to a middle-class lifestyle today."* Chang's upbringing kept him motivated and, when he had the opportunity to move to the U.S. when he was 18, he made the most of it. He studied at Harvard for a year and then transferred to Massachusetts Institute of Technology (MIT). Not long after graduating MIT, Chang joined Texas Instruments where he had a very successful 25-year tenure. However, he realised that the top job at Texas Instruments would elude him and, seeking a new opportunity, he moved to Taiwan where it was the early days of the country actively pursuing programs to develop its semiconductor industry.

Chang founded TSMC in 1987 with backing from the Taiwanese Government, some modest private investment and outdated technology that was two to three generations behind the industry leaders of the day. The vision at the time was simple: as the world's only pure-play foundry, they would begin by providing flex capacity to existing integrated companies and gradually they could win business as the fabless industry developed.

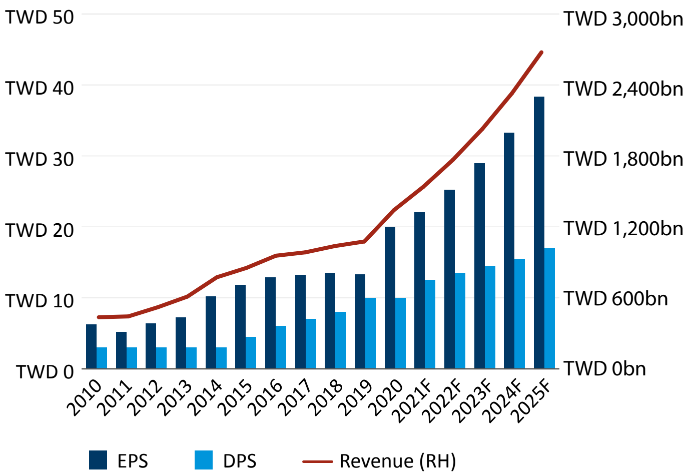
Despite immense growth and becoming the industry leader, TSMC's management remains relentlessly focused on efficiency and productivity, TSMC also places an extreme focus on innovation, consistently ranking at or near the very top of the U.S. Patent and Trademarks Office's patent grants alongside companies such as Microsoft, Amazon, Apple and Alphabet. Six of TSMC's ten board spots are held by independent directors with relevant industry experience, supporting strong governance.

Chang was widely held as the company's chief culture carrier and although he retired in 2018, he had been preparing his chief lieutenants, Mark Liu and CC Wei to replace him since 2013. Both Liu, Chairman, and Wei, CEO, received PhDs in the U.S. were operating as Co-CEOs from 2013 to 2018 while Chang was the Executive Chairman so that they could train under him. Even TSMC's succession planning is focused, methodical and forward-looking.

Compelling Business Economics

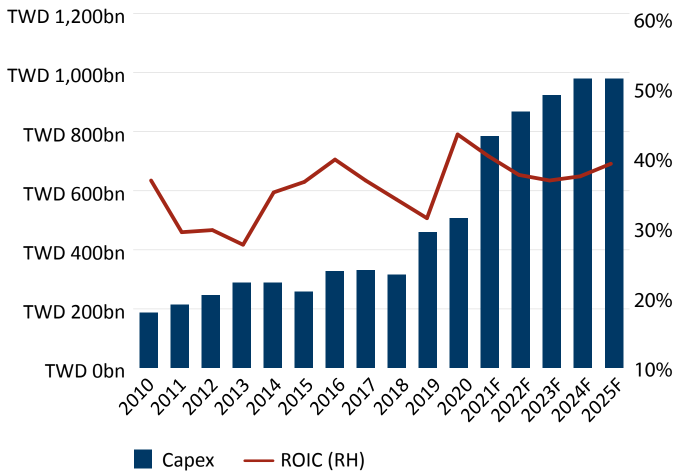
TSMC's dominant market share, scale advantages, structural tailwinds, and excellent customer relationships support substantial growth in earnings and cash flow. TSMC has produced double digit growth in revenue, EPS and DPS while achieving exceptional returns on invested capital. This growth has been funded by free cash flow and TSMC has a net cash balance.

Earnings, dividends and revenue

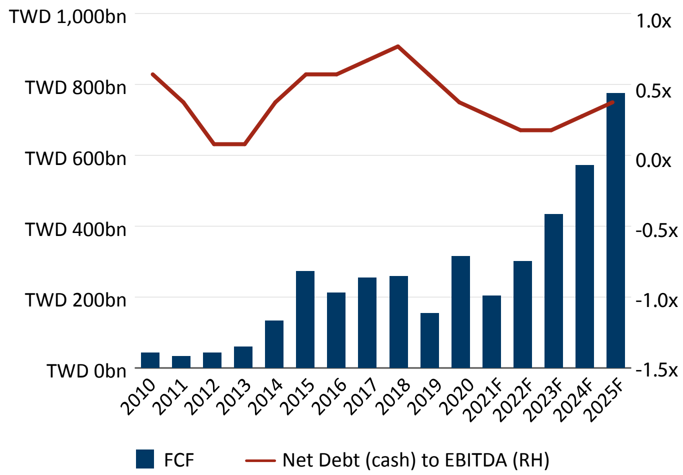


Source: TSMC and L1 Capital International

Capex and return on invested capital



free cashflow and net debt to EBITDA



Source: TSMC and L1 Capital International

Valuation and Expected Returns

TSMC is trading at a P/E ratio of around 24x our estimate of FY2022 earnings per share. We forecast TSMC will continue to compound not just its earnings power at double-digit rates but also improve its competitive position.

With supply/demand dynamics exceptionally favourable and demand for advanced semiconductors only accelerating, we think it is a great time to own the best house on a great block, with a strong sea breeze tailwind and an attractive view as far as the eye can see.

Due to sentiment shifts, the flow of capital to "value" businesses and slight market disappointment that Intel did not announce even more outsourcing to TSMC, TSMC's share price briefly fell by around 15% over the past 6 weeks. We took advantage of this share price pullback to increase our investment in the business.

At the current share price we expect to be able to earn a double-digit annual return for many years, which we consider to be attractive for an L1 Capital International Quality 2 rated business (we consider TSMC to be a Quality 1 business except for the inherent geopolitical risk).

Australia has iron ore; Taiwan has the semiconductor industry. Semiconductors are a key contributor to the Taiwanese economy, led by TSMC and supported by many other companies in the industry supply chain. Geopolitical tensions between China and Taiwan cannot be ignored, however, and portfolio risk management constrains the potential maximum size of our investment in TSMC.

L1 Capital International Fund

Quarterly Report | MARCH 2021

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, 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
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 carries forward to next 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