L1 Capital International Fund

Quarterly Report | DECEMBER 2021

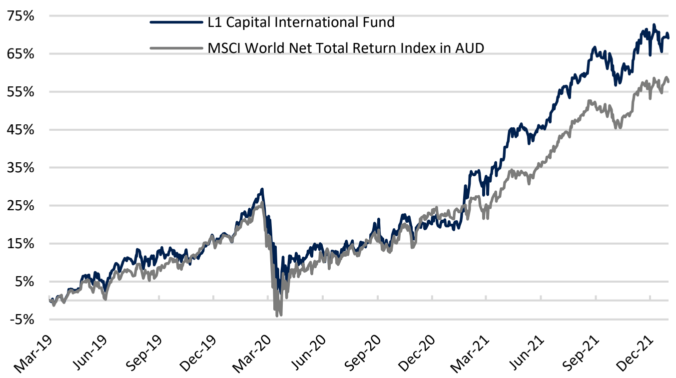
Introduction

In this December 2021 Quarterly Report, we have outlined:

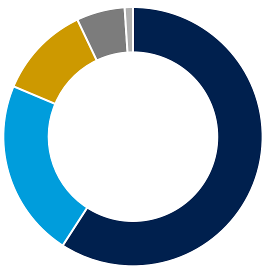
- **Our quarterly review.**
- **2021 reflections and outcomes.**
- **Current market debates.**
- **Investment opportunities and portfolio positioning for 2022 and beyond.**
- **An overview of CRH plc, the 1,100+ bagger you have never heard of.**

Fund Performance (Net) (%)[1]	Fund	Index[2]	Alpha
3 months	6.2	7.1	-0.9
1 Year	41.1	29.3	+11.9
2 Years p.a.	21.1	16.8	+4.2
Since Inception p.a.	20.3	17.4	+3.0
Since Inception cumulative	69.2	57.6	+11.5

Fund (Net) & Benchmark Returns Since Inception[1]



Revenue Exposure by Region[3]



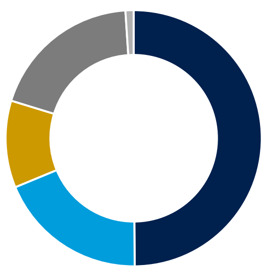
- North America 59%
- Western Europe 22%
- Asia Pacific 12%
- Rest of World 6%
- Cash 1%

Top 10 Holdings (In Alphabetical Order)	Sector
Amazon	Consumer Discretionary/Internet
CRH	Building Products
Eagle Materials	Building Products
Graphic Packaging International	Industrials
IQVIA	Health Care
Louisiana Pacific	Building Products
Marsh & McLennan	Commercial Services
Mastercard	Payments
Microsoft	Software
TSMC	Industrials

Sector Exposure[4]

- Consumer Discretionary 17%
- Building Products 15%
- Software 14%
- Commercial Services 13%
- Industrials 13%
- Payments 8%
- Internet 8%
- Health Care 5%
- Exchanges 4%
- Cash 1%

Market Capitalisation Exposure



- $100 billion+ 50%
- $50-100 billion 19%
- $10-50 billion 11%
- < US$10 billion 19%
- Cash 1%

1 Figures may not sum exactly due to rounding. Past performance should not be taken as an indicator of future performance. 2 MSCI World Net Total Return Index in AUD. Return measured from Index close on 1 March 2019. 3 Revenue by region is internally estimated on a look through basis based on the underlying revenues of the individual companies held in the portfolio. 4 Industry classification is defined by L1 International to best describe the nature of the underlying businesses.

December 2021 Quarterly Review

Performance

The L1 Capital International Fund return 6.2% (net of fees) during the December 2021 quarter compared to the benchmark return of 7.1%. The Australian dollar appreciated 0.5% against the U.S. dollar and 2.4% against the Euro, detracting from reported Fund and benchmark returns.

For the 2021 calendar year, the Fund returned 41.1% (net of fees), outperforming the benchmark by 11.9%.

Key contributors and detractors

As at 31 December 2021, the portfolio consisted of 24 companies, with the Top 10 holdings accounting for 58.6% of the portfolio.

While overall positive, contributions to performance during the quarter were somewhat mixed. 13 companies contributed 0.25% or greater (in AUD), with 3 companies – **Eagle Materials**, **Louisiana Pacific** and **Microsoft** (in alphabetical order) – each contributing more than 1% to the portfolio's performance. Four companies each detracted more than 0.25% (in AUD), with one company, **Open Lending**, detracting more than 1% from the Fund's performance.

The Fund was fully invested throughout the December 2021 quarter, ending with cash levels of around 1%. **We believe our portfolio of high-quality businesses is well-balanced for a range of operating and market conditions and we view current valuations as attractive.**

Portfolio adjustments

Adjustments to the portfolio were relatively modest and centred on some of the smaller positions. Within the Top 10 holdings, there were two additions and two exits, although both companies that exited the Top 10 remain meaningful positions.

Eagle Materials returned to the Top 10 due to relative outperformance, with the share price increasing 27% (in USD). Eagle Materials is one of the portfolio's businesses exposed to the U.S. new residential, repair and renovation and infrastructure sectors, all of which have a robust outlook.

Reflecting our positive view on these key drivers, we added to our investment in **CRH**, with the company entering the Top 10, funded by trimming our investment in **Louisiana Pacific**. We remain very positive on the outlook for Louisiana Pacific, but with the share price increasing 28% (in USD) during the quarter we prudently reallocated part of the Fund's investment to CRH, a higher quality business with overlapping industry exposure. See page 8 of this quarterly report for a detailed overview of CRH.

We trimmed our investment in **Intuit** following a period of strong share price performance. Our decision to reduce the size of Intuit's position in the portfolio was solely due to our views on Intuit's valuation relative to alternative investment opportunities, and reflects our valuation discipline, even for Quality 1 rated businesses. We would welcome the opportunity to increase our investment in Intuit should the share price fall further from current levels.

Alphabet exited the Top 10 due to relative share price performance and other portfolio adjustments – we did not divest any shares in Alphabet.

Outside of the Top 10, three companies were divested and initial positions in two companies were added to the portfolio. Both portfolio additions were companies that were promoted from our Bench. Our Bench is a group of companies that have been fully assessed and we are ready to invest, should an attractive opportunity arise. Having a Bench of high-quality investment alternatives to our portfolio is a core aspect of our investment process.

Open Lending was the key disappointment during the quarter, with the share price falling 38% (in USD). The fall in the share price reflected a combination of over-optimism on our part, challenging near-term market conditions, mixed market communications by management and a general market selloff in higher-growth, higher-multiple businesses.

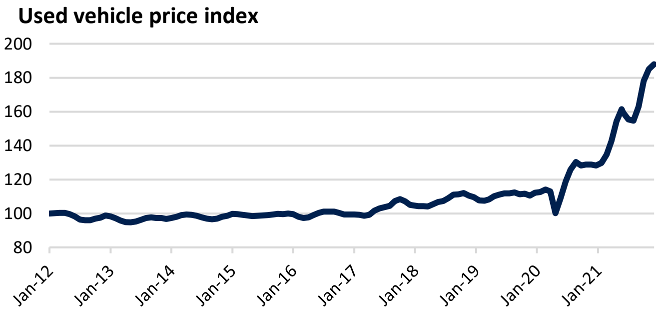
Open Lending provides software and analytics that helps credit unions, banks and the captive finance arms of auto manufacturers with underwriting 'near-prime' loans for purchasers of mostly used but also new vehicles. To mitigate credit risk exposure, the loans are underwritten with lender's protection insurance provided by independent insurance companies. Open Lending does not provide any capital to fund the loans, nor does it guarantee the performance of the loans, but it does share in the profit retained by the insurer which depends on credit performance.

In other words, Open Lending cannot lose money on origination of a loan through its software and analytics platform, but its share of the profit from the loan does depend on how the loan performs. Loan performance has been strong, ahead of base case expectations, reflecting the strength of consumer credit in the U.S. as well as robust used car prices.

The other key driver of Open Lending's financial performance is how many loans are originated through its platform. Due to acute semiconductor shortages, the number of new cars manufactured and sold in the U.S. has been constrained, with the availability of lower and mid-range cars further pressured as auto manufacturers divert limited semiconductor supplies to higher value, more profitable models. New auto manufacturing constraints have flowed through to used cars, with demand exceeding supply resulting in a sharp increase in average used car prices, pressuring affordability for 'near-prime' borrowers.

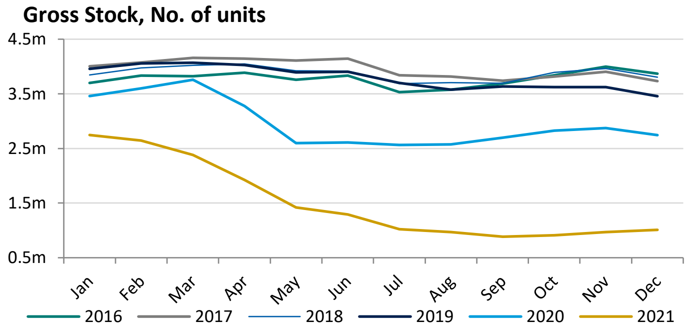
In addition, excessive auto vehicle demand relative to the supply diminishes the need for auto manufacturers to target borrowers facilitated by Open Lending's platform. This growth opportunity will be delayed until demand-supply conditions return to more normal levels.

Figure 1: Used vehicle prices have skyrocketed due to the shortage of new vehicles



Source: Manheim Consulting

Figure 2: Auto industry stock levels are exceptionally and unsustainably low



Source: Wards, Motor Intelligence, Credit Suisse

The result of these industry factors has been a reduction in the number of loans authorised through the Open Lending platform relative to management and our expectations. Loans that have been originated have performed well, and management has sought to handle the situation by increasing exposure to other market segments, such as refinancing opportunities. However, volumes are under pressure and will likely remain that way in the near term before gradually improving during the year.

These impacts on Open Lending's key business drivers were readily identifiable and our base case expectations were too slow to adjust to the change in business operating conditions. That said, we believe the market has over-reacted to the current challenging environment. Open Lending's business continues to improve, with new customer, insurer and auto industry relationships. Growth remains strong, just not as strong as it would have been absent the market distortions caused by the auto semiconductor shortages. The company operates with over 60% EBIT margins and has negligible debt. This is not a case of a newly established, unprofitable, cash-bleeding, unproven technology business. Open Lending has a 20-year operating history and a seasoned senior management team, although they are relatively new to the public company limelight. The market has generally derated 'high growth, unprofitable tech' companies recently and Open Lending's share price has been impacted by some of these market dynamics.

We believe the current share price is materially below fair value and overly reflects the challenges of near-term operating conditions. 2022 will likely remain challenging but over the next few years we expect Open Lending's growth and financial performance to revert towards our prior expectations. We have incrementally added to our investment in Open Lending during the past quarter at prices we consider to be well below fair value for patient investors.

2021 Reflections and Outcomes

Leaving COVID-19 aside for a moment, at a macro level, we wrote on our December 2020 quarterly report that interest rates would be a key driver of valuations, central banks around the world would continue very accommodative policies, inflation would be constrained to relatively small idiosyncratic areas and that interest rates would gradually rise from extremely depressed levels.

Broadly, these views proved to be correct, although inflation has certainly exceeded our expectations, both the absolute level and broadness of current inflationary pressures. We discuss these issues further in the following section on page 5.

While having a macro view is relevant, at **L1 Capital International we focus on bottom-up company investing**. Our portfolio is relatively concentrated (typically around 25 businesses) and our threshold requirement for only investing in high quality businesses means we do not invest in all sectors or all companies. Our industry exposure is flexible. We are not constrained by artificial concepts such as 'Growth' or 'Value', and we invest in a wide range of companies by size.

Contributors to the portfolio's 41.1% return (net of fees) for calendar 2021 were widespread, reflecting the flexible nature of our investment philosophy and diversified portfolio exposures.

During 2021, 16 companies each contributed greater than 1% (in AUD) to the portfolio's returns, while only Open Lending detracted more than 1% (Open Lending's negative contribution was 1.5%).

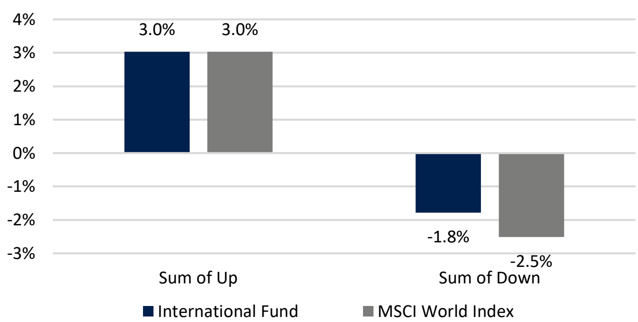
To reflect our views that the world would gradually normalise during 2021, at the end of 2020 we had deliberately, meaningfully increased our exposure to residential, renovation and repair and infrastructure spending, particularly in the U.S.. Businesses exposed to these key drivers performed well during 2021, with Eagle Materials, CRH and Louisiana Pacific being important contributors to the Fund's performance. Reflecting the diversified nature of the Fund and flexibility in our investment philosophy, higher-growth technology businesses such as Alphabet, Intuit and Microsoft also made significant contributions to performance.

Besides Open Lending, we call out **Amazon's** share price performance during 2021 as being below our expectations, only slightly increasing, and materially underperforming the benchmark average return. We explicitly state share price performance, as Amazon's business performance was strong. Amazon Web Services (AWS) exceeded our robust expectations, while Amazon's eCommerce business continues to extend its competitive advantages. Short-term earnings have been pressured by elevated investment and operating costs (partly COVID-19 related), but we believe Amazon's margins, earnings and cashflow will inflect substantially higher over coming years. Amazon is one of the largest investments in the portfolio. **We considered Amazon to be undervalued at the start of 2021 and we believe it is even more undervalued today.**

In mid-2021, we determined China was uninvestable due to increased regulatory uncertainty. We had divested the Fund's investment in **Tencent** in early January 2021 as the share price exceeded our view of value, crystallising a strong gain. We completed the divestment of **Alibaba** in July 2021, realising a modest gain on our investment. We no longer have any domestic Chinese companies in the portfolio or on our bench of potential investments. **TSMC** remains a Top 10 holding, although the position size is near our self-imposed maximum due to the inherent geopolitical risks of being a largely Taiwan-based business.

Over the longer term, investment returns are supported by minimising investment mistakes and protecting capital during more difficult environments. Since inception, despite holding cash particularly during the early highly uncertain days of COVID-19, the L1 Capital International Fund has increased in line with the market during 'up months' and decreased significantly less than the market during 'down months'. This has resulted in the Fund returning 20.3% p.a. (net of fees) since inception, 3.0% p.a. ahead of the benchmark return.

Figure 3: Average Monthly Return in Up and Down Markets



Source: L1 Capital International as at 31 Dec 2021.

Portfolio Positioning for 2022 and Beyond

Current market debates

COVID-19 was a constant, evolving backdrop during 2021. Infection rates, hospitalisations and death rates increased and decreased in waves as the world moved from season to season, Alpha became Delta only to be replaced by Omicron. Vaccination rates increased, more so in some countries than others. As we enter 2022, infection rates are spiking globally (excluding China) due to the highly contagious Omicron variant. Hospitalisation rates and death rates are also increasing, but not to the same extent as infection rates. Generally, despite Omicron being highly infectious, people are moving on with their lives, by choice or necessity. **COVID-19 tail risks, such as adverse mutations remain, but current trends support the world continuing to normalise post the COVID-19 disruptions and market expectations reflect continued normalisation of economic activity**. Recovery is unlikely to be linear and supply chain, consumer spending, employment and other distortions will likely continue.

The central market debate has moved on from COVID-19 and is now firmly focused on inflation and interest rates. It is easy to see why when looking at headline data, particularly in the U.S. where inflation has spiked (mainly for goods rather than services), unemployment rates have fallen dramatically, labour force participation rates are recovering from COVID-19 disruptions and wages growth is building.

Figure 4: U.S. CPI (Inflation) is currently 7%, well above the 2-3%, on average, over time targeted by the Federal Reserve

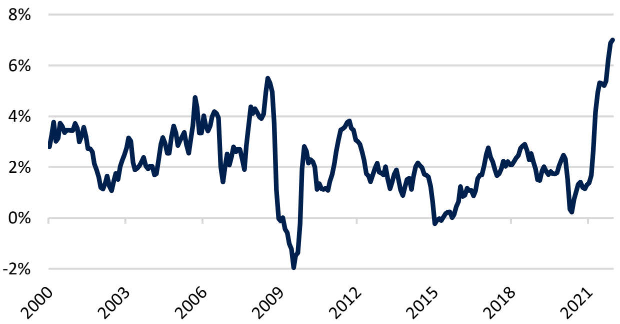


Figure 5: The U.S. unemployment rate has reverted back to pre-COVID-19 levels

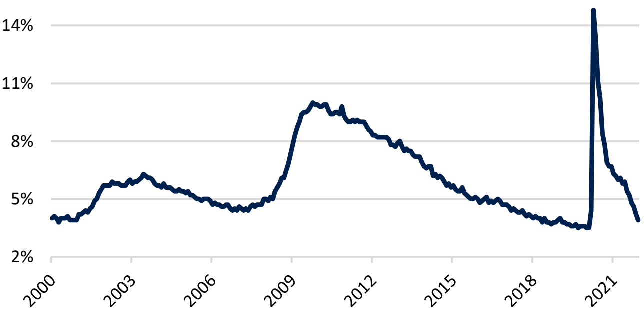


Figure 6: U.S. labour participation rate has only partially recovered from COVID-19 impacts

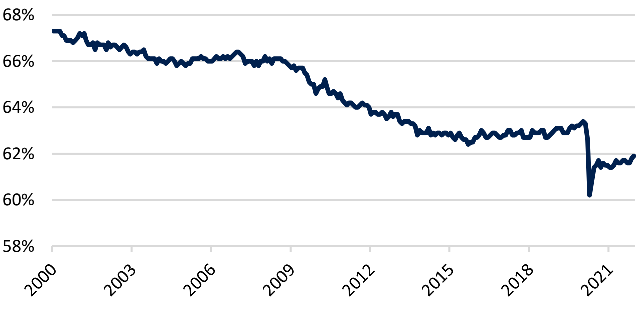
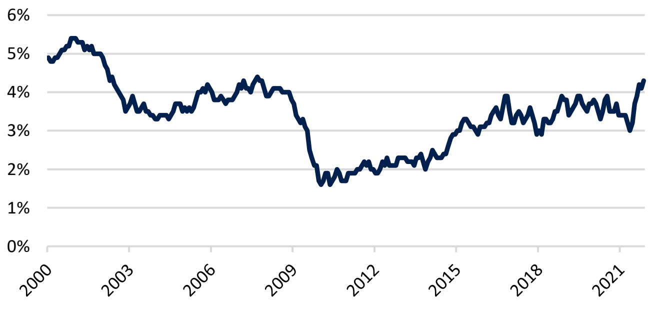


Figure 7: U.S. wages growth is accelerating



Source: Federal Reserve Bank of St. Louis, L1 Capital International

The Federal Reserve has responded with the ending of Quantitative Easing, expectations of balance sheet tapering and telegraphing to the market that U.S. interest rates will begin to be increased in 2022.

'Transitory' is now a dirty word. However, our view remains that there are factors, largely caused by COVID-19, which have exacerbated inflationary pressures in areas such as used cars, steel and other raw manufacturing materials. Energy price increases has also been a key contributor.

Household savings rates are normalising, and Fiscal stimulus is reducing. Spending patterns are still distorted by COVID-19, with elevated spending on Goods rather than Services, creating short term excess demand on already stressed supply chains.

Figure 8: The proportion of U.S. Personal Consumption Expenditure on Goods remains elevated

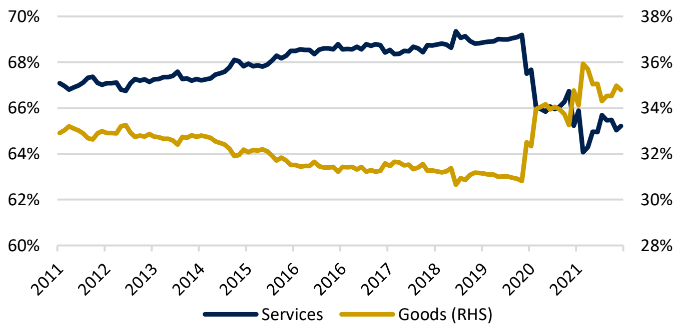
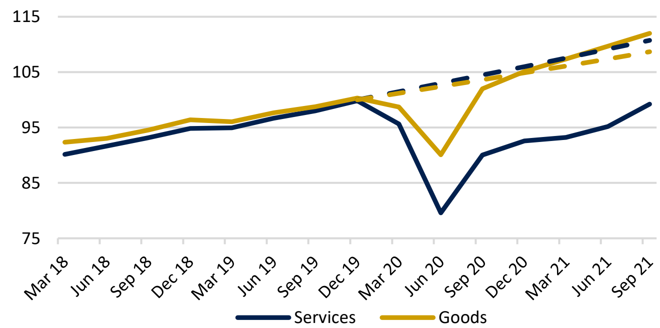


Figure 9: Globally, spending trends are similar with Goods spending well ahead of trend and Services spending well below trend



Source: Bloomberg, UBS and L1 Capital International

Real interest rates are still exceptionally low. We do expect interest rates to increase – just not dramatically. 10-year average inflation expectations implied by the bond market, while no longer artificially depressed by COVID-19, are still a 'normal' 2-3% p.a..

Figure 10: 10-year Treasury Inflation Protected Securities are still yielding negative rates

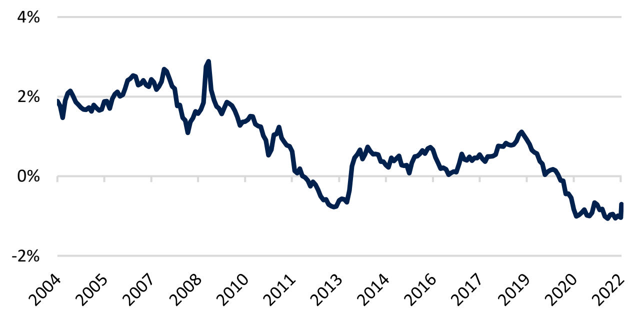
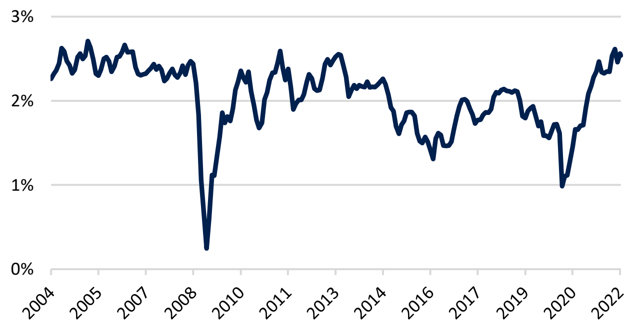


Figure 11: Market expectations remain for a sustainable 2-3% average U.S. inflation rate over the next 10 years



Source: Federal Reserve, L1 Capital International

However, we were surprised in 2021 by the degree of inflation, and inflation in 2022 and beyond could also be more widespread and exceed our expectations. We mitigate this risk through our focus on **bottom-up industry and company analysis to invest in high-quality businesses with pricing power that can adapt to an inflationary environment**, as outlined in detail in our **September 2021 Quarterly Report**.

Many companies in our portfolio demonstrated their pricing power in 2021 and continue to be well placed to adapt to changes in the inflationary environment.

Bubbles deflating, opportunities developing

Market indices can be somewhat misleading. At the time of writing, the MSCI World Index (in AUD) is down 2% from its record close, while the S&P 500 Index and Nasdaq Index are down by around 3% and 6%, respectively, from their peaks. Below the surface of the aggregate indices, the share price of many companies has fallen dramatically during 2021 and early 2022.

In our **December 2020 Quarterly Report** we noted "We see bubbles forming in some market sectors, where 'fear of missing out', record margin loan debt and the allure of a good investment story is causing share prices of some companies to disconnect from fundamental valuation metrics."

During 2021 some of these bubbles deflated, with the share price of 'unprofitable technology companies' under significant pressure and 'Growth' underperforming 'Value'. This, in part, reflected rising interest rate expectations and greater value discipline by investors. These trends have been particularly acute over the final few months of 2021 and have accelerated in early 2022. 'Rotation' is once again the word *du jour*:

Figure 12: Unprofitable technology companies were under price pressure in 2021 and 'Growth' underperformed 'Value'

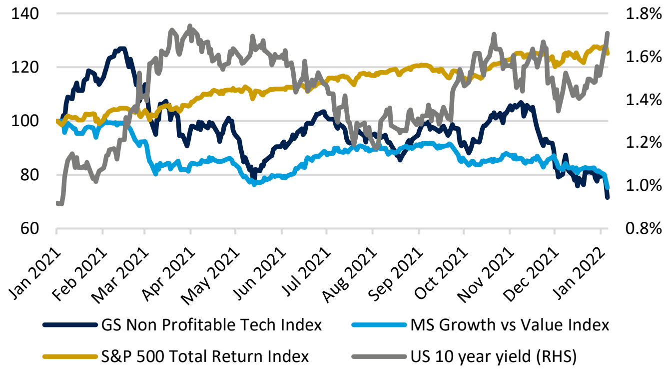
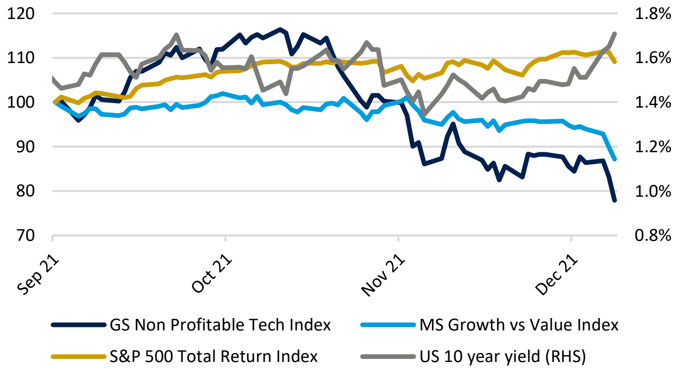


Figure 13: These trends have accelerated in recent months



Source: Bloomberg and L1 Capital International

Super Forecasting, authored by Philip Tetlock and Dan Gardner, is described by Daniel Kahneman (author of *Thinking, Fast and Slow*) as a "manual for thinking clearly in an uncertain world." COVID-19 has certainly increased the world's uncertainty, so anything that helps clear thinking is well worth the time. It is an easy read, taking somewhere between the time it takes to bowl the English side out during the current Ashes series, and receiving a COVID-19 PCR test result. To rephrase Jim Collins, *Super Forecasting* is good, not great, but it does have some interesting concepts and scores points from us for quoting Charlie Munger on the importance of understanding elementary probability analysis.

Tetlock notes that in the context of forecasting returns from the share market, people gravitate to commentators who make confident, simple statements and forecasts. Journalists don't write "The market rose today for any of a hundred different reasons, or a mix of them, so no one knows."

We believe simple statements and forecasts comparing the outlook for 'Growth' or 'Value' investing may be fleetingly attractive, but they are rarely accurate and even less rarely repeatably accurate.

L1 Capital International has a **unique investment process to invest in high quality businesses**. While all industries and companies we invest in are growing, the rate of growth varies. **Some businesses in the L1 Capital International Fund would be classified as 'Growth', while others 'Value', but all must meet our stringent definition of high quality**. We apply strict valuation discipline when assessing all investments. The Fund has no exposure to 'unprofitable technology' businesses which require too much speculation on the future to justify the present share price.

Our diversified portfolio construction led to strong investment returns during 2021 in a range of market conditions. Over recent months the share price of some of the higher growth companies in the portfolio, such as **Intuit** and **Adobe**, have been under pressure. Generally, the share prices of these higher growth businesses have fallen from around the upper end of our view of fair value and are now trading at or below the lower end of our fair value range. Should capital flows continue to move away from these businesses causing further share price pressure we will look to increase our investment in these high-quality, strongly profitable, and sustainably high-growth businesses.

The share price of more cyclical, 'Value' companies in the portfolio performed strongly during 2021. We remain highly selective and continue to believe the outlook for these businesses remains very favourable in 2022 and beyond.

We look forward to providing an update on the performance of the portfolio following the upcoming Q4 2021 results period, during which many companies will also provide outlooks for their expected performance in 2022.

Portfolio Investment | CRH plc*

Have you ever pondered which company:

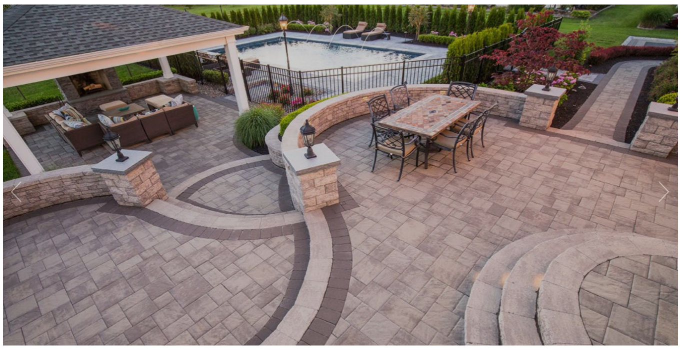
- Made the telecommunications access cover (the object formerly known as a manhole cover) you stepped on as you walked your dog?
- Supplied the asphalt and paved the road as you had a rare smooth drive somewhere in the U.S.?
- Manufactured the telecommunications cable or water pipe precast concrete protection system to ensure the electricity or water we use in everyday life is safely delivered?
- Ensured the glass wall panels in your office building stayed in place?
- Supplied the pavers, decking and even the garden mulch at your European or North American holiday resort?

All of these burning life questions can be answered with three letters… CRH.

Largest provider of asphalt and paving services in the U.S.

Diversified infrastructure products and solutions throughout Europe and North America

Extensive range of outdoor living building products



Exposure to robust infrastructure spend across transport, telecommunications, water and energy industries

Source: CRH

CRH was formed in 1970 through the merger of two Irish companies, Cement Limited and Roadstone Limited, and has grown organically and through acquisitions to become the largest building materials business in North America and Europe. It also has a small presence in the Asia Pacific region, including Australia (next time you step on a CUBIS or BVCI branded access cover embedded in the pavement you can join us in having an inner glowing feeling about your investment in the L1 Capital International Fund).

Despite, our attempts to excite, you may be feeling CRH is a somewhat mundane business. The next sentence will change your perceptions. **Over the past 50 years, CRH has delivered shareholders a compound annual total shareholder return of 15.1% – that equates to over 1,100 times your initial investment 50 years ago** (the extra 0.1% p.a. adds over 50x your initial investment due to the magic of compounding over long time horizons).

Rarely will you see CRH mentioned by market commentators in their attention seeking investment highlights, or even in an investment manager's attempted erudite quarterly report. However, we believe CRH is a genuinely under-appreciated, high-quality business trading at an attractive valuation, providing a **compelling 'get richer consistently over time' investment opportunity**.

** All values related to CRH in this section are in USD unless otherwise noted.*

CRH's quality is subtle – it is not possible to point to a universally well-known brand (although many of its trade names are very well regarded in the industry), dominant global market position or unique technological advantage. Yet CRH has provided shareholders with attractive returns over many decades even though the company operates in inherently cyclical industries. In our view, CRH's quality is due to a range of inter-connected facets:

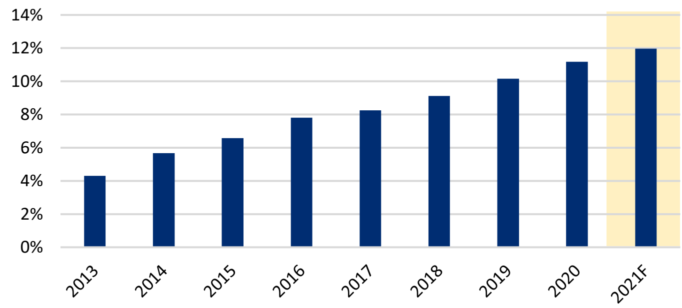
- Largely a provider of integrated building materials solutions, providing CRH with pricing power and margin enhancement opportunities,
- Attractive end-market exposures diversified by sector and geography,
- Exceptional, experienced and aligned management focused on portfolio optimisation, not empire building,
- A culture of decentralised responsibility, ownership and financial accountability,
- Long-lived, strategic, cost-advantaged raw materials with strong regional market positions utilised in a sustainable manner, and
- Strong and improving financial metrics with significant free cashflow providing flexibility to grow through value-accretive acquisitions, as well as delivering returns to shareholders through dividends and buybacks.

Integrated solutions provider

CRH's CEO, Albert Manifold, recently succinctly summarised **CRH's solutions-based approach which supports pricing power**, a key attribute held by high-quality businesses as we outlined in our **September 2021 Quarterly Report**:

"…our business now is how we take…the base materials that we have, and we convert them into products…using our technical expertise, our design knowledge to create innovative, bespoke product solutions working in conjunction with engineers and planners and architects…so we're able to provide value, solve problems for our customers and they pay us for that. So, we're no longer a price taker. We're kind of a price maker in the market, and that allows us to dislocate the relations between what we charge our customers for the solutions we solve and what we pay to manufacture our products, and that really fundamental was at the core of our margin improvement for the last number of years, and it will continue in the years ahead."

Figure 14: Significant operating margin expansion through portfolio rationalisation and increased provision of value-adding solutions to customers



Source: L1 Capital International

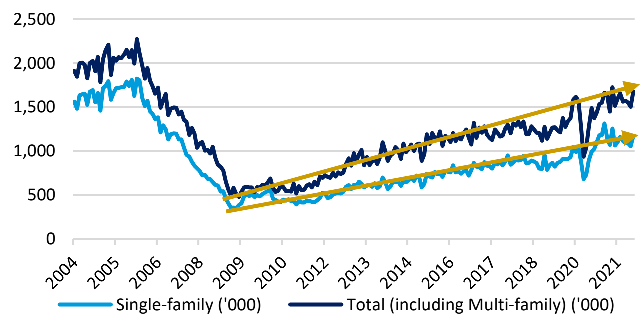
These comments are not just management rhetoric. Through portfolio rationalisation as well as operational improvements and the exercise of pricing power, CRH has significantly expanded operating margins over recent years**, demonstrating pricing power, unlike many of its commodity orientated peers.**

Attractive end market drivers

Longer term followers of L1 Capital International will be aware our investment philosophy is centred on investing in businesses with positive sustainable growth drivers. CRH has diversified exposure to residential (new homes and repair and renovation), infrastructure and commercial sectors throughout North America and UK/Europe. While these end markets are cyclical, we believe the medium-term demand environment is strong, particularly in North America which accounts for around 70% of CRH's total operating profit.

As a leading supplier of aggregates and the largest provider of asphalt and paving services in the U.S., CRH will primarily benefit from the increased highway expenditure over the next five years. CRH also stands to benefit from increased water, telecommunications and other infrastructure spending through its diversified building products businesses.

Figure 15: U.S. Residential Housing Starts



Source: U.S. Federal Reserve

Figure 16: U.S. Infrastructure Investment and Jobs Act Spending

Program	Obligation (USb)
Highways	348
Public Transportation	91
Aviation	25
Multi-Modal Grants	19
Other Programs	490
Total Spending over 5 years	973

Source: The White House

Exceptional, experienced management, shareholder aligned corporate culture

Aligned management with a strong capital allocation track record is another key tenet of the L1 Capital International investment philosophy. The building materials industry has many examples of management teams which have less than stellar capital allocation track records, often making acquisitions and retaining businesses to expand their empire rather than improve the business.

Albert Manifold was appointed CEO in 2014 and has held senior management positions at CRH for over 20 years. Under Manifold's leadership, CRH's portfolio of businesses has been significantly reshaped, with a number of material bolt-on acquisitions as well as significant divestments. Management has sought to actively improve the quality of CRH's group of businesses and not just maximise the size of the group.

CRH employs 77,000 people at 3,100 locations in 29 countries. Collectively, CRH is the largest building materials company in North America and U.K./Europe, but as outlined in the following section, individual business units are often small and regional. Empowering local management is critical to maximising market positions and delivering strong financial performance.

Incentive compensation is well-structured with key performance indicators including cashflow, return on net assets and total shareholder returns. **Cashflow and return on invested capital metrics are entrenched in the operational culture of the Group and are reflected in CRH's financial performance**.

Figure 17: Free cashflow

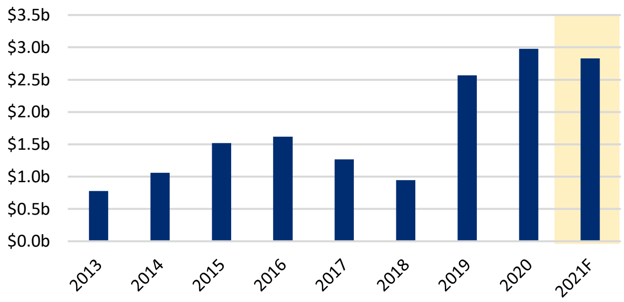
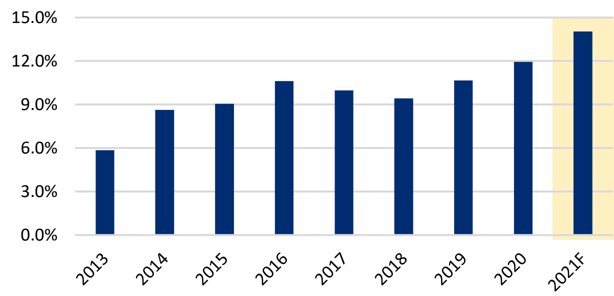


Figure 18: Return on invested capital



Source: CRH and L1 Capital International

Since 2013 (the final year before Manifold became CEO), return on invested capital has increased from 6% to 12%, with free cashflow increasing from under $1 billion to nearly $3 billion. We expect further improvement in both of these key financial metrics.

Strategic local reserves and leading regional market positions developed over decades creating strong barriers to competition

CRH is the largest building materials company in North America and Europe. However, a group-wide overview is not relevant to assessing the industry structure and market position for a business like CRH. Products and services are very local. Aggregates are heavy and have a low value relative to their weight. They can only be economically transported short distances. You need to have a permitted quarry with aggregate reserves close to your end market to be competitive. Quarries a classic NIMBY (not in my backyard) business.

Even if you operate a well-managed, environmentally compliant business, you cannot just get regulatory approval to start digging up rocks wherever you choose. A similar concept applies to cement plants, as discussed in our summary of Eagle Materials in our **December 2020 Quarterly Report**.

A key CRH business strength is to have well located reserves of base building materials such as aggregates, cement and asphalt, and then build a value-enhancing integrated solutions business around these strategic reserves. Often it takes many years and many acquisitions of small, private, family-controlled businesses to build up these dominant local industry positions.

Under Manifold's leadership, CRH has made a couple of significant bolt-on acquisitions and divestments. However, as you can see from the table in Figure 19, CRH completes tens of small acquisitions and divestments each and every year to strengthen local market positions and also regularly divest businesses which are deemed more valuable in someone else's hands. CRH's ability to consistently add value through acquisitions and divestments, many well below the radar of most casual observers, is under-appreciated, contributing to CRH's compelling valuation.

Static analysis, or just assuming CRH's portfolio of businesses stays constant, doesn't capture the full value creation by the CRH management team over time.

Figure 19: CRH Acquisition and Divestment History

Year	Acquisitions		Divestments	
	Number	Amount	Number	Amount
2021 YTD	17	$1.4b	ND	$0.3b
2020	17	$0.4b	12	$0.3b
2019	62	€0.7b	11	€2.1b
2018	46	€3.6b	20	€3.0b
2017	34	€1.9b	ND	€0.2b
2016	24	€0.2b	13	€0.3b
2015	20	€8.0b	30	€1.0b
2014	21	€0.2b	16	€0.3b
2013	28	€0.7b	ND	€0.3b

Source: CRH and L1 Capital International, ND = not disclosed. Includes deferred consideration/proceeds.

An under-appreciated step-change in profitability, cashflow generation and capital allocation flexibility

In our view, the substantial changes to CRH's portfolio of businesses over the past eight years remains under-appreciated. CRH has been able to deliver positive margin expansion during the recent period of cost inflation, due to the strength of its local market positions and differentiated integrated customer solutions.

In addition, **CRH has reached a new level of financial performance**. Over the next few years, we forecast operating cashflow to build from current levels of around $4 billion. Net debt to EBITDA is currently under 1x, below targeted levels. There is ample cashflow and balance sheet flexibility to fund around $1.5 billion in capital expenditure to support organic growth as well as to support further acquisitions as well as a consistent increase in dividends as well as buybacks.

Figure 20: Increasing dividends and buybacks

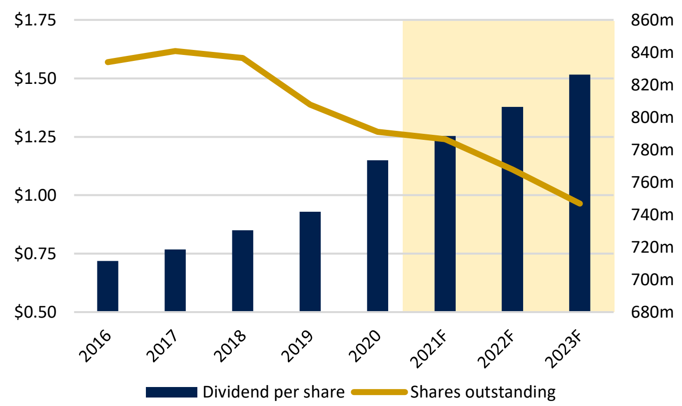
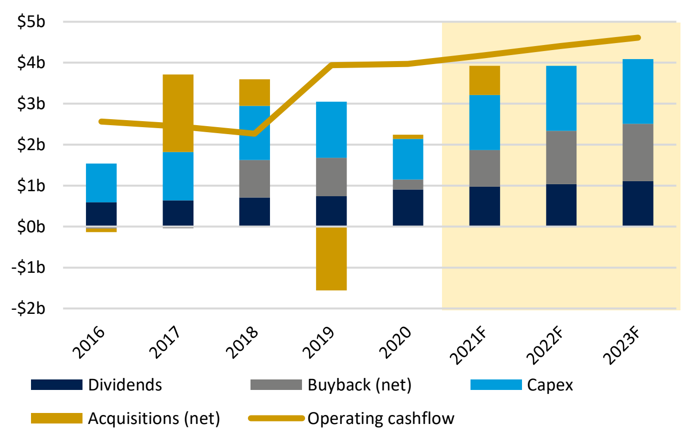


Figure 21: Significant value creation through capital allocation. Upside to base case from future acquisitions



Source: CRH and L1 Capital International

Compelling valuation

Even in strong underlying markets turbo-charged by fiscal infrastructure spending, CRH operates in relatively mature markets. Organic growth rates will likely average in the low to mid-single digits, enhanced through acquisitions over time.

Margins should continue to improve, although at a more incremental rate than recent historical improvements as the heavy lifting in portfolio rationalisation has already occurred (that said there was recently a press report suggesting CRH is looking to divest its commercial glass cladding business for $3 billion which we would view very positively if completed).

We assign a Quality Rating of 3 based on L1 Capital International's quality rating system due to the inherent cyclicality of CRH's business drivers. However, the strength of CRH's market positions and management team, diversification by end market and geography, under-levered balance sheet and consistently improving financial performance may soon warrant an upgrade to a Quality Rating of 2.

CRH is currently trading on around 12x 2022F earnings before interest and tax (EBIT), a 2022F PE ratio of 16x, a 2022F free cashflow yield of 7% and a 2022F dividend yield of 2.5% which is more than 2.5x covered by earnings. Given the robust medium-term outlook for CRH's key markets, we consider these valuation metrics to be highly attractive.

On average, for 50 years, CRH has delivered to shareholders a total shareholder return of 15% p.a.. Our base case expectations are for similar shareholder returns to be delivered over our investment horizon.

L1 Capital International Fund

Quarterly Report | DECEMBER 2021

Fund Information

Name	L1 Capital International Fund
Portfolio Management	David Steinthal, Chief Investment Officer
Types of investments	Listed securities globally. Developed market focus. No shorting, no leverage
Number of investments	20 to 40
Cash weighting	0% to 25%
Minimum initial investment	$25,000
Hedging	Unhedged
Structure	Unit Trust
Domicile/Currency	Australia/AUD
Inception	1 March 2019
Management Fee	1.2% p.a. inclusive of GST and RITC
Expenses	Nil (included in Management Fee)
Benchmark	MSCI World Net Total Return Index in AUD
Performance Fee	15% over Benchmark, subject to any underperformance being recouped*
High Watermark	Yes
APIR / ISIN	ETL1954AU / AU60ETL19543
Platform Availability	Hub24, Macquarie Wrap, Mason Stevens, Netwealth, AMP North, Powerwrap, Praemium

Service Providers

Responsible Entity	Equity Trustees
Fund Administrator	Mainstream Fund Services
Fund Auditor	EY
Fund Custodian	Mainstream Fund Services
Legal Advisor	Hall & Wilcox

L1 CAPITAL INTERNATIONAL

Level 13, 139 Macquarie Street
Sydney NSW 2000 Australia

Email **info@L1international.com**

www.L1international.com

L1 Capital International Overview

L1 Capital International is an independent active manager of global equities established as a joint venture with L1 Capital. We apply a detailed investment process built on a fundamental assessment of quality and value. We aim to deliver attractive risk-adjusted returns by investing in high quality companies that have favourable cashflow-based valuations in well-structured industries. Capital preservation over the investment horizon is central to our investment philosophy and process. We view risk as the potential for a permanent loss of capital as opposed to volatility in share prices. Additional information on L1 Capital International is available at **www.L1international.com**.

L1 Capital is a global investment manager 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. L1 Capital's clients include large superannuation funds, pension funds, asset consultants, financial planning groups, family offices, high net worth individuals and retail investors. Additional information on L1 Capital is available at **www.L1.com.au**.

* 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
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