L1 Capital International Fund

Quarterly Report | SEPTEMBER 2023

Introduction

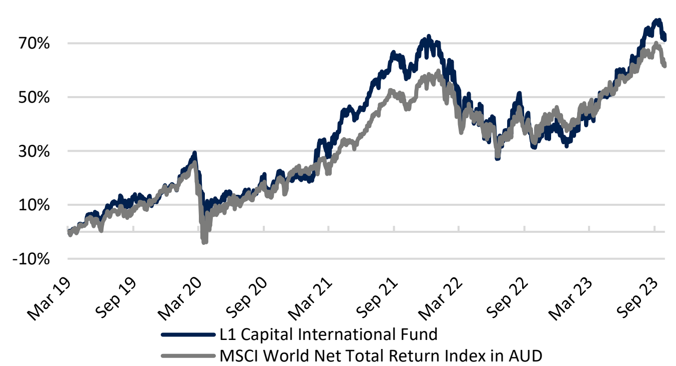
In this Quarterly Report, we have outlined:

- **Our assessment of the current investment environment including ongoing normalisation of supply and demand post COVID-19, falling inflation and the recent substantial increase in real interest rates.**
- **L1 Capital International Fund positioning in a world of increasing business and investment performance divergence.**
- **Our review of the last quarter, including key contributors and detractors to the Fund's performance.**
- **Recent Portfolio adjustments.**
- **Key takeaways from the L1 Capital International's recent travels and meetings with over 100 companies.**

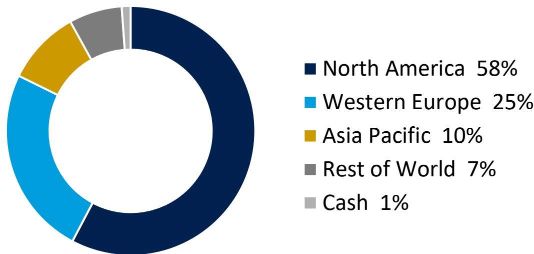
Fund performance (Net) (%)	Fund	Index**	Alpha
3 months	3.6	(0.4)	+4.0
2023 CYTD	28.3	16.7	+11.6
1 year	30.5	21.5	+9.0
3 years p.a.	13.4	11.9	+1.5
Since inception* p.a.	12.4	11.0	+1.4
Since inception* cumulative	71.2	61.5	+9.7

** Inception is 1 Mar 2019. Rounded to one decimal place. Numbers may not add due to rounding. ** MSCI World Net Total Return Index in A$. Returns measured from Index close on 1 Mar 2019.*

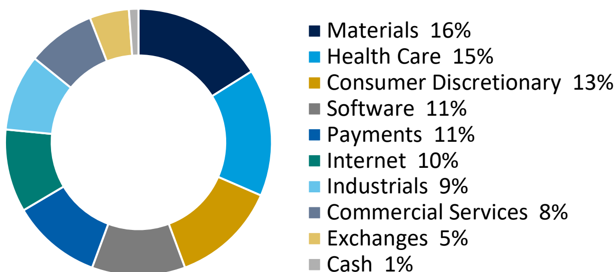
Fund (Net) and benchmark returns since inception*



Revenue exposure by region[1]

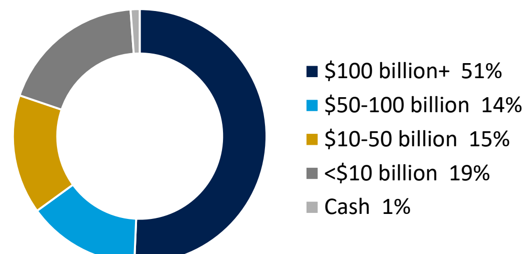


Sector exposure[2]



Top 10 holdings *(In alphabetical order)*	Sector
Amazon.com	Consumer Discretionary / Internet
Booking Holdings	Consumer Discretionary
CRH	Materials
Graphic Packaging International	Industrials
Marsh & McLennan	Commercial Services
Mastercard	Payments
Microsoft	Software
Natural Resource Partners	Materials
United Healthcare	Health Care
Visa	Payments

Market capitalisation exposure (in US$)



1. Revenue by region is internally estimated on a look through basis based on the underlying revenues of the individual companies held in the portfolio. 2. Sector exposure is defined by L1 Capital International to best describe the nature of the underlying businesses. Past performance should not be taken as an indicator of future performance.

Current investment environment

"We see the current stance of monetary policy as restrictive, putting downward pressure on economic activity, hiring, and inflation. In addition, the economy is facing headwinds from tighter credit conditions for households and businesses."

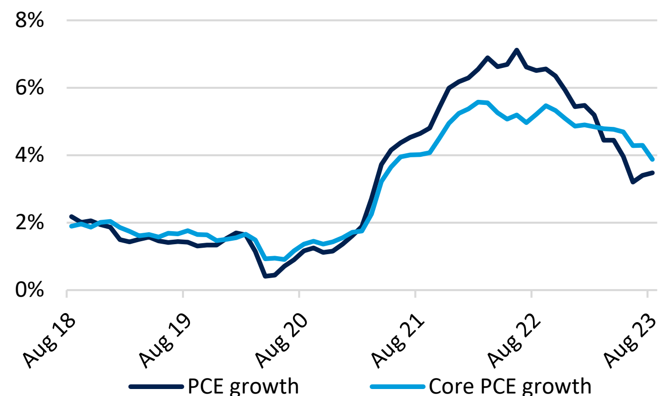
Jerome Powell, 20 September 2023

Compared to recent history, the macroeconomic environment in the September 2023 quarter was relatively benign. Economic growth is gradually softening, consensus expectations have been trending to short-term interest rates staying higher for longer and more recently there has been a substantial increase in real long-term interest rates. Equity markets were also under pressure, with the sell-off in equity markets increasing later in the quarter. During the quarter, the MSCI World Total Return Index decreased by 0.4% (in Australian dollars). However, the depreciation of the Australian dollar obfuscates equity market weakness, with the MSCI World Total Return Index decreasing by 3.8% in U.S. dollars over the quarter and is down almost 7% (in U.S. dollars) from its peak in late July 2023.

The L1 Capital International Fund outperformed the Index by 4.0% in the September 2023 quarter, returning 3.6% (in Australian dollars). Calendar year to date, the L1 Capital International Fund has returned 28.3% (in Australian dollars), outperforming the Index by 11.6%.

The **June 2023 Quarterly Report** provided a detailed historical perspective to the current investment environment, as well as our present observations and forward perspectives. In our view, **there have been minimal substantive changes to the macroeconomic environment over the past three months.** We track a host of economic and company-specific data. At a high level, globally we see economic growth across most industries and most regions slowing, but not crashing. China appears to be trending weaker than expected, while aggregate expenditure by consumers, particularly in the U.S., is reasonably strong. Employment conditions in most regions remains robust. Inflation in most areas continues to trend down, albeit above Central Bank targets. Central Banks are generally in a holding pattern, waiting to see the impact of a sharp increase in interest rates on inflation, employment and economic activity.

Figure 1: U.S. Total and Core PCE continues to trend down



Source: Federal Reserve, L1 Capital International

During the quarter the L1 Capital International team met with over 100 companies in the U.S. and Europe with these company level 'bottom-up' discussions largely confirming the economic data. Our real-world takeaways are summarised from page 6 of this quarterly report.

The June 2023 Quarterly Report outlined a **litany of worries** weighing on the economic outlook. These issues have not gone away over the past 3 months and some, such as higher energy prices, dysfunctional politics, and industrial unrest, have worsened (we didn't think politics could get more dysfunctional, but neither did Kevin McCarthy).

Endless ink is spilt speculating on Monetary Policy trends, changes in short-term interest rates and the Federal Reserve 'dot plot'. There remains a fierce debate whether the Federal Reserve, Reserve Bank of Australia and most other Central Banks are done increasing short-term interest rates, or whether there may be 1 or even 2 small short-term rate increases still to come. **From our longer-term investing perspective, we believe this debate is largely irrelevant**. **Our central view that short-term rates will be relatively high for relatively longer is becoming market consensus.** Unrealistic expectations for a sharp cut in short-term interest rates in 2024 are dissipating. **The biggest change to economic conditions, and a key factor causing equity markets to sell off, has been a significant and sharp increase in long-term real (inflation adjusted) interest rates.** Federal Reserve Chair Powell is clear that real rates are what matters:

"Real interest rates now are well above mainstream estimates of the neutral policy rate…real interest rates are positive now. They're meaningfully positive, and that's a good thing. We need policy to be restrictive so that we can get inflation down to target…we understand that it's a real rate that will matter and that needs to be sufficiently restrictive. And, again, I would say, you know 'sufficiently restrictive' only when you see it."

Jerome Powell, 20 September 2023

Interestingly, the market's pricing of longer-term U.S. inflation expectations has not changed recently, consistently remaining in the 2.0% to 2.5% range. What **has changed** is an increase in nominal 10-year bond yields and therefore **a jump in yields of 10-year Treasury Inflation Protected Securities (TIPS)** (nominal interest rate – inflation expectations = real interest rate).

Figure 2: Market expectations for average U.S. inflation over the next 10 years have not changed materially…

Source: Federal Reserve, L1 Capital International

Figure 3: …However, yields on 10-year TIPS (real interest rates) have increased meaningfully

Source: Federal Reserve, L1 Capital International

There is no simple explanation to the tightening of real interest rates, particularly in the U.S. Higher for longer short-term interest rate expectations and recent increases in energy prices are inadequate justification. Quantitative Tightening and loose Fiscal Policy are likely key contributors, but neither of these factors have changed materially recently. Real interest rates today are not excessively high by historical standards, but they are high compared to the period since the Global Financial Crisis, and particularly compared to the distorted period immediately post COVID-19. **If real interest rates stay at current elevated levels, there is likely to be further economic pressure.** The implications are also not one-dimensional, with higher real U.S. interest rates also leading to U.S. dollar strength.

Portfolio positioning

Our core view remains that the world is continuing to normalise after unprecedented widespread disruption caused by COVID-19. Inflation is trending down in most areas, allocation of consumer spending is shifting back to historical trends, labour participation is trickling upwards, immigration is returning, labour mobility is improving, and monetary policy is more 'normal' and will respond to changing economic conditions (probably with a lag). **Economies are cyclical and the current cycle is weakening**. However, we continue to view a **'hard economic landing' as less likely. For some consumers life is pretty good** – for example, those receiving salary increases, those earning meaningful interest on savings, those with no mortgage or a 30-year mortgage fixed at a low interest rate or those benefiting from strong house price appreciation and resilient stock markets.

It is not an easy operating environment for most companies. Companies which have questionable business models, operate in intensely competitive industries, have a need for cheap sources of capital and/or have over-levered balance sheets are going to struggle. **Performance divergence (operational and share price) will continue.**

Over the past 12 months, over 60% of the companies in the S&P500 Index have under-performed the Index return of around 22% (in U.S. dollars). In fact, over 25% of companies provided a negative shareholder return over this period, while over 25% of companies provided a return greater than 30%. 12 months is a very short time horizon to assess investment performance, but our point is simple – **from an investment perspective, business selection is critical.**

In a world of high real interest rates, fundamental valuation analysis is increasingly important. Capital has a cost, and capital is no longer freely available to all businesses.

Our central objective is to invest at sensible valuations in quality companies that have experienced management and enduring competitive advantages and financial strength to deliver shareholder returns over time, regardless of short-term fluctuations in economic conditions. We believe our **unique definition of quality, prudently and cautiously applied, results in a diversified portfolio of businesses that can deliver strong risk-adjusted returns across business cycles**.

Recent portfolio changes are discussed on page 5.

L1 Capital International Fund

Quarterly Report | SEPTEMBER 2023

September 2023 quarterly review

Performance

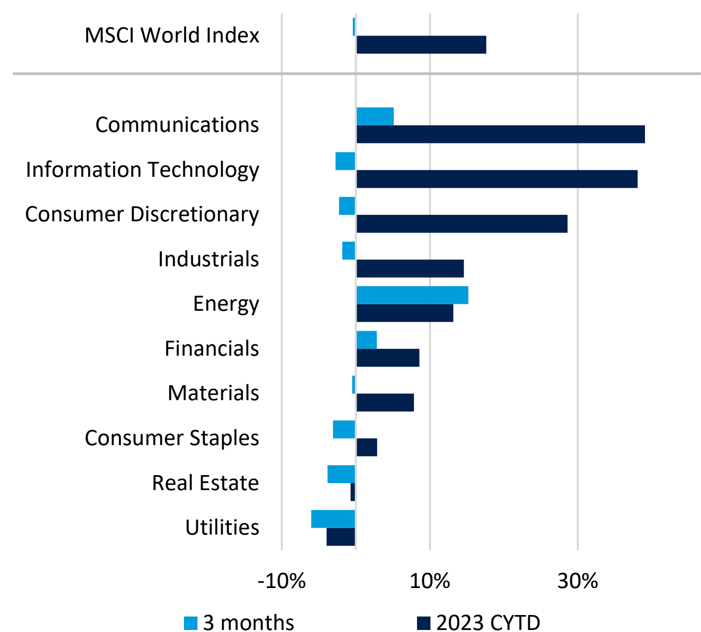
In the September 2023 quarter, the Fund returned 3.6% (net of fees), outperforming the Benchmark return of -0.4% by 4.0% (all in Australian dollars). The Australian dollar depreciated 2.8% against the U.S. dollar and was flat against the Euro, increasing the Fund and Benchmark Australian dollar reported quarterly returns.

Key contributors and detractors

Energy was the strongest sector during the September 2023 quarter as oil prices increased following OPEC extending supply cuts. Outside of Energy there were no major sector contributors or detractors to the MSCI World Index returns and the overall Index performance was flat (in AUD). Year to date there has been more divergence, with pro-growth sectors such as Communications, Information Technology and Consumer Discretionary making the largest positive contributions. In our view many companies in these sectors were over-sold in 2022 when the market was pricing in a hard economic landing. 2023 year to date, Utilities, Real Estate and Consumer Staples have under-performed in an environment of increasing interest rates.

The L1 Capital International Fund is index unaware. We invest in businesses based on a fundamental assessment of quality and valuation. The Fund's sector exposure often has little resemblance to the MSCI World Index sector composition. The Fund currently has no exposure to Utilities, Real Estate or Consumer Staples (amongst other sectors) as we believe businesses in these sectors have been over-valued by the market during an historical period of exceptionally low interest rates and due to perceived stability in more challenging economic conditions.

Figure 4: MSCI World Net Total Return Index (in A$) – Sector Performance



Source: Bloomberg, L1 Capital International

Following significant under-performance, some high-quality businesses in these sectors are now becoming more attractive from a valuation perspective – in our language they are now getting warmer on our Bench of potential investments.

Our 'all-weather' portfolio centred around our unique definition of 'quality' delivered strong performance in the September quarter. Three companies positively contributed over 0.5% (in Australian dollars) to the Fund's returns for the quarter (**Booking Holdings, Intuit** and **Natural Resource Partners**, in alphabetical order), and another three companies almost reached this level of positive contribution. No companies detracted from the Portfolio's returns by 0.5% or more.

As part of our travels during the quarter (see page 6) we had the opportunity to meet with management of both Booking Holdings and Intuit. We continue to view both companies as exceptionally well managed.

Booking Holdings, the world's leading online travel agency, continues to benefit from a strong global travel environment with particular strength in Europe, Booking Holdings' core market. Fears of peak 'revenge travel' following COVID-19 lockdowns have been misplaced in our view. We assess current travel volumes to be only slightly elevated compared to pre-COVID-19 trends, with some regions, particularly outbound travel from China, still relatively depressed. Anyone who has travelled anywhere recently will be nodding when we say hotel rates have increased meaningfully in recent times. Accommodation providers are generally doing quite well, but the increased hotel rates have been necessary to offset inflation in costs such as employee salaries and additional cleaning services. As Booking Holdings 'clips the ticket' of accommodation spend, the company has benefitted from increased average daily hotel rates. Importantly, Booking Holdings continues to invest in its business, improving the reach, quality and range of services it provides, resulting in **gains in market share and an extension of its industry leadership position**. Booking Holdings is now more fairly valued by the market, but still provides attractive base case risk-adjusted returns and remains one of the larger investments in the Fund.

Intuit held its annual Investor Day during the quarter and the presentation materials are well-worth a review. **Intuit is at the forefront of commercial application of artificial intelligence (AI) across its portfolio of businesses** – QuickBooks, TurboTax, Credit Karma and Mailchimp. Intuit has been investing in AI for many years, well before ChatGPT became a buzz word.

Intuit's historical business model was based on developing software to enable customers to do accounting, tax and other services for themselves, rather than incur significantly higher costs by outsourcing these services to a third party. **Through AI, Intuit is essentially transforming this software into an artificial, higher-quality, more-extensive, 'do it for me' capability**. No competitor is close to offering the capabilities Intuit has already developed across its businesses and its **competitive lead is increasing**.

During FY2023, Intuit spent (and expensed) over **US$2.5 billion on research and development**. This compares to Xero (ASX listed small business accounting software company) which earned **total revenue of US$0.9 billion** in FY2023. We do not see the potential for Xero or any other business to compete effectively against Intuit's QuickBooks small business account software ecosystem in the U.S.

Intuit's share price has caught up with our assessment of the company's valuation. We continue to have a very positive view of the business and its outlook, but purely for valuation considerations we have started to trim the Fund's investment.

Natural Resource Partners (NRP) is a unique business and a recent investment by the Fund. NRP is a structured as a Master Limited Partnership (MLP), a publicly traded limited partnership business structure with specific tax attributes. While not providing any advice, we caution that the tax implications of investing in an MLP, particularly from Australia, are extremely onerous and complicated.

NRP has three segments contributing to its valuation:

Firstly, NRP holds a 49% interest in one of the world's lowest cost, most environmentally friendly trona mines and soda ash production facilities, located in the Green River Basin, Wyoming, United States. Soda ash can be produced naturally from trona, or synthetically through a chemical process which is usually higher cost and less environmentally friendly. Cost effective deposits of trona are principally found in Wyoming and parts of Turkey. Soda ash is predominantly used in the manufacture of glass and NRP's joint venture partner is an integrated Turkish glass manufacturing business. NRP's soda ash operation has around 50 years of reserves, expansion potential and has significant strategic and economic value.

Secondly, NRP owns approximately 13 million acres of mineral interests and other property rights across the U.S. Revenue is predominantly generated from royalties over metallurgical coal production, but opportunities also lie in other areas such as renewable energy production. Royalties are highly valuable interests, with revenue generated from a percentage of the gross sales price or a fixed price per production unit, without the need for NRP to provide any capital or be directly subject to cost inflation pressures.

Thirdly, NRP holds what management likes to call 'out of the money call options on greatness'. Within NRP's portfolio of mineral rights are 3.5 million acres of underground pore space for the sequestration of carbon dioxide. NRP has already granted two leases to leading industry proponents of carbon sequestration. **Should the technical and financial criteria develop, carbon sequestration potentially provides NRP with a material source of additional revenue with substantial environmental benefits and without any additional capital requirements.**

NRP is family-controlled who are highly aligned with limited partnership unitholders. Management has been consistently employing a simple strategy of paying down debt since 2015, a process we expect will be complete in the next few years. Once all financial obligations have been repaid, we expect already substantial distributions to unitholders to increase materially.

Portfolio adjustments

Portfolio adjustments during the September 2023 quarter were modest, diversified, but meaningful. In total around 10% of the Fund was divested and reinvested into opportunities we consider provide a superior risk-adjusted base case return.

We continued to trim our investment in high-quality technology businesses such as Intuit, mentioned previously. These adjustments were purely for valuation considerations, rather than any business concerns and some of these companies remain significant portfolio holdings.

The Fund's remaining investment in **Moody's** was fully divested during the September quarter. Moody's is the world's leading credit rating, risk assessment and analytics business. The core credit ratings business is largely a duopoly with S&P Global, with modest competition from Fitch Ratings and regional competitors – a great example of our **preferred 'Noah's Ark' industry structure**.

The share price of Moody's has been volatile over recent times, often reacting too greatly to changes in short-term capital markets conditions. During the quarter we took advantage of positive market sentiment to divest our holding at a share price we considered to be above fair value. Moody's is very well managed and 'ticks all our boxes' for one of the world's highest-quality businesses. The company has moved from our Portfolio to our Bench of potential investments. Having a Bench of 'ready to go' investment opportunities is a core aspect of our investment process. We continue to analyse Moody's as if we owned it and are excited by the pull-back in the share price from recent highs.

Illustrating the importance of a fully-diligenced, high-quality Bench, two companies moved the other way during the quarter, from our Bench to our Portfolio. One company is in the health services sector and the other in the semiconductor sector. Both companies are leaders within their industry and are now trading towards the bottom end of our base case fair value range. We intend to increase the position size for both companies if their share price falls further.

The health care sector currently accounts for 15% of the portfolio. **Health care is generally less macro-sensitive** than some other sectors. We believe several health care businesses now offer attractive value and should perform well in a range of economic conditions.

Cash holdings (in U.S. dollars) reduced to around 1%.

A slowly deteriorating macroeconomic environment and increasing real interest rates are negative to business performance and valuations, but these pressures are reflected in current market valuations for our Portfolio. **Overall, we are seeing good value in our Portfolio, with share prices generally trading towards the bottom end of our assessment of base case fair value.**

Key takeaways from over 100 company meetings in the U.S. and Europe

Introduction

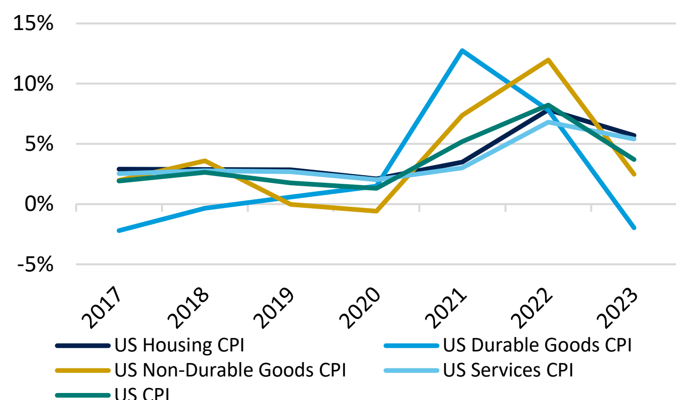
During the September 2023 quarter the L1 Capital International team travelled extensively in the U.S. and Europe, meeting with over 100 companies operating globally across a diverse range of sectors. We met with management of the majority of the companies in the Fund, many Bench companies, as well as suppliers, customers and competitors to these businesses. We also spent some time at PACK EXPO, joining 32,000 packaging industry participants and 2,300 exhibitors across 1 million net square feet of exhibit space. Who knew there were so many types of packaging and packaging machines!

Our travel is helpful to check in on existing businesses and industries we invest in, as well as to identify potential new investment opportunities. In those respects, our travel was productive. By speaking to management from a diverse range of businesses operating across industries and geographies, we also gain **real-time insight into current business conditions and underlying trends**. In this report we have briefly summarised some of important takeaways from our travel which have broad application, beyond company-specific considerations.

Inflationary pressures are reducing/there are already pockets of deflation

Figure 1 on page 2 clearly illustrates **that U.S. inflation has peaked**. The components of U.S. CPI, illustrated in Figure 5, provides additional clarity on the cause of declining inflationary pressures, with **durable goods already deflationary**. We are hearing the same directly from companies – areas repeatedly cited as deflationary include freight and some commodity inputs, while retention of labour and attracting new talent has become easier. **Some companies have already started cutting finished goods prices to stimulate demand.**

Figure 5: Goods are leading the downturn in inflation



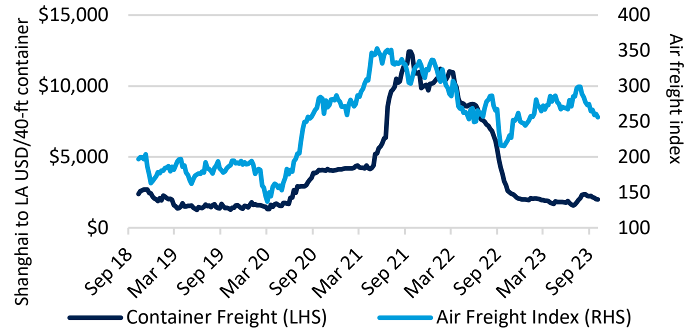
Source: Federal Reserve, Bloomberg, L1 Capital International

Supply chains are largely back to normal

Management teams are comfortable about their supply chains following a period of massive disruption during the COVID-19 pandemic.

Manufacturers no longer face missing 'golden screws' or necessary components in manufacturing. Companies are no longer air-freighting critical manufacturing inputs or stock, reverting back to traditional sea freight. As an indicator, both sea freight and air freight rates continue to normalise.

Figure 6: Sea freight and air freight rates



Source: Federal Reserve, Bloomberg, L1 Capital International

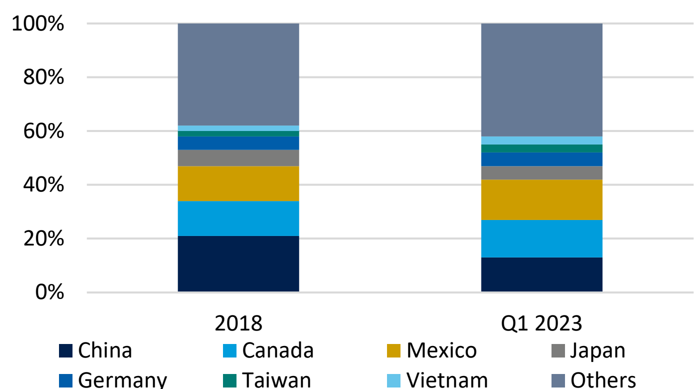
Destocking is progressing, but taking longer than expected

Supply shortages during COVID-19 were quickly followed by excess inventory and destocking, particularly by companies who sell their products through distributors or which have longer supply chains. These dynamics arose across many industries because supply challenges meant customers and distributors chased limited available stock and built contingency buffers if availability worsened. Having stock became a competitive advantage in many instances. **Subsequently, demand softened and supply improved leading to excess inventory.** As interest rates have increased, the cost of holding excess inventory has increased. Based on our discussions with many management teams across industries and regions, in general **destocking is progressing and inventory levels are returning towards normal conditions, but still remain somewhat elevated and it is taking longer to reach normal levels than expected.** We therefore expect many companies to continue to mention this issue when reporting financial performance in the second half of 2023 and some companies may not meet market expectations for sales due to this ongoing issue.

Onshoring/nearshoring continues, as does diversification of supply chains away from China

We continue to hear from management teams that they are investing in **onshoring or nearshoring of supply chains and manufacturing operations.** This trend reflects a combination of the desire to shore up supply chains following periods of vulnerability during COVID-19, and geopolitical tensions which have led to Government policy which limits business activities in some regions, imposes tariffs on certain imports and financially supporting investment in home markets. For example, European and U.S. Governments have provided financial support to increase semiconductor manufacturing in their regions, restricted the export of leading-edge semiconductor manufacturing equipment and technology to China and imposed a range of tariffs, particularly on China.

Figure 7: U.S. imports by country of origin



Source: Deloitte, U.S. Census Bureau, L1 Capital International

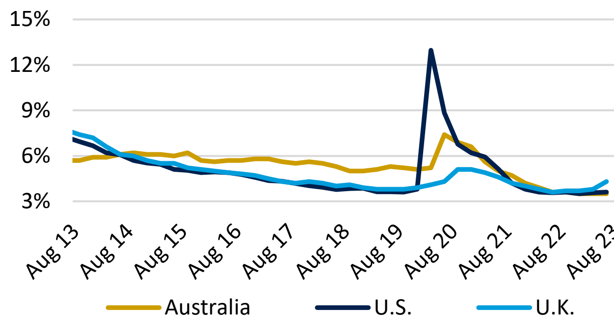
A number of the companies we spoke to or follow have increased manufacturing in Vietnam, India and other Asian countries. Foreign direct investment in Mexico continues to increase and, as illustrated in Figure 7, China's share of U.S. imports has fallen from 21% to 13% over recent years.

Employment conditions are still robust, but starting to weaken slightly

In most industries and in most regions globally, the ability to attract and retain quality employees has been challenging. Employees have had strong bargaining power and many companies in the U.S. have faced wages growth in the 6% to 8% range while having to manage high staff turnover, absenteeism and other issues.

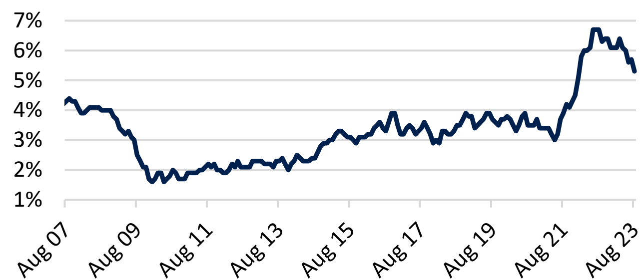
Redundancies by the Technology sector have made headlines, but these companies are the outliers – over-expanding and lacking growth discipline in recent years. Most management teams commented that employment conditions are still tight but are becoming less challenging. Companies expect employee expense growth to revert towards 3% to 4% in the near term. This bottom-up company feedback has been reflected in the most recent U.S. employment data – strong jobs creation but less wages growth. **We believe the trend of reducing wages pressure has further to go**, assisting to bring down inflation. Increasing unemployment will be a key sign of weakening economic conditions.

Figure 8: Unemployment rates by region



Source: Office for National Statistics, Australian Bureau of Statistics, Federal Reserve Bank of St Louis, L1 Capital International

Figure 9: U.S. wages growth



Source: Federal Reserve Bank of Atlanta, L1 Capital International

Lower socio-economic consumers are under financial pressure, affluent consumers are doing fine

We continue to see macroeconomic evidence and hear from a broad range of company management that **lower socio-economic people are under significant financial strain, while more affluent consumers remain well-positioned.** There has been an ongoing trend for increasing wealth inequality globally. Inflationary pressures on energy and food have a disproportionately greater impact on lower income consumers and COVID-19 induced fiscal stimulus targeted at the poor has been scaled back. We are starting to see deteriorating trends in the performance of lower quality consumer credit and financial institutions are starting to pull back from the provision of credit to consumers with lower credit ratings.

While we have not invested in either company (Dollar General – quality concerns and Ferrari – valuation and other concerns), as an illustration, it is interesting to compare Dollar General management's recent comments with those of Ferrari management:

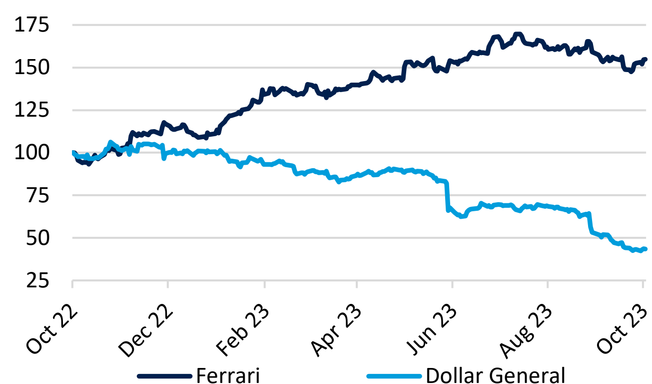
"Our customer… she's still feeling the headwinds of the SNAP [Supplemental Nutrition Assistance Program] reduction and also the lack of tax refunds. And her savings are gone... And … she is still living with the inflationary pressure…Our core customers continue to tell us they feel financially constrained…we expect continued pressure in the sales line for the duration of this year, particularly in discretionary sales as our customer focuses more on buying for need".

Dollar General, 31 August 2023

"Record high exceptional results…our order book remains stunningly high across all geographies and the full product range thanks to a robust order intake…We don't see any change in the consumer behaviour… the order component… very high and it goes well into 2025".

Ferrari, 2 August 2023

Figure 10: Ferrari vs. Dollar General share price (Indexed)



Source: Bloomberg, L1 Capital International

Unsurprisingly, Ferrari's share price is up over 50% over the past year (albeit to a very full valuation) while Dollar General's share price has more than halved over the same period, reflecting a range of business specific and macro pressures.

China's recovery post COVID-19 reopening has been weaker than expected

Almost universally, management of global businesses spoke of demand in China being weak and below expectations. These comments extended across industries and at government, business and consumer levels. **This isn't a new development.** There is a plethora of economic data to suggest demand conditions in China are broadly weak. The diversification of supply chains away from China mentioned earlier is also likely a negative contributor to economic conditions in China. The Chinese share market has been under sustained pressure since the start of 2021. We do expect additional stimulus to be announced. Expectations have been recalibrated lower for Portfolio companies with direct China exposure, albeit at levels below our prior base case. For a range of reasons, we remain cautious on investing in businesses with significant domestic Chinese exposure.

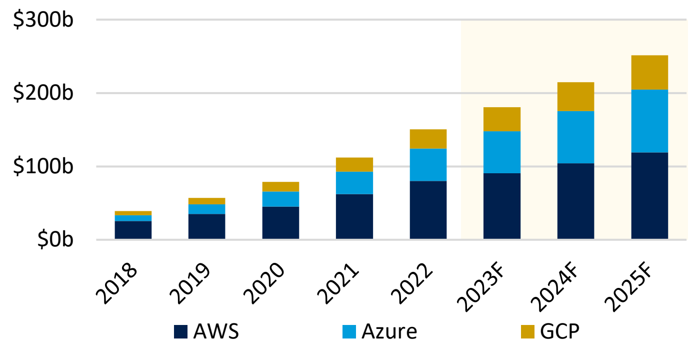
Figure 11: MSCI China Index

Source: Bloomberg, L1 Capital International

The ongoing shift to cloud computing still has a long runway

The growth in the cloud computing industry is not new, driven by both new spend directly in the cloud and a continued shift of IT spend from on-premise applications to a cloud hosted environment. Over the past 5 years, the collective revenue of the Big Three cloud service providers outside of China, namely **AWS (Amazon), Azure (Microsoft) and GCP (Alphabet)** has increased from around US$25 billion to over US$150 billion. **It was apparent from many of our company meetings that while well-established, the trend to shift IT spend to the cloud is far from complete.** Together with the growth in cloud-hosted Artificial Intelligence capabilities, we believe the growth profile for the major cloud infrastructure and services providers will continue to be strong. **These three companies have, in our view, a near unassailable lead over potential competitors in many areas.**

Figure 12: Cloud revenue of AWS (Amazon), Azure (Microsoft) and GCP (Alphabet)



Source: Company filings, L1 Capital International

All three businesses are important holdings in the Fund.

Competition authorities around the world are placing more attention on the large cloud service providers, most recently the U.K.'s Ofcom announcing a review of the industry. While we expect regulatory review and oversight to increase, the Big Three's technical and scale leadership should continue to provide strong returns to shareholders.

Artificial Intelligence is a game-changer for many industries and businesses, but still very early days

"In my lifetime, I've seen two demonstrations of technology that struck me as revolutionary. The first time was in 1980, when I was introduced to a graphical user interface – the forerunner of every modern operating system, including Windows… The second big surprise came just last year…In September, when I met with [the OpenAI team] again, I watched in awe … I knew I had just seen the most important advance in technology since the graphical user interface."

Bill Gates, 21 March 2023

Discussion of Artificial Intelligence (AI) and how management are investing in AI capabilities and planning for the future permeated every discussion during our travels. Key takeaways from our discussions include:

- AI is not buzz. It is a step change in computing that will have broad implications for many industries and businesses. In short, Bill Gates is right (again).
- It is still very early days and Chat GPT is the tip of the iceberg. Large language models and generative AI will continue to evolve rapidly and extensively.
- There are already real world commercial applications of AI, such as by Intuit, mentioned on page 5, and Microsoft's Copilot tools, but most companies are not yet at the point of generating additional revenue from AI initiatives. Over time we expect some form of AI to become ubiquitous in many industries and businesses.
- AI infrastructure, including large language models, will be provided 'as a service' with the existing **Big Three cloud providers exceptionally well positioned to extend their scale and scope of capabilities**. AI further cements the Big Three cloud providers as today's version of history's great railways and oil refineries businesses, **providing the infrastructure to support growth of modern-day business. Increased regulation will inevitably follow.**
- Nvidia's Graphic Processing Units are in a one-horse race today, dominating the industry. We expect competing technology over time.
- **Data is critical to application of AI.** Companies that control large amounts of data and can utilise this data effectively to train large language models and then infer commercial applications have significant commercial advantages.
- Social implications are complex and will require regulatory involvement.

L1 Capital International Fund

Quarterly Report | SEPTEMBER 2023

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 net of RITC
Expenses	Nil (included in Management Fee)
Benchmark	MSCI World Net Total Return Index in AUD
Performance fee	15.38% over Benchmark inclusive of GST and net of RITC*
High watermark	Yes
APIR / ISIN	ETL1954AU / AU60ETL19543
Platform availability	Asgard, Australian Money Market, BT Panorama, CFS Firstwrap, Hub24, Macquarie Wrap, Mason Stevens, MLC, Netwealth, North, Powerwrap, Praemium

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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. 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 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. L1 Capital's clients include large superannuation funds, pension funds, asset consultants, financial planning groups, family offices, high net worth individuals and retail investors. Additional information on L1 Capital is available at **www.L1.com.au**.

Key service providers for the Fund are: Responsible Entity – Equity Trustees Limited, Fund Administrator and Fund Custodian – Apex Group, Fund Auditor – EY, Legal Advisor – Hall & Wilcox. There have been no changes to key service providers since the last report.

* Fees calculated as % of the net asset value of the Fund (including GST and RITC) subject to any underperformance being recouped. There must be positive absolute performance (adjusted for distributions) in the performance period. Otherwise, positive relative performance carries forward to next Period.

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