L1 Capital Catalyst Fund

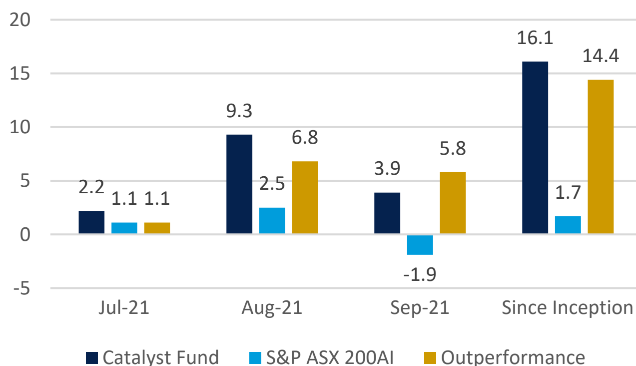
Quarterly Report | SEPTEMBER 2021

L1 Capital Catalyst Fund is a best ideas, high conviction fund with an activist overlay that focuses on unlocking value in Australian companies to achieve private equity-style returns. This long-only Fund combines the strategic advisory expertise of a dedicated Catalyst team with the L1 Capital Australian Equities team's investment management and stock selection capability. The Fund will invest in up to 10 companies at any one time, ensuring the team's expertise is fully directed to catalysing the changes that have the greatest potential to deliver value to shareholders.

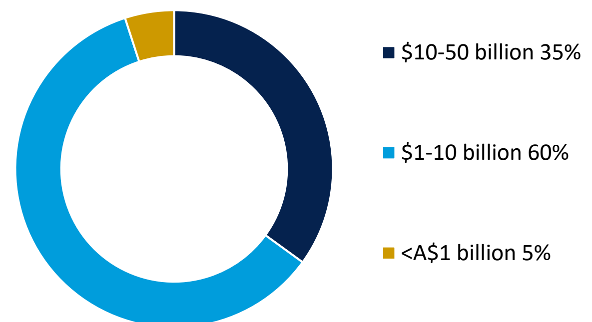
Performance

Returns (Net)[1] (%)	Catalyst Fund	S&P ASX 200 AI	Out-performance
1 month	3.9	-1.9	+5.8
3 months	16.1	1.7	+14.4
Since Inception	16.1	1.7	+14.4

Returns Chart (Net)[1] (%)



Market Capitalisation Exposure (%)



Exposure by Catalysts

	Strategic E.g., Opportunity to restructure the business.	Financial E.g., Opportunity to increase leverage to buyback undervalued shares.	Operational E.g., Opportunity to improve EBITDA margins through a cost out program.	Governance E.g., Opportunity to expand and diversify the Directors on the Board.
Stock 1	✓			
Stock 2		✓		
Stock 3	✓			
Stock 4			✓	
Stock 5	✓			
Stock 6				✓
Stock 7		✓		
Stock 8		✓		
Stock 9			✓	
Stock 10			✓	

[1] *All performance numbers are quoted net of fees. Figures may not sum exactly due to rounding. Inception date: 1 Jul 2021. Past performance should not be taken as an indicator of future performance.*

Portfolio Thematics

Given the nature of the Catalyst strategy, there are often thematics that underpin and drive portfolio construction. This quarter, we explore three key thematics.

1. Unlocking the embedded value of property and infrastructure/infrastructure-like assets

The significant appetite for acquiring property and infrastructure assets in recent months, particularly by private market investors, is being driven by historically low risk-free rates coupled with significant dry powder from infrastructure funds, property funds and super/pension funds. Furthermore, many listed companies are carrying material property and/or infrastructure assets on their balance sheets, which public equity markets are yet to fully value. Such assets can provide corporates with the opportunity to unlock embedded value without engaging in corporate activity, which is often executed by partnering with external investors. Two recent examples include:

- Telstra's Towers transaction, which saw the corporate sell a 49% interest to a consortium led by the Future Fund; and
- The Star Entertainment Group's consideration of a sale of a 49% interest in its Sydney casino.

The corporate M&A boom that has been gaining momentum since the beginning of the year shows that company management and boards are also looking externally. In somewhat of a self-fulfilling cycle, the more M&A activity, the more cognisant management become of the potential threats and opportunities that exist to unlocking latent value in their own company. The realisation that if management do not proactively make positive changes themselves, someone else may decide to do it for them. For at least the near to medium term, M&A is fuelling the acceleration of this theme.

See page 4 for further details on our views on the emerging M&A super-cycle.

2. Opportunities and risks from the reopening of Australia

As many of us are acutely aware from personal experience, Australians have been locked down, particularly in the country's most populous states of New South Wales and Victoria, for many months. Having had a brief taste of near-pre-COVID existence earlier in the calendar year, individuals, businesses and society at large could not be more keen to resume some semblance of normality. Our deep research into the path to reopening has highlighted some outstanding opportunities for gaining exposure to companies that have very attractive potential return profiles as Australia reopens and re-emerges from the pandemic.

Taking the United States as an example, many sectors of the economy are seeing greater consumer demand and business activity since the start of the reopening. We expect a similar trajectory in some Australian sectors once we reopen, with a key driver being significant pent-up demand from consumers. This will create complexity for corporates, which in some cases will need to go from being completely shut, to dealing with demand greater than they experienced prior to the pandemic. Those corporates that are most nimble and focused on making the most of the reopening are going to be best positioned to embark on strategic initiatives as we move into calendar year 2022. Those corporates that are not nimble and struggle to manage the expected reopening demand will start 2022 on the back foot and could be ripe targets for corporate activity.

When international borders reopen and Australia slowly re-connects with the rest of the world, Australian corporates may have to contend with foreign bidders, many of whom want to meet management in person and need to do physical in person due diligence. Thus far in 2021, foreign bidders have made up approximately one third of total deal value, down from the approximate two third average over the previous five-year period.

3. Leverage

Many listed Australian corporates have strong balance sheets following significant government support combined with pre-emptive capital raisings and reduced dividends during the first leg of the pandemic in 2020. In addition, record low risk-free rates have resulted in lower cost of borrowing. In combination, these facts mean that many listed Australian corporates have opportunities to execute share buy-backs, should they deem their share prices to be undervalued. In addition, unlisted investors such as private equity funds, super funds and pension funds may choose to take listed companies private through public-to-private transactions. Such deals often result in more leveraged company balance-sheets given the private sphere typically has a much higher tolerance for leverage than exists in the public markets.

Stock Spotlight | Z Energy

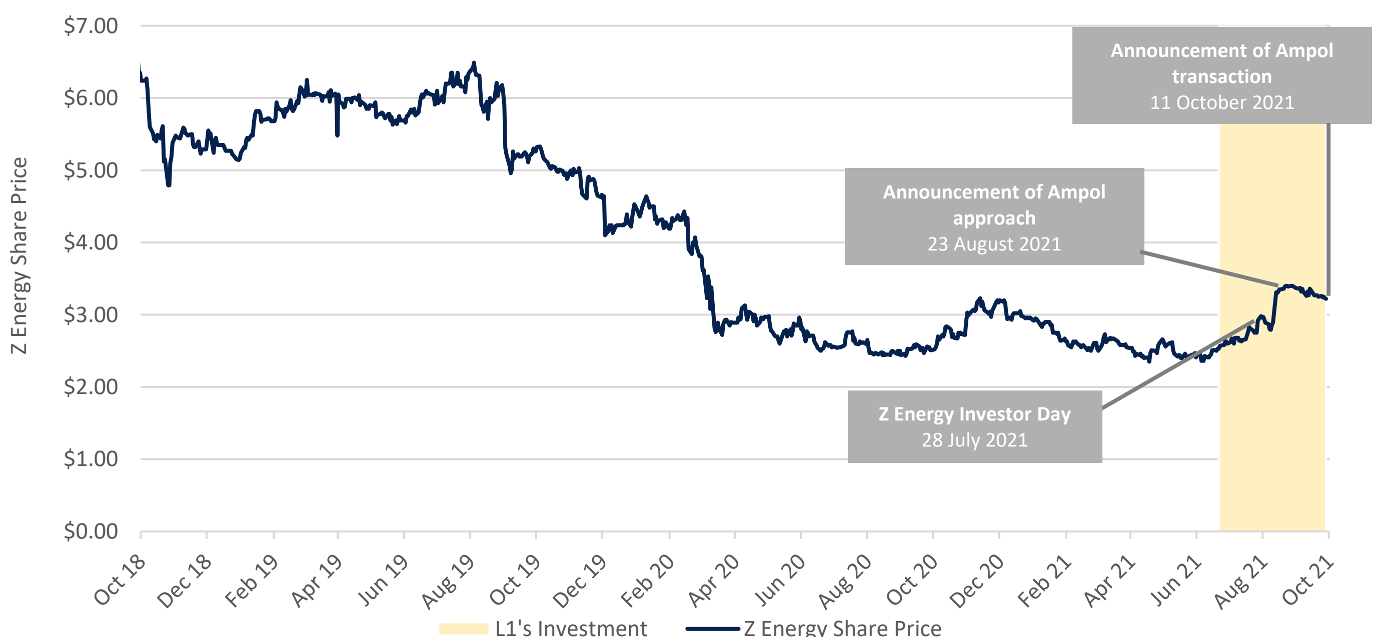
Z Energy is the dominant fuel distributor in New Zealand with circa 200 Z-branded fuel stops and 133 Caltex-branded service stations country-wide. During late August, Z Energy announced that it had received a NZ$3.78 per share bid from Ampol – a 35% premium over the Z Energy share price before the market began speculating it was a takeover target (26 July) – and had agreed to a four week (which was subsequently increased to six weeks) due diligence/exclusivity period. On 11 October, Z Energy announced that it had entered into a binding Scheme Implementation Agreement ("**SIA**") with Ampol. Pursuant to the SIA, Z Energy shareholders would receive NZ$3.78 per share and also receive NZ$0.05 per share of the interim FY22 dividend, payable in December, without adjusting the cash offer price.

Typical company weights in the Catalyst Fund are around 10% of the total portfolio, but the Fund's position in Z Energy was notably higher based on a strong investment case at the time of investment in July:

- **Quality:** Asymmetric risk/return profile from the high-quality, lowly-geared business and strong market position (~200 Z-branded fuel stops and 133 Caltex-branded service stations across NZ),
- **Value:** Undemanding valuation with a clear strategy to grow future earnings – committed to a 19 cents p/s dividend "in all conditions" (i.e., ~7% dividend yield at L1's average acquisition price), and
- **Catalysts:** Working capital release through converting the New Zealand Oil Refinery into an import oil terminal and through putting selected land and buildings into a REIT. Also, when we first invested, takeover potential was an embedded 'free option' that had not yet been priced in.

L1 Capital had encouraged Z Energy to communicate the strategic value of its assets to the market, which we believe the company did well at its Investor Day on 28 July. We have seen how the clear articulation of the strategic value of Z Energy's assets as well as explaining how it intends to grow future earnings have helped lift its share price post the Investor Day in advance of it receiving the takeover offer with the embedded control premium from Ampol.

Figure 1: Share price of Z Energy



Source: Bloomberg, L1 Capital.

Key drivers underpinning the Emerging M&A Super-cycle

Since early 2021, we have had the view that we have entered a new Mergers and Acquisition (M&A) super-cycle. As we outlined in our **August 2021 Investment Insights** piece, we believe this backdrop is likely to accelerate equity returns for investors in companies that are the beneficiaries of corporate activity.

What is underpinning this current wave of M&A deal flow?

It is often stated that there are five drivers of a successful, active M&A market[3].

Present in the 2021 M&A Super-cycle?

- ☑ Economic recovery
- ☑ Flourishing capital markets
- ☑ Structural regulatory changes
- ☑ Industrial and technological innovation
- ☑ Need for companies to adapt to changes in the economic environment

Let's explore each driver against the current backdrop.

Economic recovery

During the start and through the peak of the pandemic, many corporates were focused first and foremost on ensuring they could conduct 'business as usual', which created a backlog of M&A deals. Coming into calendar year 2021:

- Businesses had bedded down their new ways of working,
- Vaccine availability in Australia was on the horizon,
- The decision by corporates to conduct pre-emptive capital raisings and reduce dividends during the initial stages of the pandemic in 2020 meant balance sheets were strong,
- Widening valuation differentials between low-growth industrials stocks and assets with infrastructure like characteristics,
- Governments and central banks globally were stimulating their economies, and
- Strong Global GDP growth in excess of historical levels was emerging.

These factors contributed to much improved business confidence that a strong economic recovery was going to become a reality and reignited the appetite of business leaders to explore strategic deals.

Flourishing capital markets

Capital markets are strongly supportive of M&A at present. With 10-year Treasury yields at historical lows, the access to cheap and readily available debt is a significant enabler of M&A activity. In equities, many company share prices have rebounded since the March 2020 sell-off. Furthermore, private equity globally and SPACS (Special Purpose Acquisition Companies) which have been going public in large numbers in the US, are both substantial pools of capital that must be deployed in order to generate fees. Private equity in the Asia Pacific region alone, has approximately US$327 billion of funding waiting to be deployed[4]. Finally, superannuation funds and infrastructure funds continue to demonstrate a strong appetite to pursue public-to-private transactions, particularly in the infrastructure and property sectors.

[3] *'M&A Activity: Where Are We in the Cycle?', CAIA Perspective.* [4] *'Dealmakers Down Deals Second Quarter M&A Frenzy', Reuters*

Structural regulatory changes

In early September, the Australian Competition and Consumer Commission (ACCC) announced a sweeping set of proposed reforms to the mergers test and ACCC approval regime. The reforms seek to consolidate the current multiple approval methods under a single formal merger review process. Any changes will take some time to implement as the Treasury considers the proposals and the Government tests the implications before planning and putting change into motion. However, this window of time prior to the new regime is a powerful incentive for senior executives to bring forward current planned deal activities to avoid a more onerous process. This provides the M&A upswing with further support across the near and medium term.

Industrial and technological innovation

The onset of the COVID-19 pandemic put pressure on most sectors in the economy, re-shaping the way they operate and bringing forward decisions on corporate strategy and industry consolidation. Many companies and sectors have had to embrace technology in an effort to adapt, with this recalibration presenting alternative methods for operating. The retail and consumer sectors, for example, had to swiftly move in many cases wholly to an online model with significant enhancements to product display and descriptions online, click and collect services, and delivery capabilities.

Need for companies to adapt to changes in the economic environment

ESG considerations as they relate to business models and practices are also reshaping the economic environment and sparking M&A deal flow. A recent example of this would be BHP electing to divest its energy business and sell it to Woodside. Long-term momentum driven trends such as ESG are driving corporate activity, particularly in coal and other carbon intensive industries, as well as more broadly.

M&A deal flow creating Catalyst opportunities

We believe the 2021 M&A super-cycle provides a rich opportunity set and a tailwind for fundamental stock-picking. In a market environment that is more conducive to M&A, capital is typically more readily available and there is a higher velocity of potential business combinations. In turn, as the higher volume of corporate activity occurs, company managements and boards become more cognisant of the potential for unlocking value in their own or other companies, as they realise that if they do not proactively make positive changes in their organisation, someone else may decide to do it for them.

In this way, a strong M&A environment can cause companies to become more receptive to change, which could manifest itself in more openness to bidding for or accepting external M&A deals or for proactively making internally-driven strategic changes to defend or strengthen their businesses. As such, this market backdrop provides a rich set of strategic options for prospective buyers of companies or assets, and more rapid, easier and higher certainty of deal execution. Each of these aspects of an upswing in the M&A super-cycle enriches the opportunity set for stock selection and is very supportive for the new L1 Capital Catalyst Fund, which launched on 1 July 2021.

Investment strategy

- Combines high conviction, bottom-up stock picking with an activist approach to unlock major share price upside.
- Invests in a concentrated portfolio, allowing the L1 Catalyst team to focus on value-adding initiatives with the management and boards of each company in the portfolio.
- Benefits from L1 Capital's scale and relationships which enables the Catalyst Fund to be a major shareholder and to therefore have influence with company management and boards.
- Seeks to improve ESG outcomes, in particular enhancing corporate governance to make long-term structural improvements and protect shareholder interests.
- Strong alignment through the L1 Capital investment team's significant investment in the Fund alongside investors.

Research house ratings

We are please to share that Zenith Investment Partners and Lonsec have both initiated coverage of the L1 Capital Catalyst Fund, each awarding the Fund a 'Recommended' rating.

Zenith Rating[5]

Zenith notes: "We draw confidence from the high calibre of personnel and longstanding investment process that will be leveraged for the management of the Fund. We note that the holdings in the Fund will typically be a highly concentrated subset of L1 Capital's strategies, which have strong longer-term track records."

Lonsec Rating[6]

Lonsec notes: "The Fund seeks to deliver private equity-style returns with listed market liquidity by taking a hands-on 'owners mind-set' approach to each investment. The owners mind-set is anchored in constructive engagement with companies, driving the realisation of positive change by bringing strategic options, new ideas and thinking to company boards and management."

[5] The Zenith Investment Partners (ABN 27 103 132 672, AFS Licence 226872) ("Zenith") rating (ETL1293AU, September 2021) referred to in this document is limited to "General Advice" (s766B Corporations Act 2001) for Wholesale clients only. This advice has been prepared without taking into account the objectives, financial situation or needs of any individual and is subject to change at any time without prior notice. It is not a specific recommendation to purchase, sell or hold the relevant product(s). Investors should seek independent financial advice before making an investment decision and should consider the appropriateness of this advice in light of their own objectives, financial situation and needs. Investors should obtain a copy of and consider the PDS or offer document before making any decision and refer to the full Zenith Product Assessment available on the Zenith website. Past performance is not an indication of future performance. Zenith usually charges the product issuer, fund manager or related party to conduct Product Assessments. Full details regarding Zenith's methodology, ratings definitions and regulatory compliance are available on our Product Assessments and at http://www.zenithpartners. com.au/RegulatoryGuidelines

[6] The rating issued October 2021 is published by Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL 421 445 (Lonsec). Ratings are general advice only and have been prepared without taking account of your objectives, financial situation or needs. Consider your personal circumstances, read the product disclosure statement and seek independent financial advice before investing. The rating is not a recommendation to purchase, sell or hold any product. Past performance information is not indicative of future performance. Ratings are subject to change without notice and Lonsec assumes no obligation to update. Lonsec uses objective criteria and receives a fee from the Fund Manager. Visit lonsec.com.au for ratings information and to access the full report. *© 2020 Lonsec. All rights reserved.*

Fund information

Fund / Class Name	L1 Capital Catalyst Fund – Retail Class
Structure / Currency	AUD
Investment Approach	The Investment Manager seeks to deliver private equity-style returns with listed market liquidity by taking a hands-on "owner's mindset" to each investment in a tightly focused portfolio of up to 10 companies.
Investment Objective	To deliver strong positive risk adjusted returns over the long term.
Benchmark	S&P/ASX 200 Accumulation Index
Minimum Investment	$25,000
Management Fee	1.28% p.a.
Performance Fees	20.5% over benchmark, subject to any underperformance being recouped
Vehicle	Australian Unit Trust
Launch Date	1 July 2021
Platform Availability	Netwealth, Hub24, Praemium, Mason Stevens, HSBC, Macquarie Wrap

James Hawkins, Partner and Head of L1 Capital Catalyst Fund

The Catalyst Fund is headed by James Hawkins, who has over 20 years of professional experience advising boards and management. Prior to joining L1 Capital in 2021 James spent nearly ten years at Flagstaff Partners, where he was a Managing Director that originated and executed M&A, equity and debt transactions.

Prior to that, James worked at Macquarie Capital in Melbourne and New York where he was involved in a wide range of principal investments and investment banking transactions. Before that, James began his career as a solicitor at Clayton Utz. James is a generalist with experience covering a range of sectors including industrials, gaming, infrastructure, retail, education, mining services and financial services. James holds a double degree in Law and Commerce from Monash University, with Honours in Law.

Team update | Appointment of Benjamin Ng, Senior Investment Analyst

B.Com & Info Sys, (Accounting and Finance), MBA

Benjamin joined the L1 Catalyst Team as a Senior Investment Analyst in October 2021. Prior to joining L1, Benjamin spent over 10 years at management consultancy Bain & Company, based in Melbourne and London. He was an Associate Partner, focused on strategy and large-scale transformations, executing both growth and cost initiatives. Benjamin was also a leader in the Private Equity Group, supporting financial investors and corporate clients on commercial and operational due diligences.

Prior to that, Benjamin spent three years at J.P. Morgan in the Investment Banking team based in Melbourne, covering the Consumer and General Industrials sectors. He holds a Bachelor of Commerce and Bachelor of Information Systems from the University of Melbourne, and an MBA from London Business School.

L1 Capital | Overview

L1 Capital is a global investment manager with offices in Melbourne, Sydney, Miami and London. The business was established in 2007 and is 100% owned by its senior staff, led by founders Raphael Lamm and Mark Landau. The team is committed to offering clients best of breed investment products through strategies that include long only Australian equities, long short equities, international equities, activist equities, a global multi-strategy hedge fund and U.K. residential property. The firm has built a reputation for investment excellence, with all L1 Capital's strategies delivering strong returns since inception versus both benchmarks and peers. The team remains dedicated to delivering on that strong reputation through providing market-leading performance via differentiated investment approaches with outstanding client service, transparency and integrity. L1 Capital's clients include large superannuation funds, pension funds, asset consultants, financial planning groups, family offices, high net worth individuals and retail investors.

Contact Us

Chris Clayton
Head of Distribution
M: + 61 417 279 183
E: **cclayton@L1.com.au**

Aman Kashyap
Investment Specialist
M: +61 477 341 403
E: **akashyap@L1.com.au**

Alexander Ordon
Investment Specialist
M: +61 413 615 224
E: **aordon@L1.com.au**

Wayne Murray
Investment Specialist
M: + 61 424 300 003
E: **wmurray@L1.com.au**

Alejandro Espina
Investment Specialist
M: + 61 423 111 531
E: **aespina@L1.com.au**

Level 28, 101 Collins Street
Melbourne VIC 3000 Australia

www.L1.com.au

Information contained in this publication

Equity Trustees Limited ("Equity Trustees") (ABN 46 004 031 298), AFSL 240975, is the Responsible Entity for the L1 Capital Catalyst Fund ARSN 650 484 263. Equity Trustees is a subsidiary of EQT Holdings Limited (ABN 22 607 797 615), a publicly listed company on the Australian Securities Exchange (ASX: EQT).

This publication has been prepared by L1 Capital Strategic Equity Management Pty Limited (ACN 648 751 928), (an authorised representative (no. 1286013) of L1 Capital Pty Ltd (ACN 125 378 145, AFSL 314 302)) and its officers and employees (collectively "L1 Strategic"), to provide you with general information only. In preparing it, we did not take into account the investment objectives, financial situation or particular needs of any particular person. It is not intended to take the place of professional advice and you should not take action on specific issues in reliance on this information. Neither L1 Strategic, Equity Trustees nor any of its related parties, their employees or directors, provide any warranty of accuracy or reliability in relation to such information or accepts any liability to any person who relies on it. All performance numbers are quoted after fees. Past performance should not be taken as an indicator of future performance. You should obtain a copy of the Product Disclosure Statement before making a decision about whether to invest in this product.

Copyright

Copyright in this publication is owned by L1 Strategic. You may use this information in this publication for your own personal use, but you must not (without L1 Strategic's consent) alter, reproduce or distribute any part of this publication, transmit it to any other person or incorporate the information into any other document.