L1 Capital International Fund

Quarterly Report | JUNE 2021

Introduction

In this quarterly report we have outlined:

- **June 2021 Quarterly Review.**
- **Positioning of the L1 Capital International Fund, including our perspectives on the current investment environment.**
- **Review of the inflation debate.**
- **An overview of Graphic Packaging, a U.S. centric global provider of sustainable paperboard-based packaging solutions to food, beverage, foodservice, and other consumer products companies. We believe the quality of Graphic Packaging's business is under-appreciated, environmental sustainability trends will drive higher revenue growth, current business initiatives will lead to a step-change in free cashflow, and the company is trading at a compelling valuation.**

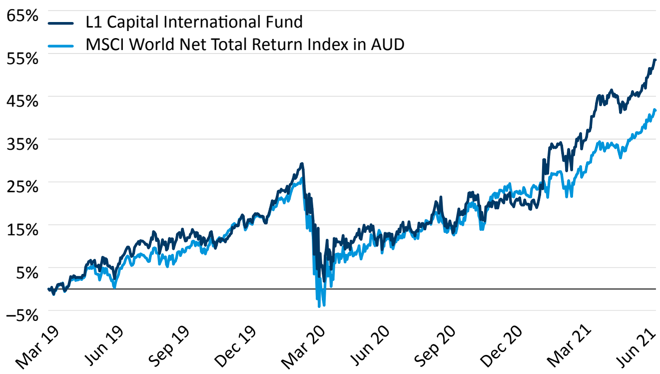
Fund Performance

Returns (Net) (%)*	Fund	Index**	Excess
1 Month	5.5	4.6	+0.9
3 Month	11.5	9.3	+2.1
1 Year	37.4	27.5	+9.9
2 Years p.a.	19.1	15.6	+3.5
Since Inception p.a.	20.2	16.1	+4.1
Since Inception – 1 March 2019	53.6	41.7	+11.9

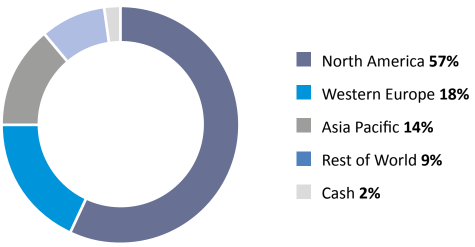
* *Figures may not sum exactly due to rounding. Past performance should not be taken as an indicator of future performance.*

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

Fund (Net) & Benchmark Returns Since Inception



Revenue Exposure By Region*

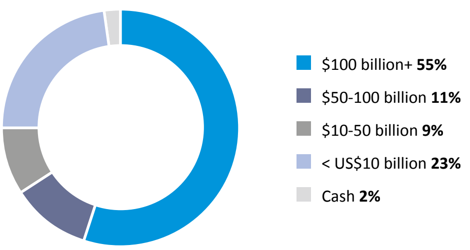


* *Revenue by region is internally estimated on a look through basis based on the underlying revenues of the individual companies held in the portfolio.*

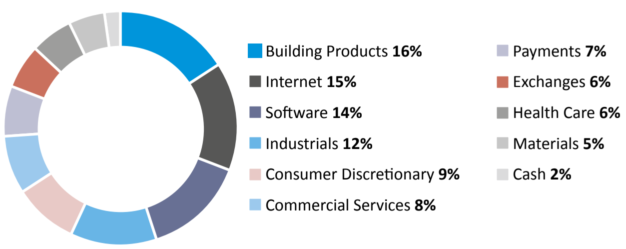
Top 10 Holdings (in alphabetical order)

Top 10 Holdings	Sector
Alphabet	Internet
Amazon	Consumer Discretionary/Internet
Eagle Materials	Building Products
Graphic Packaging International	Industrials
Intuit	Software
Iqvia	Healthcare
Louisiana Pacific	Building Products
Marsh & McLennan	Commercial Services
Microsoft	Software
TSMC	Industrials

Market Capitalisation Exposure



Sector Exposure**



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

June 2021 Quarterly Review

The L1 Capital International Fund's performance during the June 2021 quarter was strong, returning 11.5% (net of fees), outperforming the benchmark by 2.1%. For the year to 30 June 2021, the Fund returned 37.4% (net of fees), outperforming the benchmark by 9.9%.

A distribution of 9.96 cents per unit was announced for the 2020/2021 financial year with an ex-entitlement date of 30 June 2021 and payment date of 15 July 2021. Please email **L1@MainstreamGroup.com** if you wish to elect reinvestment for future distributions.

Sir Donald Bradman, the world's greatest cricketer of all time, averaged 99.94 runs per innings during his Test career, yet hit only six 6's in his total 6,996 test runs over a 20-year career. When investing, we do not "swing for the fences" either, but rather focus on building attractive risk adjusted returns over time.

Pleasingly, the contributors to the portfolio's strong returns for the June 2021 quarter were widespread. 16 companies contributed 0.25% or greater (in AUD returns) with the strongest contributors being **Alphabet**, **Amazon**, **Intuit**, **Iqvia** and **Microsoft**.

It is no coincidence that these companies are all in the portfolio's top 10 holdings. Position size is critical to overall investment returns, as is business selection. As of 30 June 2021, the portfolio consisted of 26 companies with the top 10 holdings accounting for 54.2% of the portfolio, reflecting an appropriate **balance between conviction and diversification**.

Amazon flipped from being the largest detractor from portfolio performance in the March 2021 quarter, to one of the leading contributors in the June 2021 quarter. We took advantage of negative near-term sentiment in the March 2021 quarter to add to our Amazon investment. We continue to view Amazon as one of the best positioned businesses globally, with its share price still not reflecting fair value.

Detractors to the portfolio were limited, with only one company detracting more than 0.02% from the portfolio's total returns, and no individual companies detracting more than 0.25%.

Changes to the portfolio during the June 2021 quarter were relatively modest. We added to our investments in Iqvia and Intuit, with both companies entering the top 10 holdings.

Our increased confidence in **Iqvia** reflects consistent execution across the Group including favourable Q1 2021 results.

Intuit has been part of the portfolio since inception of the Fund and was featured in the **September 2020 Quarterly Report**. In December 2020, Intuit completed the acquisition of Credit Karma for around $5 billion. Credit Karma is a consumer technology platform with more than 110 million members in the U.S., Canada and UK. Credit Karma combines technology, personal financial information and network effects to provide financial products, expertise and advice to deliver better financial outcomes to a consumer, or as the company describes it, "To unlock smart money decisions for consumers". There is the potential for significant value creation through Credit Karma becoming part of the Intuit group of businesses. Intuit aims to leverage the power of its verified income, employment, assets and identity data from TurboTax, Mint and QuickBooks combined with Credit Karma's credit and debt data to deliver a range of financial products and services such as automated online loan pre-approval letters. Early signs are promising, with Credit Karma delivering record quarterly revenue and 40% of new Credit Karma members coming from the TurboTax franchise. We believe Credit Karma will become the third pillar supporting Intuit's long-term growth, alongside QuickBooks and TurboTax.

Insight Enterprises, a previous top-ten holding, was divested in full during the quarter. In conjunction with inline Q1 2021 results, Insight announced the intention for CEO, Ken Lamneck to retire by the end of this year. A new CEO has not yet been announced. Ken Lamneck has been CEO of Insight for over 11 years and is currently 65 years old, so his retirement was not a shock. However, we do consider Lamneck to have been central to shareholder value creation, including through successful acquisitions. A period of uncertainty while leadership is transitioned to an unknown new CEO, as well as share price appreciation led us to conclude more attractive risk adjusted opportunities lay elsewhere in our Portfolio and Bench of potential investments.

Relatively minor additional changes to the portfolio were made outside the top 10 holdings. These adjustments included the divestment of the remaining shareholding in **Bytes Technology Group**. Bytes was a very successful, albeit by our standards, brief investment for the fund.

Bytes is a value-added reseller and servicer of software in the UK. We invested in Bytes when it was a newly listed, relatively unknown spin-off of a South African conglomerate. Initially Bytes was trading materially below fair value. As awareness of the company and the quality of its management team and business became appreciated by a wider range of investors, the share price increased significantly to the top end of our view of fair value. Bytes remains a high-quality business and is included in our Bench of opportunities in the event the share price falls back to more attractive levels.

The fund was **fully invested** throughout the June 2021 quarter, with cash levels ending the quarter around 2.0%. We believe our portfolio of businesses provides an attractive risk adjusted return profile based on our conservative but realistic base case scenarios with significant upside potential if our companies exceed our expectations, which they often do.

Positioning of the L1 Capital International Fund

We outlined the positioning of the Fund in the **March 2021 Quarter Report** and in our view little has changed in the operating environment for our portfolio of businesses.

When we invest in a business, our **investment horizon is usually 3 to 5 years on a rolling basis**. Many companies in today's portfolio were held by the fund at inception over 2 years ago. Changes to the portfolio have been for company-specific reasons rather than a shift in our views on the **drivers underpinning the performance of our portfolio of businesses**.

COVID-19 remains the central issue for many industries and businesses. We are all rapidly relearning the Greek alphabet. The Delta variant is certainly concerning, although current evidence suggests the COVID-19 vaccines retain high efficacy against known variants to date, albeit far from a perfect panacea. Generally speaking, the world is adapting to COVID-19 being part of life, particularly as the population's vaccine rate increases or people at least have the opportunity to receive a vaccine. Australia remains far behind the Western world in both vaccine availability and acceptance of some level of COVID-19 as part of everyday society going forward.

Our base case view remains the world is on a path to normalisation, economically and socially.

U.S. economic conditions remain remarkably strong for both consumers and businesses.

Figure 1 – U.S. residential loan charge off rates remain at 0% for the past five plus years

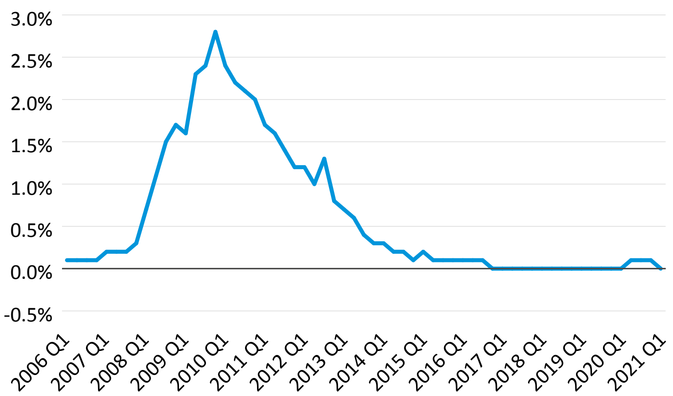
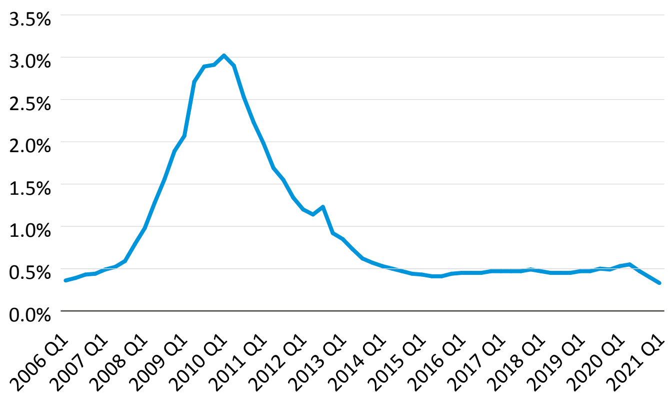


Figure 2 – U.S. commercial and industrial loans and leases charge off rates are low and continue to reduce



Source: Board of Governors of the Federal Reserve System data for all banks

Figure 3 – U.S. Household Savings Rate remains elevated

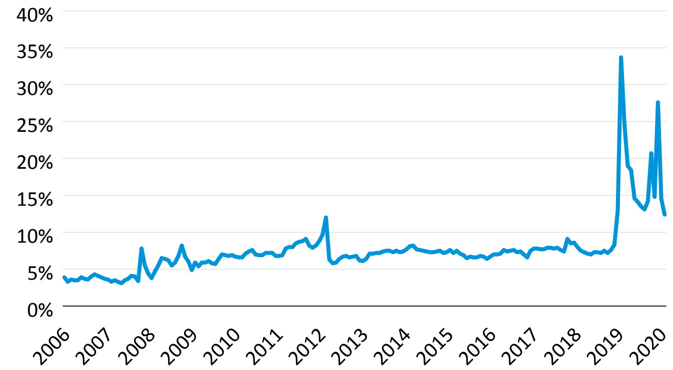
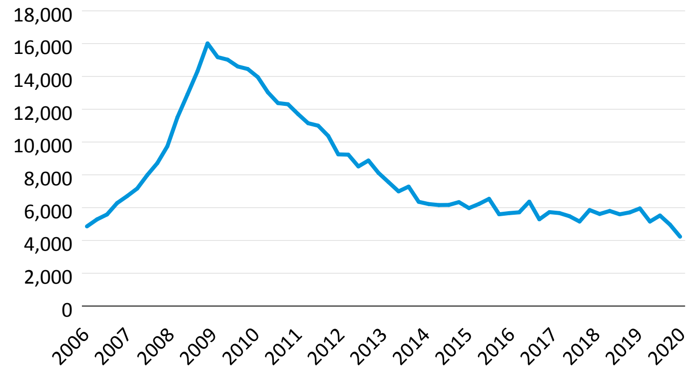


Figure 4 – New U.S. business bankruptcy cases are falling



Source: Bloomberg, Federal Reserve Economic Data, Administration Office of the U.S. Court

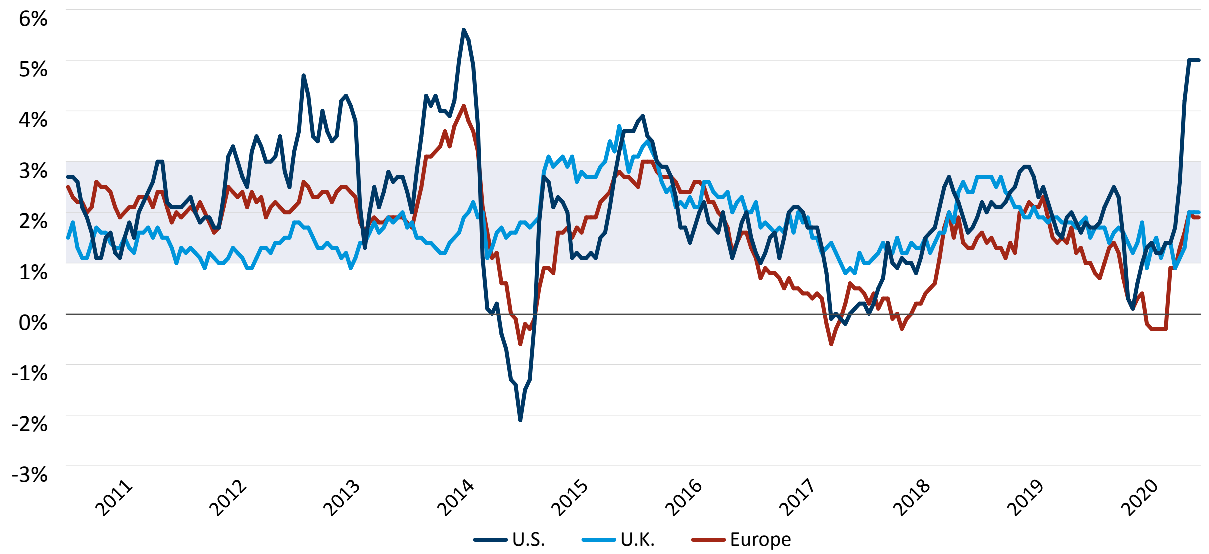
Not all human behaviour will be as it was pre COVID-19, and not all economic damage inflicted by COVID-19 will be transient. Our investment in industries and businesses remains highly selective, and we expect our portfolio of businesses to be able to perform well, **notwithstanding likely periods of uncertainty caused by COVID-19 in the future**.

Our portfolio of high quality, growing businesses remains well positioned to perform strongly in a range of operating conditions. We continue to avoid "story stocks" which lack rational valuation support or low-quality businesses which benefit from indiscriminate buying in a favourable investment environment.

The Inflation Debate

The U.S. reported inflation rate was reported at 5.0% for the year to May 2021, a sharp increase from the sub 2% rate recorded for most of the past few years. Inflation in the UK and Europe remains benign.

Figure 5 – Consumer Price Indices (Inflation)



Financial headlines blared warnings of uncontrolled inflation, stagflation and the risk of crashing equity values. The performance of equity and bond markets would suggest otherwise with the MSCI World Index reaching new highs, benchmark 10-year U.S. yields drifting lower and a relatively modest increase in long term inflation expectations priced by the bond market:

Figure 6 – MSCI World Index (in USD)

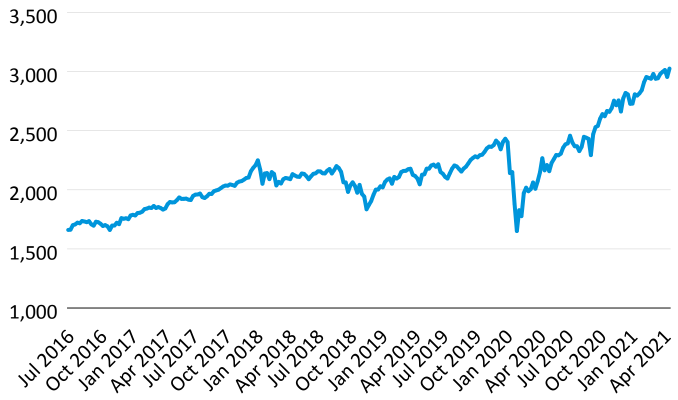
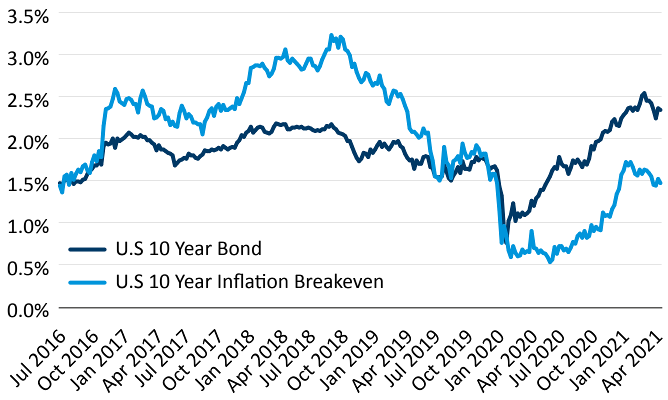


Figure 7 – U.S. interest rates and inflation expectations



Source: Bloomberg

Our central view remains the steep increase in inflation reported over recent months will be **transitory** and reflects:

- Comparisons to depressed conditions during worldwide lockdowns in early to mid-2020,
- Supply chain disruptions caused by COVID-19, and
- Temporary supply demand imbalances as both supply of and demand for some products has been distorted by COVID-19.

When you look in detail at the contributors to the recent increase in the U.S. inflation rate there were some clear **abnormal significant contributors**, such as increased prices in used cars (due to the widely reported shortage in semiconductors impacting new car manufacturing).

Structurally, we see few pressures to caused sustained inflation. By definition, structural inflation requires a sustained imbalance between supply and demand, and there are very few areas where we see the potential for these conditions to persist.

Rather, we see many factors which will continue the trend of relatively low inflation and interest rates:

- Ageing populations in many key countries globally.
- Deflationary pressures from technology.
- High level of debt incurred by households and Governments around the world, in part due to COVID-19 stimulus/mitigation efforts, which will have a magnified effect on modest increases in interest rates.
- Increased spending on services and intangible goods and experiences (like travel), after a period of elevated spending on goods due COVID-19, reducing the need for growth capital in physical goods industries.

The Federal Reserve, the European Central Bank and Bank of England have all been clear that they will err on the side of letting inflation increase above prior limits of 2% inflation when inflationary pressures are considered transitory and structural inflation remains at or below expectations/policy goals:

- ***Federal Reserve:*** "an episode of one-time price increases as the economy re-opens is not the same thing as, and is not likely to lead to, persistently higher year-over-year inflation." – Jerome Powell, 24 April 2021.
- ***ECB:*** Removing "below but close to 2%" to its 2% inflation target – "The new formulation removes any possible ambiguity, and resolutely conveys that 2 per cent is not a ceiling." – Christine Lagarde, 8 July 2021.
- ***Bank of England:*** "Inflation was "likely to exceed 3% for a temporary period." – BoE, 24 June 2021. "It is important not to over-react to temporarily strong growth and inflation, to ensure that the recovery is not undermined by a premature tightening in monetary conditions." – Andrew Bailey, 1 July 2021.

Accordingly, we expect the Federal Reserve and other Central Banks to **maintain very accommodative Monetary Policy**, even if near term reported inflation is above targeted 2% levels.

We expect the words you are going to increasingly read are a transition from **reflation** to **disinflation**. Reflation reflects current Fiscal and Monetary Policy to stimulate the economy after the acute impacts of COVID-19. Disinflation occurs when the rate of inflation slows, albeit remains positive e.g. the rate of inflation reduces from 3% p.a. to 2% p.a. We would not be surprised if the period of peak reported inflation is near if not already passed.

We do not expect deflation. A little inflation is a good thing. Average wages growth in the U.S. are recovering after a period of COVID-19 induced disruption. Some of the lowest wage sectors such as Leisure and Hospitality and Retail have had slightly higher than average wage growth, particularly recently:

U.S. Average Hourly Earnings

Figure 8 – Consistent c. 3% annual average hourly wage growth

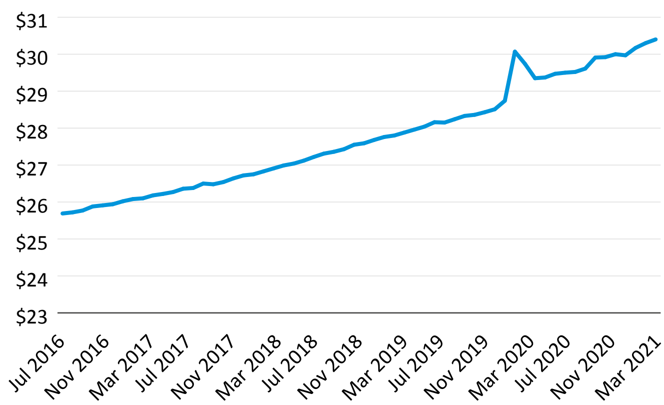
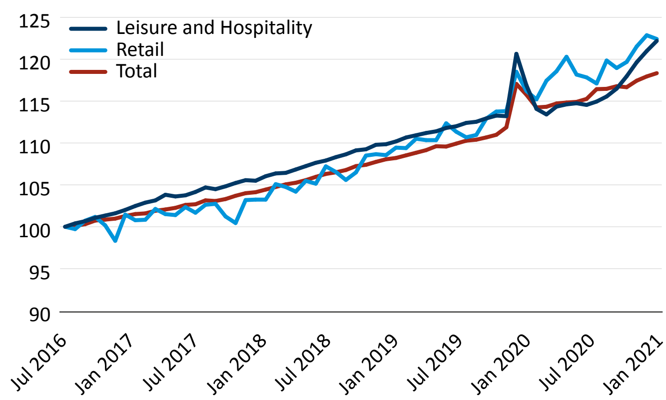


Figure 9 – Low-income sectors have demonstrated stronger wage growth recently



Source: U.S. Federal Reserve Economic Data

Portfolio Investment – Graphic Packaging International ("Graphic Packaging").

Have you ever raced back from the shops, jumped on the couch with your favourite box of biscuits or six pack of beer, ripped open the packaging and looked under the glued down tabs with mixed feelings of excitement and anticipation to see which company made the box? Probably not. However, if your couch were located somewhere in the United States you would have around a 40% chance of seeing Graphic Packaging's logo on the packaging. Soon you will have an increasing chance of having this experience in Europe, and you even have a small possibility of coming across Graphic Packaging in Australia. Welcome to the thrilling world of paperboard-based packaging.

While some might find packaging companies boring, we consider the investment case quite exciting. Graphic Packaging satisfies all our requirements for a high-quality company, and is **trading at a compelling valuation for investors with a multi-year investment time horizon**:

- Market leading position in the U.S. with only one key competitor.
- Stable demand for its products from many of the world's leading food, beverage, food service and other consumer products companies.
- Benefits from an ongoing shift to sustainable packaging as consumers and companies recognise the environmental issues associated with plastic packaging.
- Experienced, operationally focused management who continue to invest in the company's facilities to strengthen competitive advantages and improve financial performance.
- Vertically integrated, which means Graphic Packaging converts 70% of the paperboard it manufactures into the completed printed packaging product, providing increased stability and improved investment returns.
- Earnings and cashflow are expected to increase materially over coming years as the benefits of strategic initiatives, many years in the making, come to fruition.

Product range

Graphic Packaging manufactures a range of products you don't think twice about, and when you are done with the food or beverage, you recycle (hopefully) or throw away the packaging without a further thought. Increased demand for sustainable packaging is supporting growth and an expansion in Graphic Packaging's addressable markets:

Figure 10: Graphic Packaging's addressable market and platform enablers

Source: Graphic Packaging

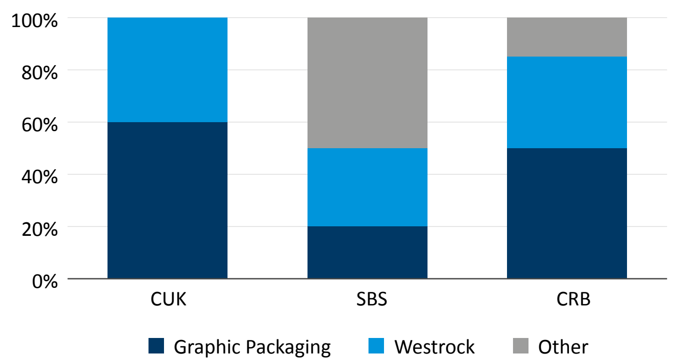
Highly consolidated, "Noah's Ark" industry structure

Graphic Packaging manufactures three substrates or types of paperboard in the United States:

- Coated Unbleached Kraft (CUK), used in beverage packaging,
- Solid Bleached Sulfate (SBS), used in frozen food and pharmaceutical packaging, and
- Coated Recycled Board (CRB), used in products such as cereal boxes.

Market share is illustrated in the graph below. The industry is dominated by Graphic Packaging and Westrock. Westrock also produces corrugated boxes which is a completely separate segment of the packaging industry:

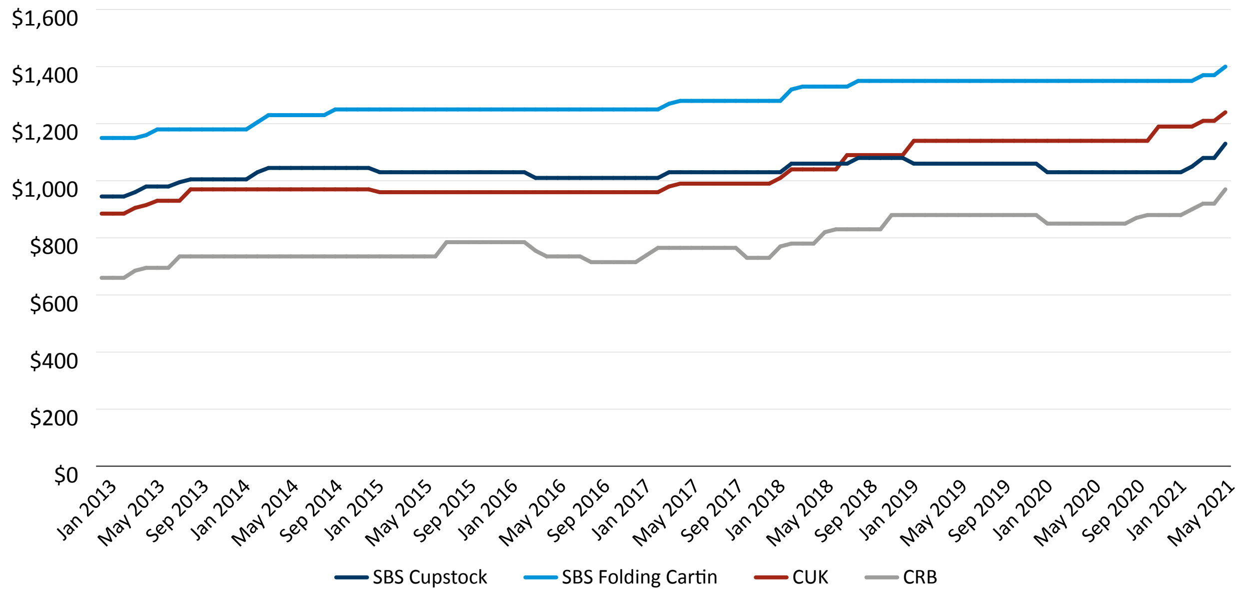
Figure 11 – Graphic Packaging market share by product segment



Source: Jefferies, L1 Capital International estimates

A well-structured industry leads to rational industry pricing.

Figure 12 – Paperboard packaging prices



Source: Risi, Morgan Stanley and L1 Capital International. Price per tonne

Management continues to implement a sensible strategy to improve its market position and increase vertical integration through a series of **bolt-on acquisitions** in the United States. We expect these acquisitions to be synergistic and boost Graphic Packaging's earnings and cashflow.

Sustainability trends and product innovation driving market share gains and an expanded addressable market

KeelClip™, **Paperseal®** and **ProducePack™** are innovative products with environmental benefits, shifting packaging away from plastic, and which will support further growth in Graphic Packaging's addressable market and earnings. Next time you go into the supermarket you will see the higher quality cuts of meat are packaged on a Graphic Packaging Paperseal™ tray, rather than a plastic tray. In time your strawberries may be packaged in a paperboard-based ProducePack™. Graphic Packaging estimates there is a **$5 billion opportunity to convert North America and European packaging from plastic and foam to paperboard**.

Figure 13 – KeelClip™

Figure 14 – Paperseal®

Figure 15 – ProducePack™

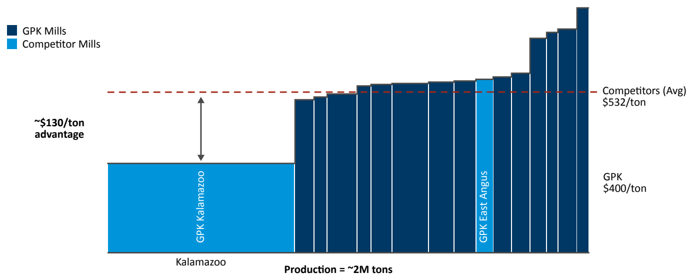
Source: Graphic Packaging

Continued operational investment providing strategic and financial benefits

Graphic Packaging is **finalising a $600 million investment** in a new efficient CRB mill, located next to its existing major CRB mill. In conjunction with this investment, Graphic Packaging is closing down four smaller, older, less efficient mills. While net total capacity will not increase, Graphic Packaging's average cost of production will fall dramatically, providing a **substantial $100 million cost benefit**. The financial benefits will be partially reflected in Graphic Packaging's 2022 financial results and should be fully recognised by 2023.

Figure 16 – New CRB mill, consolidating 4 mills into 1

Figure 17 – $100m earnings benefit over the next 2 years



Source: RISI, Graphic Packaging

Major acquisition in Europe

In May 2021, Graphic Packaging announced the acquisition of AR Packaging for $1.45 billion. This acquisition transforms Graphic Packaging from a niche participant to the number 2 position in the European folding carton market.

In addition to financial benefits, Europe is at the leading edge of adoption of more environmentally friendly packaging. We expect there will be meaningful benefits introducing best in class products across the expanded global Graphic Packaging business.

Figure 18 – Graphic Packaging and AR Packing locations in Europe

Source: Graphic Packaging

Seasoned Management Team

Michael Doss, President and CEO, leads **an experienced, focused management team**. Doss has been CEO for the past 5 years, having spent over 30 years with the company. Under his leadership, Graphic Packaging has implemented a consistent and clear strategy to improve the quality of the company's operations and market positions and deliver increasing shareholder returns. Incentive compensation is well structured, based on an appropriate mix of KPIs centred on earnings growth, cashflow and return on invested capital.

Business economics to inflect as strategic initiatives come to fruition

We expect Graphic Packaging's earnings and free cashflow to increase materially over coming years as acquisitions are completed and integrated, the new CRB mill reaches capacity, and new environmentally friendly products gain market share.

Figure 19 – Significant revenue and EBITA growth

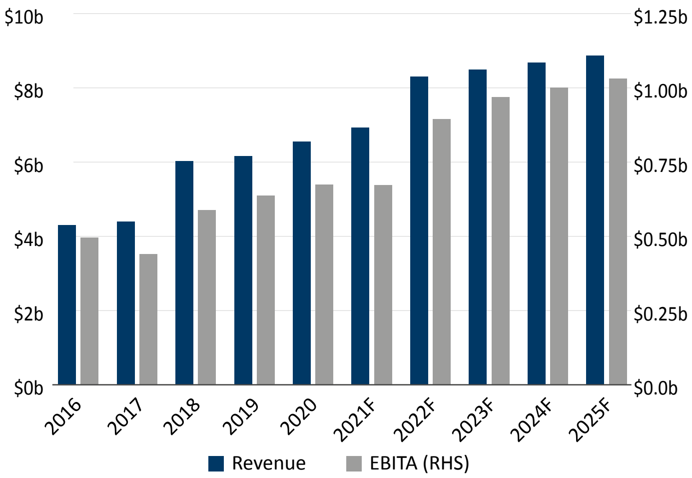


Figure 20 – Margins increasing, debt reducing

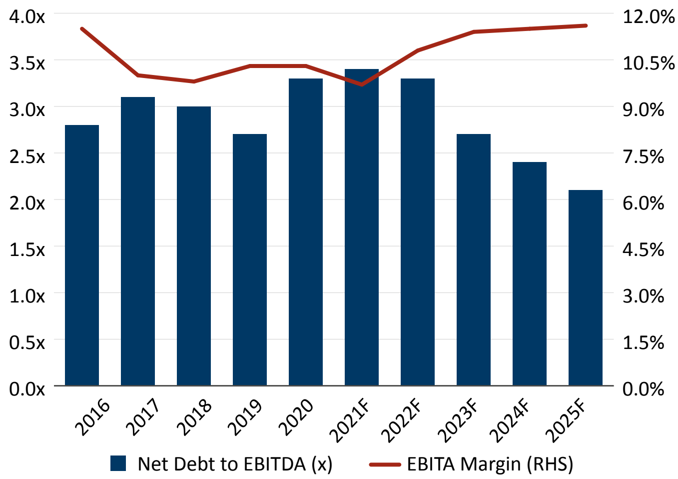


Figure 21 – Improving Return on Invested Capital and Equity

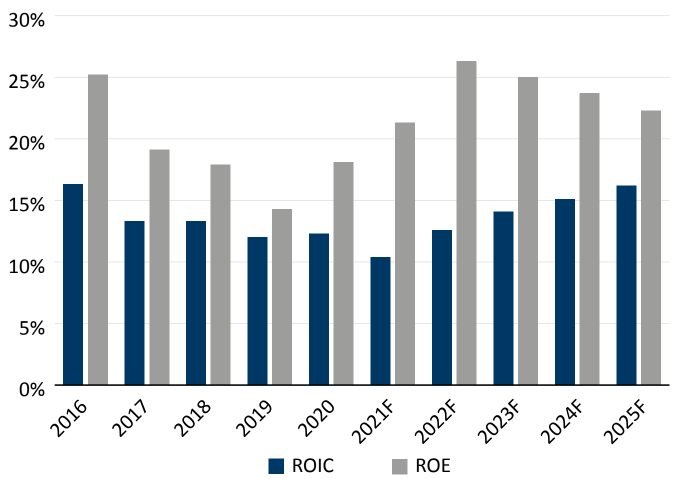
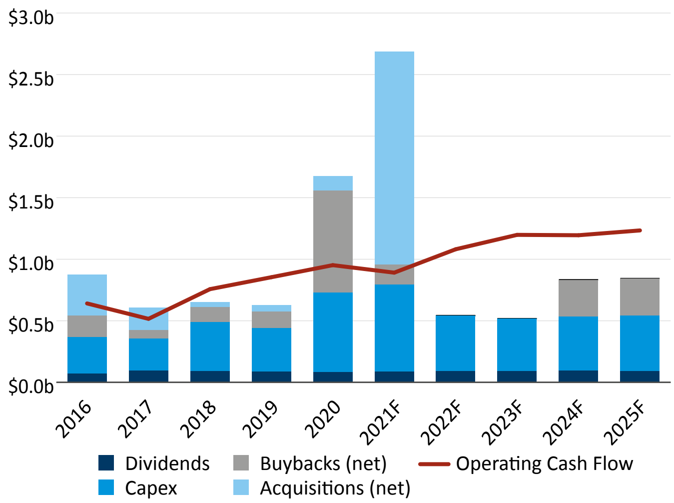


Figure 22 – Strategic value accretive acquisitions and investments



Source: Graphic Packaging, L1 Capital International

Compelling valuation

We assign a Quality Rating of 3 (Good) based on L1 Capital International's quality rating system. While Graphic Packaging has leading market positions and operates in a stable demand industry, its customers are some of the largest multinational food and beverages companies which have powerful negotiating positions. Overall revenue growth rates are low single digit and raw material inflation is likely to pressure margins near term before contract pricing increases take effect.

Management has a long track record of operating success and integrating acquisitions, but they still need to deliver the expected financial benefits from the current investment in the new CRB plant and the European acquisition. Graphic Packaging has one of the highest leverage ratios of all businesses in the L1 Capital International Fund, although we consider debt levels comfortable reflecting consistent, growing cashflows. Gearing should rapidly reduce over coming years.

Graphic Packaging's share price has increased meaningfully since our initial investment. However, we believe the **share price is still below fair value**. It is necessary to look forward a few years when recent acquisitions and growth initiatives will be fully reflected in Graphic Packaging's earnings and cashflow. **Based on our forecasts, Graphic Packaging is trading on a 2023F PE of 9x, and around 14% free cashflow yield. We consider these valuation metrics compelling given the quality and stability of Graphic Packaging's business.**

L1 Capital International Fund

Quarterly Report | JUNE 2021

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.*
High Watermark	Yes
APIR	ETL1954AU
Platform Availability	Hub24, Macquarie Wrap, Mason Stevens, Netwealth, Powerwrap, Praemium

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

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L1 Capital 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 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**.

* There must be positive absolute performance (adjusted for distributions) in the performance period. Otherwise positive relative performance carries forward to next Period.