L1 CAPITAL

Quarterly Report

L1 Capital International Fund (Managed Fund)

June 2024

In this Quarterly Report, we have outlined:

- Our assessment of the current investment environment including:
  - Inflation gradually trending down but staying above Central Bank targets
  - Mixed macroeconomic data and business performance
  - Clear signs growth is slowing, and increasing risks that the Federal Reserve and other Central Banks fall behind the curve in cutting interest rates
  - Implications of very 'narrow' equity markets, where a few companies are driving index returns
- Review of the last quarter, including key contributors and detractors to the Fund's performance
- Recent Portfolio adjustments, including new additions to the Fund
- A detailed overview of AerCap, the largest aircraft leasing business in the world. AerCap is currently a top 10 holding in the Fund and in our view is trading at a compelling valuation at around 8x P/E and 1x understated tangible book value.

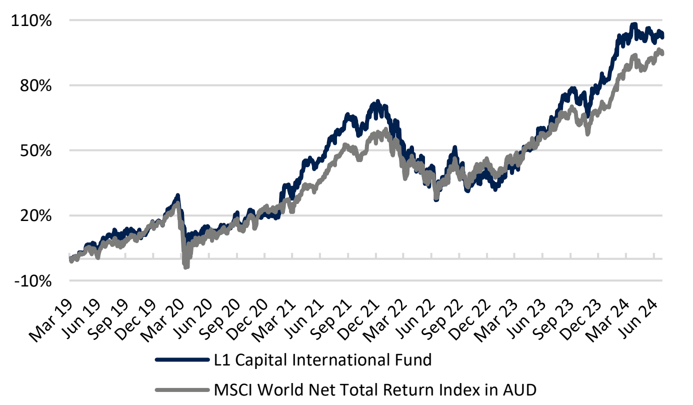
Fund Performance (Net) (%)[1]

	Fund	Index**	Alpha
3 months	(3.0)	0.3	(3.2)
1 year	22.2	19.8	+2.4
3 years p.a.	9.6	11.1	(1.5)
5 years p.a.	13.3	12.9	+0.4
Since Inception* p.a.	14.1	13.3	+0.8
Since Inception* cumulative	102.0	94.3	+7.7

NAV price as at 30 June 2024	**$5.65**

* Unit Trust Inception is 1 March 2019 (returns measured from Index close). ETMF Inception is 22 November 2023. Numbers rounded to one decimal place and may not add due to rounding. ** MSCI World Net Total Return Index in A$.

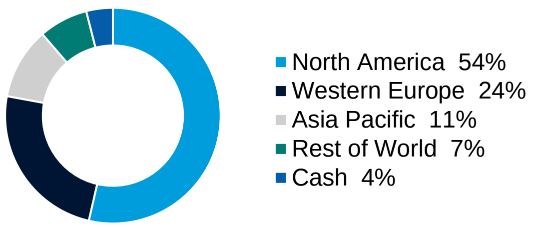
Fund (Net) and benchmark returns since inception*



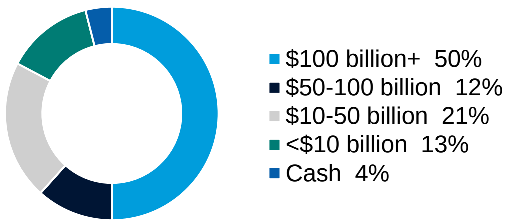
We are pleased to announce that in late July 2024, we will be launching L1 Capital International (Hedged) Active ETF, a hedged version of the L1 Capital International Fund, which will be listed on the ASX under ticker L1HI. As the Fund will be available as a dual registry structure, investors will have two ways to buy and sell units, either through the ASX using a broker, shares account or platform just like they do for shares in any listed company, or by submitting forms to the unit registry. For more information, please contact us on info@L1.com.au.

1. All performance numbers are quoted net of fees. Net returns are calculated based on the movement of the underlying investment portfolio. Figures may not sum exactly due to rounding. Past performance should not be taken as an indicator of future performance.

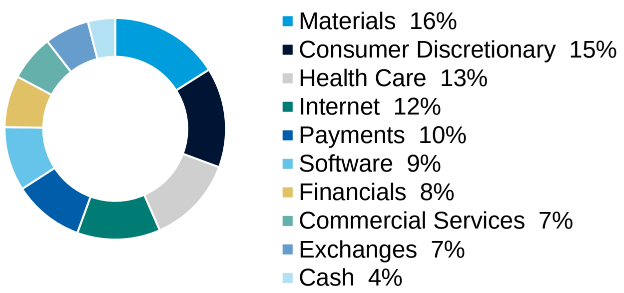
Revenue exposure by Region[2]



Market capitalisation Exposure (in US$)



Sector exposure[3]



Top 10 holdings

As at 30 June 2024 (In alphabetical order)	Sector
AerCap Holdings	Financials
Amazon.com	Consumer Discretionary / Internet
Booking Holdings	Consumer Discretionary
CRH	Materials
HCA Healthcare	Health Care
Intercontinental Exchange	Exchanges
Mastercard	Payments
Microsoft	Software
Natural Resource Partners	Materials
United Healthcare	Health Care

2. Revenue by region is internally estimated on a look through basis based on the underlying revenues of the individual companies held in the portfolio. 3. 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.

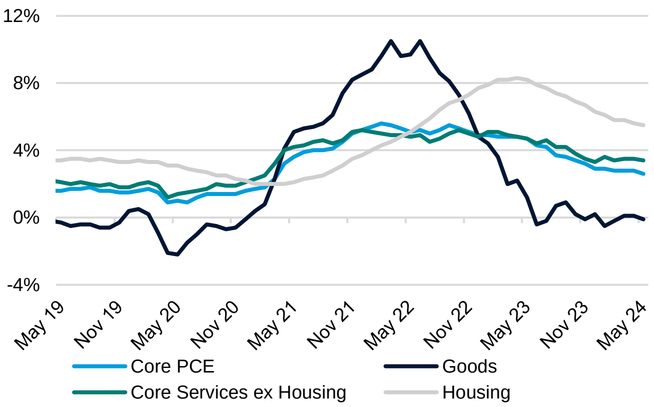
Current investment environment

> **"The important question for the investor is not whether conditions are good or bad (if, in fact, they can be measured on such a scale), but whether they are changing for the better or the worse relative to expectations."**
>
> **Arthur Zeikel**

Macroeconomic conditions

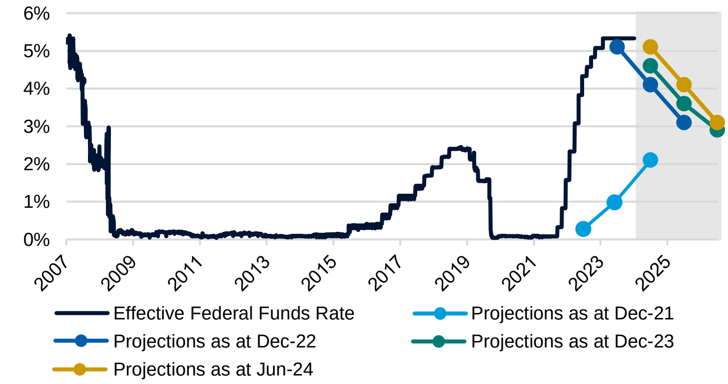
Macroeconomic data has been mixed over the past three months. In the U.S., inflation remains too high, and the labour market remains too strong, for the Federal Reserve to cut interest rates. Market expectations for cuts in the Federal Funds Rate continue to push out. According to the CME FedWatch, the market is pricing in a more than 96% probability that interest rates will be left on hold by the Federal Reserve in July 2024, with an initial cut of 25 basis points in September 2024 being the 70% favourite. In our view, other than for the importance of the signalling affect for potential future monetary policy changes, whether the Fed cuts rates once, twice, or even doesn't cut during 2024 is not important in isolation and needs to be considered in the context of other macroeconomic data. We continue to expect interest rates to broadly remain 'higher for longer', a view that is increasingly becoming consensus.

Figure 1: Core U.S. PCE growth by category



Source: U.S. Bureau of Economic Analysis

Figure 2: Federal Reserve Funds Rate and expectations



Source: St Louis Federal Reserve, Federal Open Market Committee

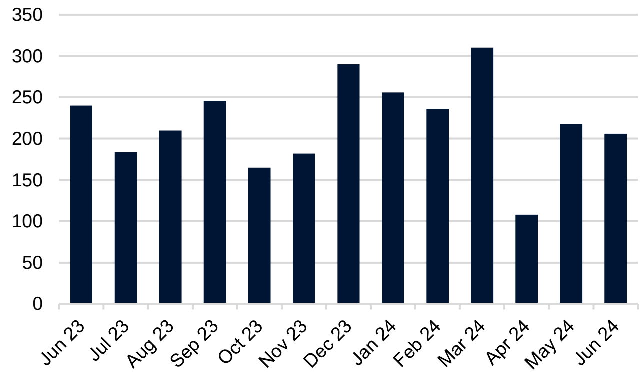
The quote from Arthur Zeikel at the start of this quarter's report is insightful on many levels. The part in the brackets, namely the difficulty in measuring economic conditions on a macro scale, is not lost on us. The data is so mixed currently that it is possible to find evidence to support both bearish and bullish prognoses. **Let's drill one level down on the two key variables** that the Fed (and all central banks) focus on – **inflation** and **labour market** conditions.

As illustrated in Figure 1, Housing inflation remains elevated at around 5.5%. Shelter accounts for around 16% of the components of core PCE and is therefore a key contributor to why core PCE, the Fed's preferred measure of inflation, has stayed above its target of 2% (shelter accounts for a much higher 33% of the CPI measure of inflation). Housing inflation includes both rents paid by tenants and a concept of owners' equivalent rent (OER), which is the rent that homeowners would pay if they instead were tenants in their homes. However, in reality, around two thirds of Americans don't pay rent because they own their own home. Of these homeowners, around 40% own their home outright and do not pay any mortgage repayments, while the remaining 60% have a fixed rate mortgage.

This detail highlights two issues. Firstly, OER is an economic concept that people actually don't pay. This means the Fed is responding to a component of inflation that isn't actually impacting these homeowners. Secondly, as around two-thirds of Americans have no mortgage or have a long-term fixed rate mortgage, higher interest rates do not impact their mortgage repayments, unlike Australia where mortgages are largely based on floating interest rates. **If you exclude OER, core PCE is already close to the Fed's 2% target.**

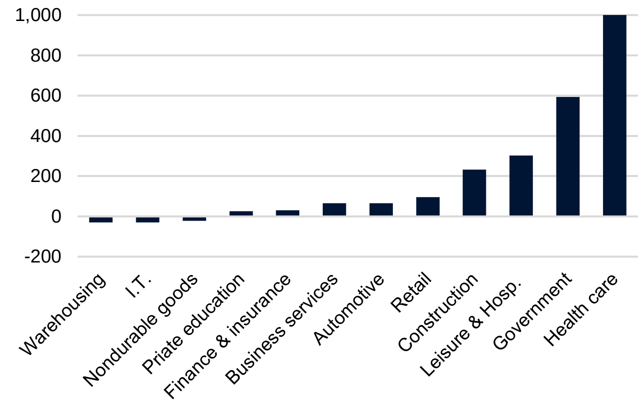
Now let's look at U.S. labour market conditions. In aggregate, the U.S. economy continues to add a healthy 200,000 jobs most months (see Figure 3) and unemployment remains low at around 4%. Tick for the Fed's mandate of maximum employment. **However, as illustrated in Figure 4, job creation has been concentrated in a few industries**, mainly Construction, Leisure and Hospitality, Government and Healthcare. **Despite all the headlines and fever about the growth in Artificial Intelligence (AI)**, industry trackers estimate there have been over 100,000 layoffs from tech companies in the U.S. so far this year, consistent with the Bureau of Labor Statistics calculating **negative job creation for the IT industry as a whole**.

Figure 3: Aggregate monthly net jobs created (000s)



Source: U.S. Bureau of Labor Statistics

Figure 4: Change in jobs by sector – last 12 months (000s)



Source: U.S. Bureau of Labor Statistic

Similar to our commentary below on equity market indices, **headline economic data can be misleading**. **Below the surface, the economic environment for many industries and businesses continues to weaken**. Stepping back:

- In the U.S., GDP growth and consumer spending growth is slowing, unemployment, while low, is increasing slowly, job growth by industry is variable and there are cracks appearing in credit performance of sub-prime borrowers.
- In Europe, economic growth is anaemic, and the ECB has already made its first interest rate cut.
- Australia is already in a per capita recession.
- China is, well, China. Recent economic data remains subdued.
- Many emerging countries are facing acute inflationary pressures, weak currencies and challenging economic conditions.

Domestic politics around the world range from entertaining, to farcical, to downright concerning, while geopolitical tensions remain acute.

Our central view remains economic growth is slowing, not crashing, and the U.S. is better placed than other developed economies. Inflation is well in hand in our view and is likely to continue to trend down over time, although there will be bumps along the way, and energy prices can be a wildcard. Below the surface of relatively solid macro data, we are seeing many industries and businesses showing signs of an accelerating slowdown. Consumers remain under pressure, particularly lower socioeconomic consumers more susceptible to cost of living increases**. Central Banks**, almost by definition, **are reactionary**, and Chair Powell has repeatedly reiterated the Fed will respond to economic data. While also saying he recognises the risks of holding rates too high for too long, **in our view there is an increasing risk that the Fed is behind the curve in cutting rates, as it previously was slow in raising rates to curtail inflationary pressures.**

Equity market implications

> **“Extrapolating existing conditions too far into the future is likely to lead to disappointment. But as long as people continue to make this mistake, and as long as the market consensus reflects it, history will continue to repeat itself in Wall Street.”**
>
> **Arthur Zeikel**

We couldn’t choose which Arthur Zeikel quote to include in this quarter’s report – both are perfectly applicable to the current investment environment. While many equity indices are at or near all-time highs, at the company level there is significant variance.

Volumes have been written on the limited number of companies contributing to the increase in U.S. equity indices. We will keep it brief – yes, the market’s performance has been narrow, extremely narrow. In the first half of 2024, Nvidia alone contributed 30% of the increase in the S&P500 Index, and collectively with Alphabet, Amazon.com, Apple, Meta and Microsoft, these six companies accounted for two thirds of the S&P500 Index returns year to date. **In 2024 year-to-date, the average return for companies in the S&P500 has underperformed the S&P500 Index by the widest margin since 1990.**

We are seeing wide variation in the business and share price performance within industries, both up and down. In our view some of these share price movements are justified, some less so.

In this environment, **we are finding opportunities in a range of industries and in businesses of varying size.** Portfolio performance and adjustments are discussed from page 5 of this report.

We believe our unique definition of Quality, prudently and cautiously applied, results in a diversified portfolio of businesses of varying size that can deliver strong risk adjusted returns over time, despite current mixed economic conditions.

June 2024 quarterly review

Performance

In the June 2024 quarter, the Fund returned -3.0% (net of fees), compared to the Benchmark return of 0.3% (all in Australian dollars). The Australian dollar appreciated 1.8% against the U.S. dollar and appreciated 2.7% against the Euro, decreasing the Fund and Benchmark Australian dollar reported quarterly returns.

For the year ended 30 June 2024, the Fund returned 22.2% (net of fees), outperforming the Benchmark return of 19.8% by 2.4% (all in Australian dollars). Currency had a limited impact on Australian dollar returns of the Fund and Benchmark over the past 12 months, with the Australian dollar appreciating 0.3% against the U.S. dollar and appreciating 2.0% against the Euro.

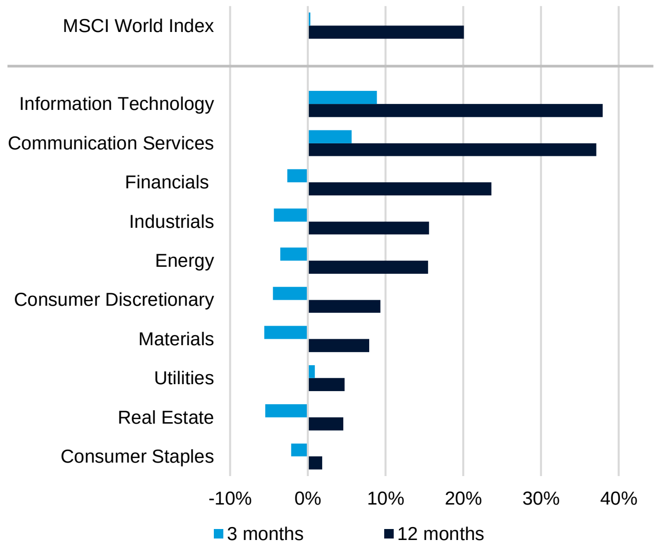
Key contributors and detractors

As discussed, the market's performance in the June 2024 quarter and year to date has been driven by a handful of companies. Only three sectors (see Figure 5) delivered positive returns in the June 2024 quarter (measured in Australian dollars), led by Information Technology and Communications Services (the sector classifications for most of the large technology and online businesses).

Simply not owning Nvidia was a key contributor to the relative underperformance of the Fund against its Benchmark. The *Wall Street Journal* even published a recent article with the title '*No Nvidia in Your Portfolio? You're Just Toast'*. While that is a little melodramatic, it is rare for one company to have such an outsized impact on index returns.

We readily admit that we underestimated the speed and scale with which **Nvidia** has been able to monetise its leading position in supporting the growth of AI. We have refreshed our financial analysis and while our valuation of the business has increased materially, we continue to view the current share price as providing an unattractive risk adjusted return in most scenarios. We appreciate the business has surprised to the upside in the past and we continue to follow Nvidia closely.

Figure 5: MSCI World Index (in A$) – Sector Performance



Source: Bloomberg

Share price performance of the companies in the Fund was mixed during the June 2024 quarter. Measured in local currency, the share price of the majority of the Fund's investments increased. Only Alphabet positively contributed more than 0.5% to the Fund's returns when measured in Australian dollars, although Booking Holdings' contribution was very close to this level. Three companies detracted from the Fund's performance by more than 0.5% – CRH, Eagle Materials and Mastercard.

In our view, **measuring the performance of investments over short time horizons such as three months is meaningless**. While CRH and Eagle Materials detracted from the Fund's returns this quarter, they were both leading positive contributors in the prior quarter. **Since Inception of the Fund over 5 years ago, both companies have been top ten contributors to the Fund's returns**.

Recently, there has been some negative data that is causing a sell-off in the share price of CRH and Eagle Materials. Both these companies supply building products to the infrastructure, residential and commercial construction sectors. CRH has around 75% exposure to North America, with the remainder principally Europe (CRH has also recently acquired the majority of Adbri in Australia). Eagle Materials solely operates in the U.S.

Demand from the U.S. infrastructure sector is likely to remain robust for the medium term due to increased Federal and State spending, supported by the $1.2 trillion Infrastructure Investment and Jobs Act. Short term activity has been disrupted by bad weather – we think this is complete noise and is just slightly delaying projects, although CRH and Eagle Materials' June 2024 quarterly results will likely be impacted.

Housing activity has recently softened a little, with affordability remaining an issue. **Demand for housing remains strong**, and the housing construction industry is responding through incentives such as subsidising mortgage rates for buyers, and building slightly smaller, cheaper homes.

While there will always be short term fluctuations in activity levels and we do expect softening in apartment construction, over time we expect solid new housing construction as well as repair and renovation activity levels to support demand for CRH and Eagle Materials' products, with potential for meaningful upside in a lower interest rate environment. Commercial activity remains mixed, with pockets of strength such as data center construction and resilient areas such as hospital and education construction, offset by weakness in areas such as office construction.

In our view the market is not always efficient. Back in our December 2022 Quarterly Report we were pounding the table on **Amazon.com (Amazon)**, stating that the share price had been oversold and offered compelling value. Since then, Amazon's share price has increased nearly 140%. Over recent months, the share price of Eagle Materials and CRH have fallen 20% and 15% respectively from their recent highs. Now trading on a P/E ratio of 13x to 14x, we consider both companies are **trading at attractive valuations for investors with a longer-term investment horizon, willing to look through short term pressures**.

The share prices of **Mastercard** and **Visa**, both long term Fund investments, have both drifted down over recent months. There have been no dramatic developments, but there has been a general slight softening in the rate of growth of consumer spending in the U.S. and globally, a court decision rejecting Mastercard and Visa's proposed settlement of a long-lasting dispute with U.S. merchants as well as other modest adverse regulatory developments**. We continue to view Mastercard and Visa as two of the highest quality businesses in the world**, and both are well placed to continue to deliver attractive, risk adjusted returns to shareholders over time.

Portfolio adjustments

We made a number of relatively modest adjustments to the Portfolio in the June 2024 quarter, totalling less than 10% of the Fund's investments.

We divested our remaining holding in **Danaher**. Danaher is one of the leading providers of equipment and services to the life sciences and diagnostics industries and is one the best run industrial businesses in the world. Many companies aim to emulate the 'Danaher Business System' of continuous improvement. We have no concerns with the quality of Danaher, **the share price simply increased above our view of fair value**. A core principle of our investment process is to maintain valuation discipline and we divested our investment, purely on valuation grounds. Danaher has moved to our Bench of potential future investments. Danaher's share price has fallen around 10% since we sold our investment, and if it continues to drift down, we may have the opportunity to reinvest in a very high-quality business at a more attractive valuation.

We added to our investment in **AerCap Holdings** (AerCap), with the company entering the top ten Fund holdings. We consider the current share price to be highly attractive. The investment thesis for AerCap is profiled in detail in the next section of this quarterly report.

Three new additions were made to the Fund, all at initial position sizes of around 2%, while two smaller positions were divested. This is an expected outcome from our investment process. Smaller positions are businesses where we have lower conviction, either due to valuation or quality considerations. We are always challenging ourselves to find more attractive risk adjusted opportunities than the companies already in the Fund and currently we see a healthy tension between existing investments and prospective new investments in companies on our Bench.

Two of the new additions to the Fund are European centric companies. The current low growth environment and political turmoil in Europe is creating uncertainties. Against that backdrop, we are starting to see some high-quality European businesses trade at attractive valuations.

We also **topped up our investment in a number of existing holdings** at prices we consider to be at or below fair value. **Cash reduced slightly to around 4%.** Cash is an outcome of our investment process, not a target. Over time the Fund is expected to be broadly fully invested.

Portfolio investment – AerCap

Introduction

Every time you catch a flight, you probably don't spend a huge amount of time thinking about whether the plane you are sitting in was bought or leased by the airline. Yet this is an important decision for the airline management team. Aircraft leasing is a well-established, but highly specialised niche of the secured asset lending industry. There are a wide range of aircraft leasing capital providers, but publicly traded aircraft lessors are limited, and the sector is not well known outside of the industry. While AerCap is by far and away the largest participant in the aircraft leasing industry, we believe it is flying below the radar of most investors.

It is not often you can invest at an understated tangible book value and a single digit P/E ratio in a business:

- With an industry leading position,
- Supported by drivers that will reliably sustain growth for many years,
- Led by the industry's best management team,
- Generating strong returns on equity invested in the business,
- Holding an investment grade credit rating, and
- Paying a dividend and returning excess capital to shareholders through buybacks.

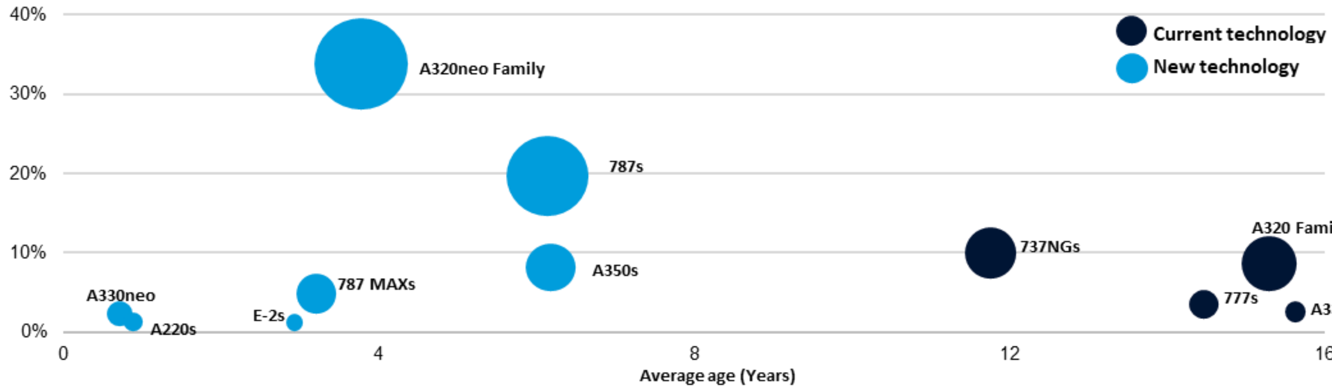
AerCap is a top 10 holding in the Fund and we believe it currently presents a **very attractive opportunity to generate strong, compounding investment returns over time.**

AerCap Overview

AerCap's history traces back to the 1970s and the company has been publicly listed since 2006. However, there was a step change in the scale of AerCap's operations through the acquisition of International Lease Finance Corporation (ILFC) from AIG in 2014 for $28 billion, and the acquisition of GECAS from GE for $30 billion in 2021.

AerCap owns 1,465 passenger aircraft, 69 freighter aircraft, manages nearly another 200 passenger or freighter aircraft, owns over 400 and manages another 600 aircraft engines, and also owns over 300 helicopters for good measure. These aircraft and related assets have a **combined book value of around $60 billion.** AerCap also has forward orders to purchase over 300 aircraft as well as engines over the next few years for a **total additional investment approaching $20 billion.** The fleet is a mix of makes and models, have a relatively young average age of around 7 years (weighted by book value) with new technology aircraft accounting for over 70% of the existing fleet. **Average utilisation for the owned aircraft in the fleet is 98%.**

Figure 6: AerCap fleet age and technology profile

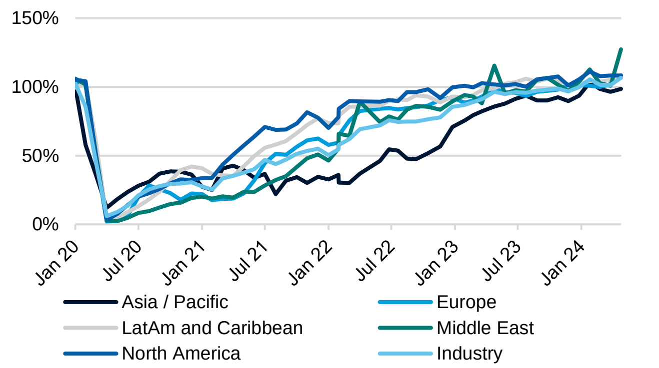


Source: AerCap

Travel demand has recovered while aircraft and engine supply are constrained

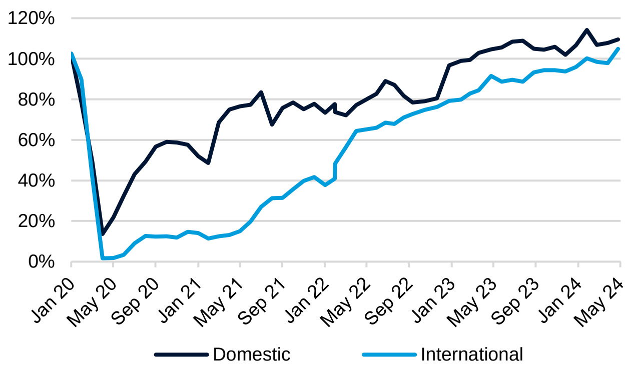
During the **COVID pandemic** the airline industry effectively shut down and airlines went to ground, literally. Orders for aircraft were restructured and **Airbus, Boeing and their long supply chain responded by dramatically reducing production**. Many experienced employees were either retrenched or retired and have not returned to the industry. Subsequently air travel rebounded strongly and demand for aircraft resumed. **Passenger traffic is now ahead of pre-COVID levels**, led by domestic travel.

Figure 7: Change in monthly RPKs* vs 2019 by region



Source: IATA, BofA, L1 Capital International. * RPK = Revenue Passenger Kilometres.

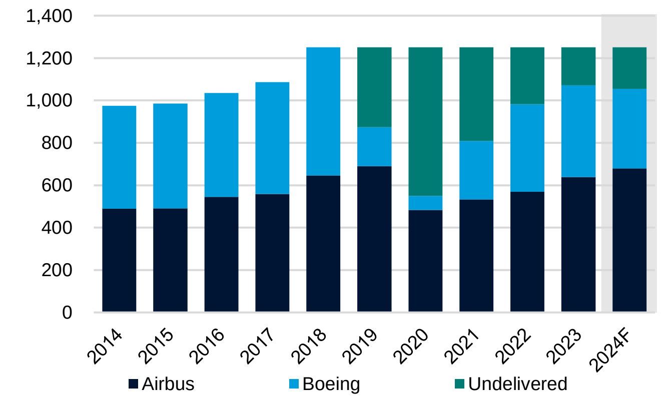
Figure 8: Change in monthly RPKs* vs 2019 – Domestic and International



Source: IATA, BofA, L1 Capital International. * RPK = Revenue Passenger Kilometres.

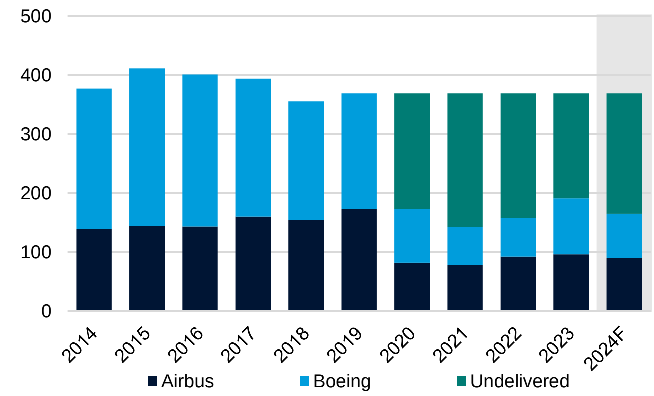
However, **Boeing, and to a lesser extent Airbus, have struggled to return production levels to pre-COVID levels** due to a host of well-publicised operational issues. As can be seen in Figures 9 and 10 below, it is estimated around 2,200 narrowbody aircraft will not be delivered for the period 2019 to 2024 compared to 2018 delivery levels, and over 1,000 widebody aircraft will not be delivered for the period 2020 to 2024 compared to 2019 delivery levels. **It is not a case of just a delay in production, these planes will never be built.** Furthermore, **industry production issues are likely to persist well beyond 2024.**

Figure 9: Narrowbody deliveries



Source: Airbus, Boeing, AerCap, L1 Capital International

Figure 10: Widebody deliveries



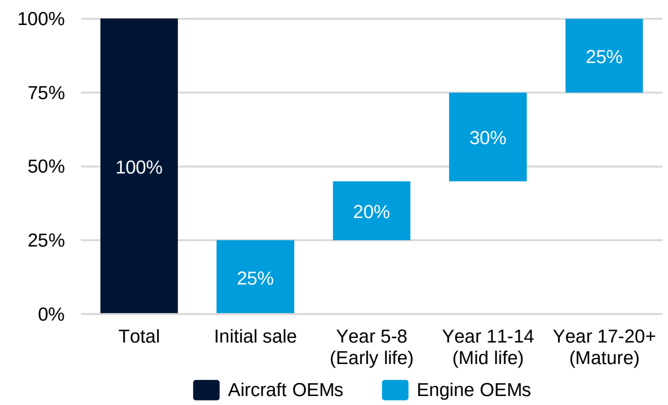
Source: Airbus, Boeing, AerCap, L1 Capital International

With demand recovering ahead of supply, and supply likely to be constrained for a while, you don't need to be Alfred Marshall to work out that aircraft lease rates have been increasing. In addition, **the cost of the aircraft to an airline, even at current higher aircraft values or lease rates, is small relative to the cost of employees or fuel.** Having enough aircraft, or what the industry calls 'lift', is critical to an airline's operations.

But wait, there's more…**Not only is there a structural shortage of aircraft, but there is also a structural shortage of engines.**

Unlike Airbus and Boeing, which are incentivised to maximise earnings by selling more aircraft, the oligopolistic aircraft engine industry operates under the quintessential 'razor-razorblade' economic model where new engines are sold at losses, with profit made over the 20 plus year useful life of the engine through aftermarket maintenance. This means engine manufacturers benefit from engines having a longer useful life and more service revenue and are less incentivised to maximise production of new engines.

Figure 11: Lifecycle revenue sources for OEMs

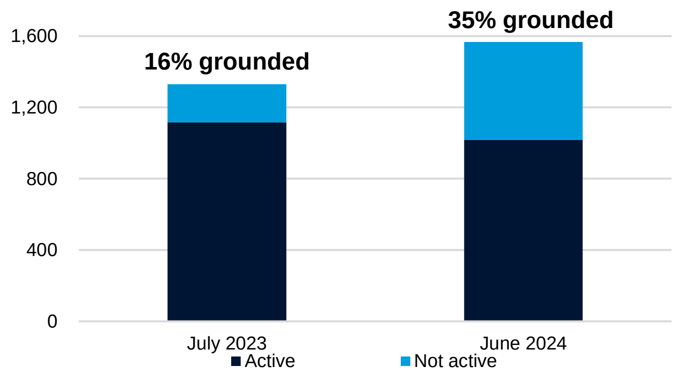


Source: GE Aerospace, AerCap

Further, in July 2023, Pratt & Whitney (PW) announced a recall to inspect around 1,500 engines that power the Airbus A320neo family of aircraft. Currently around 35% of the PW1100 fleet is grounded, and **it can take up to a year for these engines to be serviced** due to a shortage of industry maintenance capacity.

Today there a large number of grounded aircraft awaiting serviced engines. Commercial aircraft don't work very well without engines (the industry parlance is a 'Glider') and recently, Airbus downgraded its aircraft delivery guidance in part due to engine supply chain issues. **Catching up on the backlog of engines requiring maintenance and spare parts is likely to take a few years.**

Figure 12: Pratt PW100 fleet (No. of aircraft)



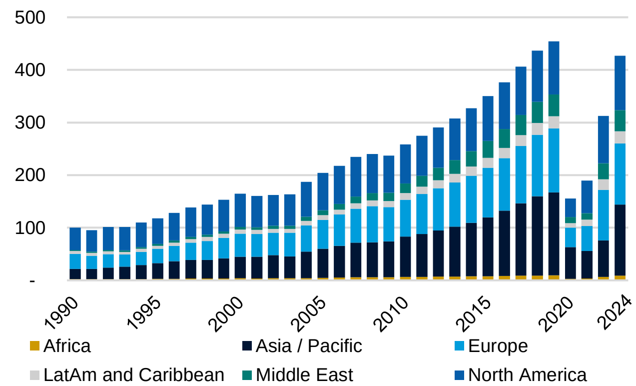
Source: IBA InsightIQ, Bernstein Analysis, L1 Capital International

Sustained growth in air travel, airlines increasingly dependent on aircraft lessors

Over time, despite recessions, wars, pandemics, global aircraft passenger traffic has increased at over 4% p.a. with aircraft fleet growth slightly lower due aircraft increasing in size over time. An amazing statistic provided by AerCap at their recent Investor Day was that in 2024, 15% of all people on an aircraft in India, or around 25 million people, will be first time flyers. **Air travel is likely to continue to grow soundly for many decades to come.**

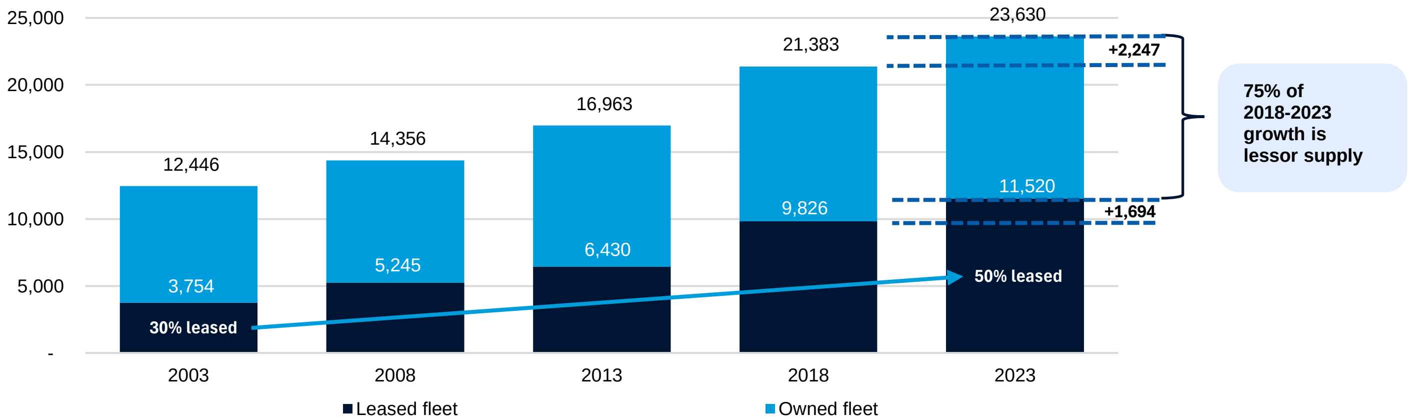
Over the past 20 years, due to a range of advantages, leasing companies have increased their share of the total global fleet from 30% in 2003 to 50%, with **75% of the global fleet growth over the past 5 years supplied by lessors.**

Figure 13: Total Annual Global RPKs* growth – indexed to 100 in 1990



Source: IATA, BofA, L1 Capital International. * RPK = Revenue Passenger Kilometers.

Figure 14: Proportion of global Fleet on operating leases



Source: Cirium, AerCap

AerCap's multi-faceted competitive advantages

Not only are lessors in general gaining share of the global aircraft fleet, but we believe AerCap, as the largest and most diversified aircraft leasing company, is **best placed to optimise returns on equity invested in its business and deliver strong returns to shareholders**. AerCap management has identified seven areas that **drive its competitive advantages** and to deliver superior returns through the life cycle of an aircraft:

- **Financing** – cost of financing is critical for any financing business. Having a strong investment grade credit rating as well as greater scale and diversity of operations lowers AerCap's debt financing costs relative to most other lessors, as well as many airline customers, most of which do not have an investment grade credit rating. AerCap's credit rating was recently upgraded by both Moody's and S&P.

- **Purchasing** – The aircraft leasing business is as much about capital allocation as it is about operational matters. AerCap management has added significant shareholder value by making industry transforming acquisitions at low points in the cycle, as well as committing to buy aircraft from Airbus and Boeing when airlines were being cautious. In the current environment where aircraft values have increased due to supply and demand pressures, **we expect a greater proportion of AerCap's cashflow to be directed to share repurchases.**

- **Specification** – The buying decision is not simply the headline price paid for an aircraft, but also detail such as the terms agreed with the manufacturer and fit-out costs. AerCap has the experience and breadth of operations to not just focus on the initial lease of a new aircraft, but also to consider how to maximise the value of the aircraft over its total life, including subsequent leases or sale.

- **Leasing** – With over 300 airline customers around the world, AerCap has the scale and expertise to tailor transactions to meet the needs of a broader range of customers and their leasing requirements, while managing risk and return.

- **Maintenance** – **Over an aircraft's useful life, the cost of maintenance exceeds its upfront purchase price.** While airlines are usually responsible for aircraft maintenance, AerCap still needs to ensure the maintenance is done properly and, in some instances requires the airline to reserve cash to fund future maintenance in case they get into financial difficulties. Minimising the downtime of an aircraft will maximise its value. AerCap has the ability to move aircraft and engines around so that the downtime of its fleet is minimised.

- **Transitions – There is a constant need to reposition aircraft from one airline to another** since some airlines may only want new or near new aircraft in their fleet. AerCap's management has done this 300 times since 2021, and in so doing managing certification and other regulatory issues, fit out and avionics. AerCap has in-house part-out capabilities (i.e. retiring an aircraft and selling off its component parts), as well as a cargo aircraft business and has selectively converted passenger aircraft to cargo aircraft to maximise their value. Over time, appropriately transitioning aircraft during their economic life maximises returns on capital invested.

- **Trading and End-of-Life** – The decision to sell an aircraft, re-lease it, or part it out is made aircraft by aircraft to maximise total lifetime value, not near-term earnings. AerCap has sold 1,600 aircraft over the past 18 years and has consistently received a premium to book value overall.

To the above 7 points, we add an eighth, being **risk management. Everyone can look back and see the return generated from an investment, but identifying the real risk taken to generate that return is much harder to see or measure.** For the technical readers, we know that there are industry accepted measures such as the Sharpe Ratio for measuring the risk taken in generating investment fund returns, but **in our view volatility is not a good measure of risk, the probability of losing money is.** This is a core tenet of the L1 Capital International investment philosophy.

From the perspective of a public equity investor, it is even harder to see the operating risk assumed by a management team. Yes, you see the Profit and Loss Statement, as well as the Balance Sheet and Cashflow, but that only gives you some insight into the risks associated with the business, and is **principally focused on financial risk, not operational risk.**

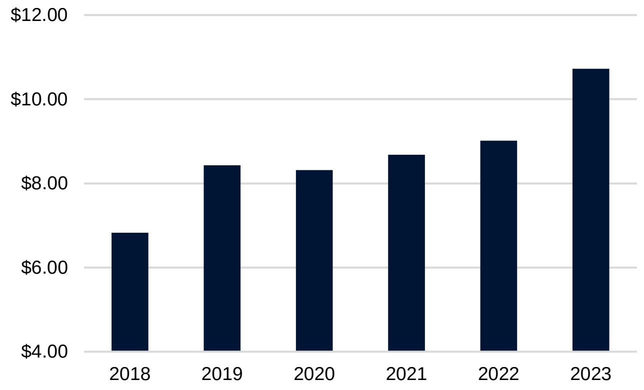
AerCap's business model is systematically built around risk management. It starts with working with the right lessees, and extends to lease term construction, minimising receivables, requiring reserves for maintenance and other expenses when required, financial and technical surveillance and the procedures and capabilities to respond when a lessee has difficulties, including repossessing aircraft which AerCap has done over 200 times from over 65 airlines.

Consistently strong financial performance

AerCap should be considered a financing company which requires assessment of leverage, funding and liquidity. It is not hard for a financing company to grow. There are plenty of people and businesses that will take your money if you offer to lend it to them. They just might not pay you back. Likewise, there are plenty of airlines that will happily lease an aircraft from you for a low rental or other favourable lease terms. They just might not pay the lease, and/or maintain or even return your aircraft. **Growing purely to be bigger is unlikely to deliver strong investor returns.**

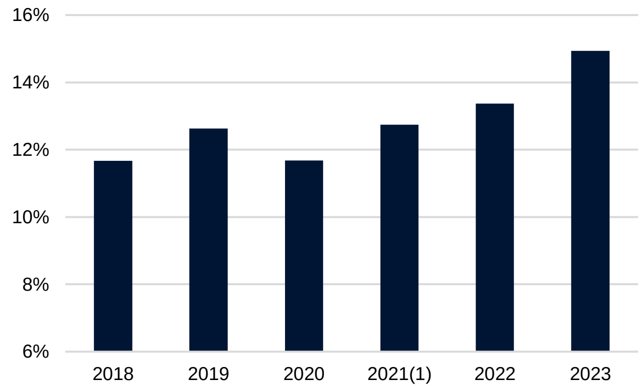
In our view, **AerCap management has demonstrated the right balance between growth and returns on equity invested in the business, through prudently allocating capital and managing risk.**

Figure 15: AerCap earnings per share – consistent growth



Source: L1 Capital International

Figure 16: AerCap return on equity – achieving target of 8 to 10% above risk free rate



Source: L1 Capital International. Note 1: 2021 ROE adjusted for the timing of the completion of the GECAS acquisition

Attractive valuation, and even more 'hidden value'

AerCap is trading on a forward P/E ratio of around 8x and 1x tangible book value. In other words, at the current price, we are investing at the net equity value of the aircraft owned by AerCap and **are paying no goodwill for a business that has consistently delivered returns well above its cost of capital, and which is run by an exceptional management team, operating from a position of competitive strength in an industry with sustainable long term growth drivers.**

But wait, there's still more… We believe AerCap's **tangible book value of around $90 per share is materially understated:**

- GECAS was acquired for $30 billion in 2021, funded with both equity and debt. Management estimates they acquired the assets at a $3.3 billion discount to market value, or around **$15 per AerCap share**.

- **Aircraft values have increased materially in recent times**. The tight supply and demand conditions are leading to both increased lease rates and higher aircraft values when sold. Every 5% increase in market value of aircraft above book value also adds around **$15 to AerCap's tangible book value per share**.

- When Russia invaded Ukraine, AerCap and many other lessors had a number of aircraft in Russia. Effectively the Russian airlines and authorities stole these aircraft from the lessors and AerCap was forced to record a $3 billion write-down of these assets, resulting in zero book value for these aircraft. Subsequently there have been partial settlements with the Russian authorities and airlines and AerCap has recovered $1.3 billion. AerCap remains in discussions with the Russian authorities as well as pursuing litigation against its insurers to recover the balance of the losses. We believe **further recoveries are likely** and represent additional value of **$5 per share** or more that is not reflected in tangible book value.

- AerCap has commitments to purchase around $20 billion of aircraft and engines over coming years. It is unusual to consider commitments to spend money as a source of value, but in the current world of acute aircraft shortage we believe **the ability to secure aircraft** from Airbus and Boeing, even if delayed, represents an **additional source of value**. Many of these aircraft are already committed to airlines at agreed lease rates, which does temper any additional value to AerCap.

Outside of unusual events such as COVID-19 and the Russian situation, AerCap has consistently realised net gains on sale when it sells aircraft. We expect **AerCap will continue to realise a premium to book value when it divests aircraft.**

Our unique definition of 'Quality', detailed industry knowledge and consistent focus on Value has highlighted a compelling opportunity to invest in AerCap. We have continued to add to our investment in AerCap over the past 3 months, with AerCap now being a top 10 holding of the Fund.

Fund Information

Name	L1 Capital International Fund (Managed Fund)
Portfolio Manager	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	$25,000
Hedging	Unhedged
Structure	Dual Registry
Domicile/currency	Australia/$
Inception	Unit Trust: 1 March 2019. ETMF: 22 November 2023
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 $
Performance fee	15.38% over Benchmark inclusive of GST and net of RITC*
High watermark	Yes
APIR / ISIN / ASX Ticker	ETL1954AU / AU0000302960 / L1IF
Platform Availability	Asgard, Australian Money Market, BT Panorama, CFS Firstwrap, Hub24, Macquarie Wrap, Mason Stevens, Xpand, Netwealth, North, Powerwrap, Praemium

L1 Capital International overview

L1 Capital International is an independent active manager of global equities. 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.

Contact us

Level 32, 1 Farrer Place
Governor Phillip Tower
Sydney, NSW 2000
Email info@L1.com.au

www.L1International.com

Invest now

Head of Distribution	Chris Clayton	cclayton@L1.com.au	+61 3 9286 7021
Researchers	Aman Kashyap	akashyap@L1.com.au	+61 477 341 403
Advisors	Lisa Salamon	lsalamon@L1.com.au	+61 406 585 322
	Bryce Leyden	bleyden@L1.com.au	+61 407 876 532
Brokers	Alejandro Espina	aespina@L1.com.au	+61 423 111 531
Private Wealth	Hugo Brettingham-Moore	hb-m@L1.com.au	+61 408 371 473
Private Clients	Alexander Ordon	aordon@L1.com.au	+61 413 615 224
Investor Services	Jeffrey Lau	jlau@L1.com.au	+61 403 194 728

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.

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

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 International Fund (Managed Fund) ARSN 631 094 141 (ASX:L1IF). 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 International Pty Limited (ACN 628 068 717), (an authorised representative (no. 1273764) of L1 Capital Pty Ltd (ACN 125 378 145, AFSL 314 302) and its officers and employees (collectively 'L1 International'), 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 International, 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. The Managed Fund's Target Market Determination is available here.