



L1 Long Short Fund Limited

(ASX Code: LSF)

Key Details

ASX code	LSF
Share price	\$1.29
Market capitalisation	\$848m
Shares on issue	658,114,144
Listing date	24 April 2018

The L1 Long Short Fund returned 11.0% in May (ASX200AI 4.4%).

The Fund has now recovered 36.7% since the end of March.

The Fund performed strongly in May due to the recovery in many oversold long positions, along with very strong performance in a number of new positions bought near the market lows.

Global equity markets continued to recover with government stimulus measures and a gradual easing of lockdown restrictions increasing investor confidence in May. The ASX200 Accumulation Index gained 4.4%, following developed markets which were also higher (MSCI World 4.6%, S&P500 4.5%, FTSE 3.0%). The best performing sectors in Australia were Information Technology (+14.5%), Communication Services (+8.4%) and Materials (+8.1%), while Healthcare (-5.3%) and Consumer Staples (-0.4%) lagged.

Some of the key contributors and detractors to performance in May were:

Atlas Arteria (long) – Part owner of one of France’s best quality toll road networks, which had a very eventful last few months both at the corporate and asset level. As French and US lock downs precipitated traffic declines of up to 90% on the company’s toll roads, Atlas Arteria shares declined by almost 50% from February highs of ~\$8.50. We re-entered Atlas Arteria during late March and April, buying the bulk of our position for around ~\$5.00. It has subsequently rallied to above \$6.50 at month end, as traffic has started to steadily recover. At month-end, Atlas Arteria launched a placement and SPP to raise up to \$495m to strengthen the balance sheet and allow them to fully benefit from likely investment opportunities emerging as the French Government encourages infrastructure stimulus spending to boost economic recovery. Despite the strong recent rally, we still see further substantial upside in Atlas Arteria as dividends return in 2021 and 2022 towards our previous expectations.

Oil Search (long) declined from January highs of ~\$7.50 to below \$2.00 in March as oil prices cratered under the dual impact of dramatically falling demand and a breakdown in the OPEC+ cartel. Oil Search was one of the earlier ASX companies to launch a large capital raising to protect their balance sheet against the risk of a prolonged downturn in oil markets. We participated in the raising and significantly added to our position between \$2.00-3.00/share. Over the course of April and May we have seen oil prices stage a modest recovery with a gradual improvement in demand and a meaningful reduction in supply as OPEC+ reached a belated agreement to attempt to balance markets. Oil Search has a large stake in two very substantial growth projects in PNG and Alaska and, as oil prices recover, we believe the market will likely reincorporate meaningful value for these projects in group valuations. Furthermore, we believe the more difficult economic backdrop in PNG is likely to incentivise the PNG Government to resolve their differences with the joint venture to enable this project to proceed, subject to market conditions.

Net Performance*

	NTA pre-tax
One month	10.96%
Three months	5.31%
Six months	(7.64%)
One Year	3.19%
Total return since inception	(16.66%)

*Source: Mainstream Fund Services. Net performance is defined as the movement in NTA pre-tax. Performance is shown after all applicable fees and charges. Past performance should not be taken as an indicator of future performance.

Worley (long) – The Fund bought back into Worley around \$6.80 (after fully exiting the position at the start of the year around \$10-\$13). After falling by over 50% during the March quarter, Worley shares staged a modest recovery in April and May. We believe Worley is much better placed to handle this downturn relative to the last cycle. Post the Jacobs ECR acquisition, Worley is more diversified across sectors and geographies, with upstream oil and gas capital expenditure now representing only 20% of group project work and ~45% of revenues derived from customers’ operating expenditure (rather than capex investment). Worley’s non-upstream business lines should remain relatively resilient in this environment. While upstream capex will likely be very subdued in the near-term, this should normalise over the medium-term given the global oil industry faces depletion rates of ~5-6% p.a. requiring oil companies to increase investment just to maintain production levels. In late April, Worley provided a very positive market update that showed considerable resilience over the last couple of months and highlighted a proactive approach to managing costs and staff utilisation levels going forward.

Hotel Property Investments (HPI) (long) is the owner of a strategic pubs/hotels property portfolio that is critical for Coles liquor licensing. Queensland law requires liquor stores to be associated with a nearby hotel and defaults on pub/hotel leases would result in Liquorland having to shut liquor retail outlets in Queensland. HPI shares have recovered strongly from the March sell-off but are still trading on a yield of over 7% and a discount to NTA which has been struck on a conservative 6.1% cap rate. In the coming weeks we expect a gradual reopening of HPI venues which should continue to improve market confidence in the asset base. We believe the 12 year average lease term with high quality tenants makes HPI one of the most attractive and lowest risk opportunities in the Australian REIT sector.

CK Hutchison (long) was a key detractor for the Fund in May given the general weakness in the Hong Kong market driven by an increase in US/China tensions (despite Hong Kong representing only ~1% of group earnings). CK Hutchison delivered a solid earnings result in March and flagged their appetite for acquisitions given their substantially under-gearred balance sheet and the raft of undervalued assets on offer. CK Hutchison is currently trading on a P/E of less than 5x normalised earnings, with a 7% dividend yield and a free cash flow yield of over 20%. We see a major positive catalyst for the shares in the coming months, as the firm is set to sell down its €5b telco towers assets, which can be redeployed for highly accretive deals/buybacks. We are also encouraged by the large scale share buying by the CEO in recent months. While its minority stake in Husky is a small component of the group valuation, any oil price recovery will assist in restoring group EPS to pre-COVID-19 levels, which we expect to see later in the current year.

Other strong performers in May included Chorus, Alacer Gold and Perenti. The Fund exited its investment in Alacer Gold over April and May at around ~\$10.00 after initially establishing a position in June 2018 at around ~\$2.50. Given Alacer's strong performance over the past two years, we elected to rotate those proceeds into other gold stocks that we believe now offer more significant valuation upside.

The Fund's very strong recent performance has been pleasing, but we would caution investors to expect heightened Fund volatility in the short term, given still elevated market volatility, ongoing news flow regarding COVID-19, large swings in economic activity, policy responses and investor sentiment. We recognise the outlook for the global economy is uncertain and market volatility is likely to remain elevated, however, the Fund is well placed to navigate these events. We believe the rotation out of safe havens (which are actually expensive and far from safe) and into oversold and undervalued companies has further to go and the Fund is ideally positioned to benefit from this move. We remain very excited and optimistic about the medium-term outlook for the Fund.

Portfolio Exposures (month end)

Number of positions	90
Number of long positions	65
Number of short positions	25
Gross long exposure (%)	191%
Gross short exposure (%)	91%
Gross exposure (%)	282%
Net exposure (%)	100%

Investment Guidelines

Typical number of positions	50-100 securities
Geographic exposures	Max 30% gross outside of Aust/NZ
Net exposure limits	Max 150% of NAV; typically 30-90%
Gross exposure limits	Max 300% of NAV; typically 150%-300%

Overview and Investment Philosophy

L1 Long Short Fund Limited has been established to invest in a portfolio of predominantly Australian and New Zealand securities, with up to 30% invested in global securities. The Company has the ability to both buy and short-sell securities, which provides a flexible strategy to deal with changing stock market conditions. The objective is to deliver strong, positive, risk-adjusted returns to investors over the long term. The portfolio is managed by L1 Capital Pty Ltd, which has established a reputation for offering clients best of breed investment products. L1 Capital manages money for a range of clients including large superannuation funds, endowment funds, financial planning groups, asset consultants, family offices, high net worth individuals and retail investors.

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Net Tangible Assets Per Share (as at 31 May 2020)*

NTA pre-tax	\$1.6668
NTA post-tax	\$1.7775

*Source: Mainstream Fund Services. The NTA pre-tax is calculated before the provision for deferred tax on unrealised gains and losses on the investment portfolio. The NTA post-tax is calculated after all taxes.

Board of Directors

Andrew Larke	Independent Chair
John Macfarlane	Independent Director
Harry Kingsley	Independent Director
Raphael Lamm	Non-Independent Director
Mark Landau	Non-Independent Director

Key Contacts

Company secretary	Mark Licciardo
Investor relations	Wayne Murray WMurray@L1.com.au
Manager	L1 Capital Pty Ltd +61 3 9286 7000 info@L1LongShort.com
Registry	Link Market Services Limited 1300 554 474 registrars@linkmarketservices.com.au