# L1 Capital Catalyst Fund

Quarterly Report | MARCH 2023

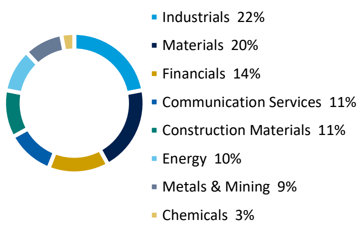
- **During the March quarter, the L1 Capital Catalyst Fund returned 6.9%[1] (ASX200AI 3.5%).**
- **Since inception the L1 Capital Catalyst Fund has returned 14.8%[1] p.a. (ASX200AI 3.5% p.a.).**
- **Outperformance over the quarter was driven by strong portfolio company trading updates, positive movements in select commodities which portfolio companies have exposure to and the Catalyst Fund having no direct exposure to the banking sector, which underperformed following the collapse of several banks in the U.S. and Europe.**
- **Funds under management ('FuM') in the L1 Capital Catalyst Fund is now above $1bn, with total FuM across L1 Capital's Australian equities portfolio of ~$4bn. This gives us the ability to be an investor of scale and drive value creation across the Catalyst portfolio companies.**

Global equity markets performed well during the March quarter. The S&P 500 (+7.5%) had its strongest start to the calendar year since 2019, as slowing inflation and stress in the global banking sector bolstered expectations of a moderation to the rate-hiking cycle. During the quarter, the U.S. Federal Reserve raised the federal funds rate by a further 50bps, a deceleration compared to the 125bps in the December 2022 quarter. Domestically, the RBA increased the cash rate a further 50bps, but subsequently at its April meeting, elected not to increase the cash rate for the first time since April 2022.

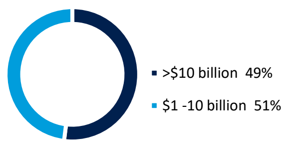
Stress emerged in the global financial system as a result of liquidity issues due to the rapid increase in interest rates, most notably with the collapse of the Silicon Valley Bank (the U.S.'s 16th largest bank), and the regulator-induced acquisition of Credit Suisse by UBS. Against this backdrop, there was a resurgence in many of the underperformers from 2022, most materially being the 'mega-cap' technology names, which rose +21.7%[2] during the quarter, as medium-term interest rate expectations moderated and funds flowed towards relative safety and to companies with low gearing.

| Returns (Net)[1] (%) | Catalyst Fund | ASX 200AI | Out-performance |
|---|---|---|---|
| **3 months** | 6.9 | 3.5 | +3.4 |
| **6 months** | 16.0 | 13.2 | +2.8 |
| **12 months** | 4.7 | 0.1 | +4.6 |
| **Since inception (p.a.)** | **14.8** | **3.5** | **+11.3** |
| **Since inception (cum.)** | **27.4** | **6.3** | **+21.1** |

**Sector exposure (%)**




**Market cap exposure (%)**




The ASX200AI rose 3.5% in the quarter with 'quality' factors outperforming as investors sought to moderate risk in the context of global volatility. The 'big 4' domestic banks were the largest negative contributors to the ASX200AI performance. Notable positive contributors included iron ore, as Chinese economic activity rebounded following the end to its zero-COVID policy, and gold, benefiting in part from a flight to safety. The strongest sectors were Consumer Discretionary (+11.4%), Communication Services (+9.4%) and Information Technology (+8.1%), whilst Financials (-2.7%) and Energy (-1.0%) lagged.

## Portfolio exposures by primary catalyst as at 31 March 2023

| | Strategic | Financial | Operational | Governance |
|---|---|---|---|---|
| **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. Note: Fund returns and Australian indices are shown in A$. 2. Goldman Sachs mega-cap tech index (GSTMTMEG). NOTE: Fund returns and Australian indices are shown in A$. Returns of U.S. indices are shown in US$. Index returns are on a total return (accumulation) basis unless otherwise specified.*

## Portfolio commentary

During the March quarter, the Catalyst Fund's performance relative to the ASX200AI was positively impacted by:

- **Favourable portfolio company trading updates:** QBE, one of the Catalyst Fund's key holdings, released strong FY22 results on 17 February 2023, with its share price increasing ~9% for the March quarter. We discuss the drivers of this positive performance further in the Stock spotlight on QBE on the following pages.
- **Select commodity exposure:** Certain portfolio companies benefited from positive movements in select commodities which they have exposure to. In each instance, our portfolio companies are exiting a period of organic investment to expand production volumes, with very attractive returns expected on these projects. This will enable them to further benefit from strength in these underlying commodity prices.
- **Continued capital management:** Numerous portfolio companies continued to use their strong balance sheets and undervalued share prices to pursue material on-market buybacks.
- **No direct exposure to the banking sector:** On a relative performance basis, the Catalyst Fund benefited from having no direct exposure to the banking sector, which underperformed during the quarter.

During the March quarter, the Catalyst Fund's performance relative to the ASX200AI was negatively impacted by:

- **Energy markets**: Crude oil prices declined materially during the March quarter (Brent oil down 7.3%) impacting a Catalyst Fund position with energy exposure. The oil price weakness was driven by increased expectations of a global recession in part driven by concerns regarding the global banking system, combined with higher oil inventory levels and a delay by the U.S. government to replenish its strategic oil reserves.
- **Portfolio company transition points:** At times, the Catalyst Fund will invest in companies during a period of transition, including operational turnarounds or expanding cash flow profiles. During such transition periods, volatility in performance on those investments is to be expected. During the March quarter, two such investments negatively contributed to performance, albeit the core thesis for each of these investments remains solid.

**The L1 Capital Catalyst Fund continues to find value in low P/E stocks with undergeared balance sheets, strong cash flow generation and realisable near-term catalysts. We remain focused on identifying and enacting these catalysts through active engagement with company management and Boards. We believe this engagement will ultimately create better shareholder returns for investors and outcomes for the companies themselves.**

## Stock spotlight | QBE Insurance Group

QBE Insurance Group (ASX:QBE, 'QBE') is a diversified global insurer headquartered in Sydney. Founded in 1886, QBE employs ~12,000 people across 27 countries, and reported Net Profit After Tax ('NPAT') of US$770m in FY22 (December year-end).

QBE offers a diverse portfolio of commercial, personal and specialty insurance products and risk management services. Key insurance products include property, motor, crop, public/product liability, professional indemnity, workers' compensation, energy, marine and aviation insurance.

QBE is structured into three geographic operating segments:

1. **International:** includes QBE's businesses in the U.K., Europe, Canada and Asia. Key business lines include property, public/product liability and energy, marine and aviation insurance products.
2. **Australia Pacific:** includes QBE's businesses in Australia, New Zealand and Pacific. The company provides all major lines of commercial and personal insurance, with a focus on property, motor and crop insurance products in the region.
3. **North America:** includes QBE's business in the United States, which is focussed on commercial, crop and specialty professional indemnity insurance products.

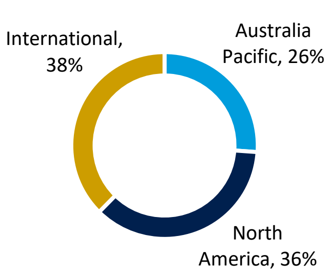
Over the last two years, QBE's share price has returned +52% compared to the ASX200 return of +6% (an outperformance of 46%). This performance has been driven by strong insurance premium rate growth, a rising interest rate environment that has enabled QBE to earn incremental investment income and greater earnings consistency.

### Figure 1: QBE (A$)*

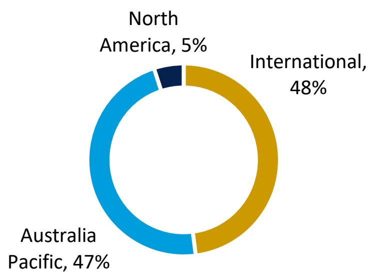
| | |
|---|---|
| **Market cap (31 Mar 2023)** | $21.7b |
| **FY23E NPAT** | $2.2b |
| **FY23E P/E (x)** | 9.9x |
| **FY23E dividend yield (%)** | 5.1% |

*Source: Visible Alpha consensus estimates. NPAT is pre-exceptional items.*
** Financials converted to A$ using AUD:USD exchange rate 1:0.67 as at 31 Mar 2023.*

### Figure 2: FY22A gross written premium by region

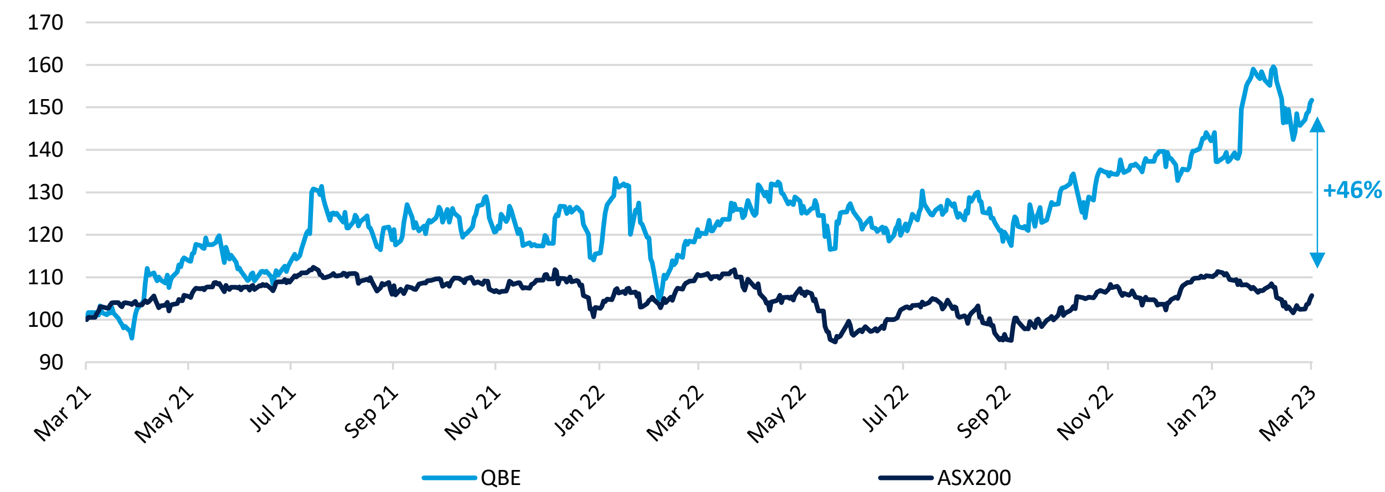



### Figure 3: FY22A underwriting profit by region




*Source: Company financials as at 31 Dec 2022.*

### Figure 4: QBE share price performance vs. the ASX200 (indexed to 100) since 31 Mar 2021



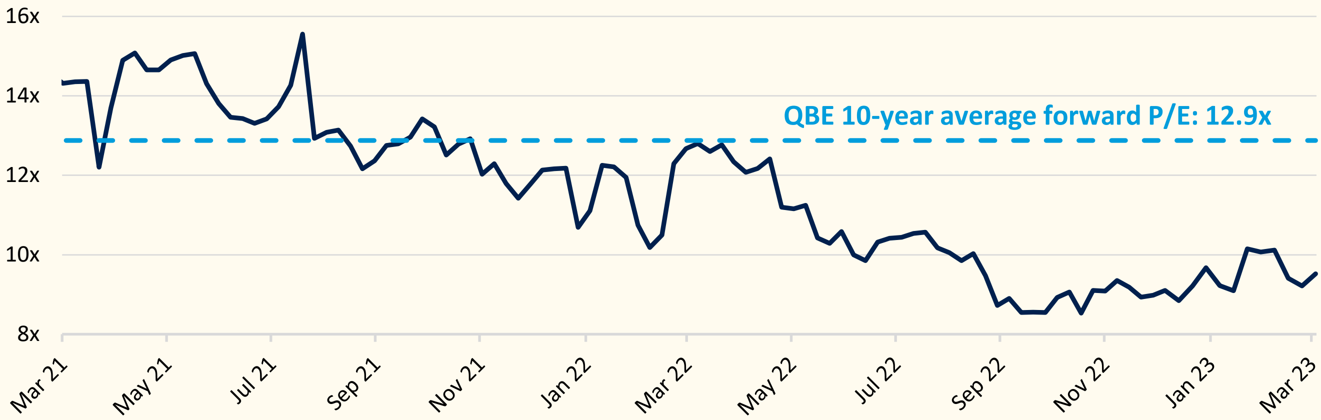

*Source: IRESS. Data from 31 Mar 2021 to 31 Mar 2023.*

## Investment case

L1 Capital has been cautious on QBE for many years given the clear industry and company-specific issues it was facing. However, we believe QBE has now reached an inflection point in business performance and going forward is set to deliver improving margins, dividends and Return on Equity ('ROE').

**Value:** QBE currently trades on a ~10x 1-year forward consensus P/E (versus a 10-year average of ~13x). We believe the company is undervalued because the market is backwards looking and has not yet fully factored in the reversal of industry and company-specific headwinds into its expectations. Going forward, we expect QBE to benefit from strong premium rate increases, elevated investment yields, and its higher asset quality.

**Figure 5: QBE 12-month forward P/E (since 31 Mar 2021)**

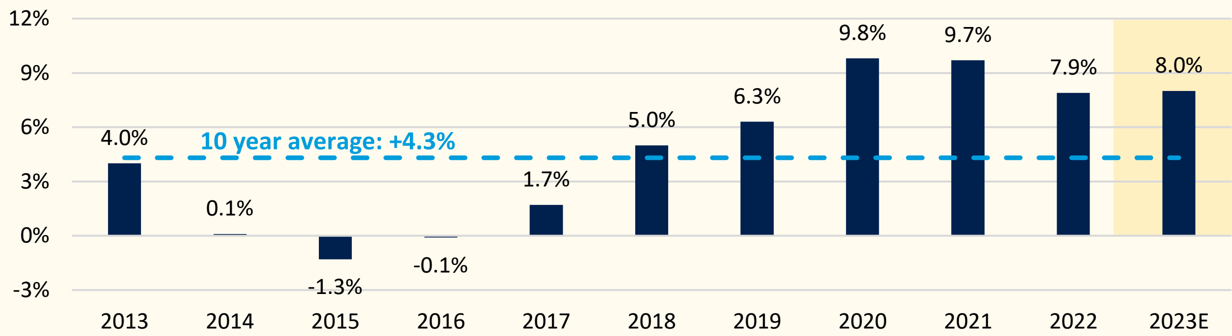



*Source: Thomson Reuters and Credit Suisse.*

**Quality:** The investment in QBE is supported by favourable industry dynamics, operating trends and a proven leadership team.

- **Industry dynamics:**
  - **Strong premium rate increases:** After enduring a challenging premium market for many years, QBE is benefitting from a material step-up in insurance premium growth from its 10-year average of 4.3% p.a. We believe premium increases will persist globally in 2023, supported by several offshore peers recently confirming their confidence in the growth of premium rates.

**Figure 6: QBE premium rate movements (year-on-year, %)**




*Source: J.P. Morgan, Company reports. QBE 10-year premium rate growth average (year-on-year) between FY13-22*

  - **Elevated investment yields:** QBE have been able to earn additional investment income on its ~US$25b investments in fixed income assets, as a result of the risk-free rate increasing since the start of 2022 (e.g. U.S. 10-year Treasury bond rate was 1.5% on 31 December 2021 versus 3.6% on 31 March 2023). A 1% increase in the fixed income running yield results in a ~US$250m increase in investment income for QBE. Despite some recent softening in longer-dated investment yields, fixed income returns remain elevated versus the last decade.

- **Operating trends:** We believe QBE is in a strong position to deliver consistent earnings growth over the next few years, and is now a higher-quality business compared to the previous decade due to the following reasons:
  1. **Strengthened its reserves and reduced exposure to more volatile parts of the business**: including recently completing a reinsurance transaction to de-risk its exposure to more volatile claims.
  2. **Improved the performance of its North American business which has historically struggled**: North America achieved a full year underwriting profit in FY22, its first full year profit since FY18.
  3. **Exited some poor performing geographies:** including its loss-making Latin American division and parts of its Asian operations (e.g. Thailand, Indonesia and the Philippines) in 2018 and 2019.
  4. **Developed targeted plans for profitable volume growth:** including building global cyber insurance products and stopping growth in commercial property insurance in 2023 as QBE believes claim costs have kept up with increased pricing.
- **Proven leadership team:** QBE is led by an experienced Chair, Michael Wilkins, the former Managing Director and CEO of Insurance Australia Group. QBE's CEO, Andrew Horton, in place since 1 September 2021, had an excellent track record of driving organic growth and share price performance during his ~13-year tenure as CEO of Beazley, a listed U.K. insurer. We also believe QBE management incentives are appropriately aligned to shareholder outcomes, including appropriate ROE and Total Shareholder Return targets.

**Catalysts:** We see three upcoming catalysts for QBE as the company continues to execute on its strategy and positive earnings trajectory:

1. **Continued improvement in underwriting margins**: driven by strong premium rate increases, organic volume growth and moderating inflation which should support a lower claims cost environment. Broader operational improvements will also continue to drive QBE's margins, including improved profitability in North America where the company plans to increase exposure to Crop Insurance, close down unprofitable lines of business and continue to scale the commercial mid-market business. QBE's 1Q trading update is scheduled to be held on 12 May 2023 at its Annual General Meeting.
2. **Increased dividends**: supported by QBE's strong balance sheet, with regulatory capital of 1.8x (as at 31 December 2022) at the top end of QBE's target range of 1.6-1.8x. QBE's strong capital position and earnings momentum should enable it to increase its dividend payment going forward, with consensus anticipating a >85% increase in QBE's dividend payment per share for FY23E versus FY22A, implying a 5.1% FY23E dividend yield. QBE is scheduled to report its 1H23 results and interim dividend on 10 August 2023.
3. **Improved ROE and valuation re-rate:** QBE achieved a 10.5% ROE in FY22 with management guidance implying an FY23 ROE in the mid-teens, which our analysis suggests can be achieved. Combined with an improved ROE, we believe a valuation re-rate is supported by greater earnings consistency and increased transparency, with QBE recently committing to provide quarterly trading updates.

## Team update | Appointment of Tom Crowhurst, Investment Analyst

**Tom Crowhurst**
Investment Analyst

*B.Com (Fin and Econ), MEng (Mech Eng)*

Tom Crowhurst joined the L1 Capital Catalyst Team as an Investment Analyst in February 2023. Prior to joining L1, Tom worked in Private Equity at BGH Capital in Melbourne and in the Investment Banking Group of Goldman Sachs in the Natural Resources team and the Consumer, Retail, Healthcare and Technology, Media & Telecommunications teams in Melbourne. He holds a Bachelor of Commerce, Finance and Economics, and a Master of Mechanical Engineering, both from the University of Melbourne.

L1 CAPITAL CATALYST

# L1 Capital Catalyst Fund

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## Fund information

| | |
|---|---|
| **Fund/Class Name** | L1 Capital Catalyst Fund – Retail Class |
| **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. inclusive of GST and net of RITC |
| **Performance fees** | 20.5% (inclusive of GST and net of RITC) over benchmark, subject to any underperformance being recouped |
| **Vehicle** | Australian Unit Trust |
| **Launch date** | 1 July 2021 |
| **Platform availability** | Australian Money Market, BT Panorama, CFS FirstWrap, HSBC, Hub24, Macquarie Wrap, Mason Stevens, Netwealth, North, Powerwrap, Praemium |

## Research house ratings

### Zenith Rating[3]

**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."

Zenith RECOMMENDED

### Lonsec Rating[4]

**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."

Recommended Lonsec Research

3. The Zenith Investment Partners (ABN 27 103 132 672, AFS Licence 226872) ("Zenith") rating (assigned to L1 Capital Catalyst Fund in June 2022) 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, including target markets of financial products, where applicable, 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.

4.The rating issued September 2022 for the L1 Capital Catalyst Fund 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. 

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## 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 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 short Australian 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. 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.

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L1 CAPITAL

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

**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.