

2fold: Take Stock

Raphael Lamm

L1 Capital

CAROLINE GURNEY: I'd like to begin by acknowledging the Traditional Owners of the land on which we meet today, and recognise their continuing connection to lands, waters and communities. We pay our respects to Elders past and present.

RAPHAEL LAMM: I think the most important thing is to not get sucked in by current fads, now whether it's AI (Artificial intelligence) this year or EVs (Electric Vehicles) last year, or cannabis a couple of years ago, and try to take a long-term perspective on what the cash flow generation is going to be for companies. And the most important question to always ask is "What is already priced into the stock?". It can be a fantastic company but if everyone knows that information that's priced in, there's probably no opportunity.

CAROLINE GURNEY: Hello, and welcome to Take Stock, a podcast by Future Generation. In this series, we get a backstage pass into the minds of leading fund managers and work out how and why they make the stock choices they do. I'm Caroline Gurney, CEO of Future Generation. We're Australia's first listed investment companies to deliver investment returns for our shareholders, while building better futures for young Australians.

And we do this by harnessing the generosity of our top fund managers. Do well, do good. So far we've donated more than \$75 million to not for profits. And that's because of people like Rafi Lamm, the Co-Founder of L1 Capital. They charge zero management or performance fees for managing Future Generation's money.

Rafi is talking to me from his office in Melbourne. Rafi, welcome to the podcast.

RAPHAEL LAMM Thanks, Caroline. And happy to be with you.

CAROLINE GURNEY: Rafi, I've got so many questions for you, but before we get into the meaty investment stuff, I want to know something. You and Mark Landau founded L1 Capital in 2007, and I think it's fair to say that you are the yin to Mark's yang.

How do you work so well with someone for so long when you've got very different styles?

RAPHAEL LAMM: While people say that, in reality, Mark and I were best friends before we set up L1 Capital. I think the thing that we have in common is we're both super passionate about markets. We love trading shares. We love investing. We love researching.

And ultimately, we think very similarly about investing. We like the same stocks. What we have in common is so much more than what's different. But we're best friends still after 17 years. We never have an argument. It's hard to think of a better business partner.

CAROLINE GURNEY: Oh, that's fantastic.

And to be best friends still and work together, that's actually pretty admirable. So, you've just released your quarterly report and there are very, some really interesting big themes there. So can we start with copper? You know, prices are going through the roof, surging demand, scarcity of supply.

What's driving that?

RAPHAEL LAMM: I think you have to look at things both on the supply and the demand side. On the supply side, there's been roughly a decade of underinvestment in new projects. In many cases, new projects are held up by social issues, by regulatory issues. The CapEx for new projects has really dramatically increased over the last decades.

So, all those factors are combining to constrain supply. In addition to the strong demand out of emerging markets, we're also seeing very strong demand for energy transition related copper usage.

CAROLINE GURNEY: So, if a shareholder wanted to take advantage of higher copper prices what stocks would you suggest they look at?

What interests you?

RAPHAEL LAMM: In the Australian market we're very impressed by the recently listed Capstone Copper (ASX: CSC). That's a Canadian based copper mining company that recently commenced trading as a secondary listing on the ASX. Offshore, we really like names like Hudbay Minerals (NYSE: HBM) and Teck Resources (NYSE: TECK).

CAROLINE GURNEY: Presumably there's a really massive lag before new copper mines are up and running.

So how long do you reckon that copper prices will run high?

RAPHAEL LAMM: We think the market's currently in modest undersupply, and we see that undersupply growing between 2025 and 2030, and even beyond. So, we think this investment idea has a very long duration to it.

CAROLINE GURNEY: So maybe if we look at BHP Group (ASX: BHP) and Rio Tinto (ASX: RIO), do you think they've actually got the balance right between returning money to investors and investing in projects that are going to deliver the next era of growth?

RAPHAEL LAMM: I think BHP and Rio Tinto are to some degree victims of their own success. They've become so large and so profitable, the new projects have to be very significant to move the needle. In the case of both companies, while they have excellent management teams, excellent execution capabilities, the challenge is new, large scale, greenfield projects today are very hard to deliver.

Typically, they run over budget. They encountered many different delays and so it's very hard to generate high IRRs on such large greenfield projects. So, we encourage them to consider brownfield expansions and acquisitions ahead of major greenfield new projects.

CAROLINE GURNEY: Let's talk about the energy sector because obviously that features in your quarterly report as well because, again, oil prices are surging.

OPEC recently agreed to extend output cuts into the second quarter. What is this going to mean for markets and for investors, in your opinion?

RAPHAEL LAMM: I think one other factor that a lot of people are missing is the fact that a lot of supply growth over the past decade has actually come out of North America, out of shale oil.

That has now roughly flatlined over the past six months, and we see very limited growth in US oil production going forwards. That, along with higher-than-expected ongoing demand growth out of emerging markets, means that oil should be relatively tight for the foreseeable future.

CAROLINE GURNEY: So, let's continue in terms of oil. Obviously, by defending high oil prices OPEC is making it even more difficult to get inflation under control in the short term.

What's your outlook for interest rates and inflation? What are you talking to your shareholders about?

RAPHAEL LAMM: So in terms of oil, while we're relatively optimistic about oil and we've got a number of energy companies in the portfolio, we're also realistic. We think that as oil gets towards 100 (US dollars a barrel) and beyond, you start to see major demand destruction.

And so we think oil is probably going to stay within the range of roughly 75 to 90 or 95 (US dollars a barrel) over the medium term. We think from an inflation perspective, that's not going to have a dramatic impact. And you should also keep in mind that other portions of the energy universe have been relatively weak or benign.

So whether it's natural gas prices or thermal coal prices, the overall energy complex isn't particularly inflationary as we sit here today. When we look at inflation more generally, it's been very pleasing, the decline in inflation over the past 12 months. However, it hasn't declined anywhere close to where the central bank's targets are set.

We think those targets are going to be hard to achieve. And so while we see ongoing progress on inflation normalization, it's not quite going to get to the targeted levels. That's going to mean the interest rates can't come down as quickly as markets were expecting and as dramatically over the medium term.

So we see maybe one or two cuts in the US this year, but only 0.25 percent cuts. And over the medium term, we see interest rates staying much higher than the levels that we got to, we got used to over the past two decades.

CAROLINE GURNEY: Thank you for that. So I might just take you back to oil because obviously it's been well known that L1 has been agitating for Santos (ASX: STO) to split out its LNG (liquid natural gas) assets. Tell me, where are you on that now? What's your thinking there?

RAPHAEL LAMM: We still think it's a good idea. However, we believe that Santos is a really good company. It's underpriced in the market. And there's different ways that this value can be realized over the short and medium term. So in the absence of the company pursuing our breakup proposal,

we think there are asset sales that they can do and there are other opportunities to bring forward this value creation.

In the absence of them taking advantage of those opportunities, we see a very high free cash flow yield in calendar year 2026 and beyond compared to the peer group, which should lead to a re-rating at that point. We think there's an opportunity to bring that forward.

CAROLINE GURNEY: Excellent. So now let's turn to gold.

What is going on with gold? Is it out of whack with market fundamentals? And what does that also mean for markets and investors? I'm really interested in your opinion there.

RAPHAEL LAMM: LSF has recently increased our net long to gold. We invested across a number of names on the long side, but also on the short side. We see gold stocks having some of the best free cash flow yields across the ASX 200, which really attracts us to the sector.

In terms of the recent rise in the gold price, it's always hard to explain or predict gold prices, but a few of the things that we're seeing in the background include; very strong buying by Chinese consumers, very strong buying by Chinese and other emerging markets central banks, and very limited production growth. We think all those factors are likely to continue over the medium term.

And we see a higher gold price over the next few years than we've come to get used to over the last couple of years. I should also add that we're seeing increasing nervousness around the sustainability of the US budget, US federal government budget. The deficits are massive and they're set to continue into the medium term.

We think this is going to be inflationary and again provide upside contribution to gold prices.

CAROLINE GURNEY: Excellent. So let's stick with that theme of very expensive metals: uranium. That's obviously been very hot. Uranium prices and stocks have both been moving higher. Is this a trend that you are continually watching?

RAPHAEL LAMM: We think uranium is one of those metals that's been unloved for a couple of decades and so the opportunity is dramatic. There's been literally two decades of underinvestment in uranium. The time delay to get new projects up and running is very long. So that's the good news. The bad news is everyone knows that uranium is an attractive commodity.

And so a lot of the shares are priced very much for perfection. The one key opportunity we see in the uranium space is NextGen (ASX: NXG), which is listed both in Canada and Australia. We think they have a great asset, a great management team, and they can deliver a really unique project.

CAROLINE GURNEY: So that basically begs the question, do you reckon that we're going to have nuclear power in Australia?

RAPHAEL LAMM: I would like to think that would be the case, however, I think to the extent that it's going to happen, it's very much in the distant future. These projects take something like 10 years to get to commercialization. And so we have nothing on. It's not legally possible at the moment. There's nothing on the drawing board. So we're talking about something more than 10 years out. So it's sort of beyond our investment horizon. To the extent that there's a change of government, I guess that becomes more likely. We definitely think that uranium is a good solution or partial solution for green based power.

CAROLINE GURNEY: Let's look at lithium prices. Obviously, it's a complete contrast to gold and uranium. Do you see any improvement coming? And what's your exposure to lithium?

RAPHAEL LAMM: At the moment, the portfolio has some long positions and some short positions, roughly neutral across the sector. We believe that the market has some upside over the medium term in terms of both hydroxide, carbonate and spodumene pricing.

That being said, we don't think we're going to regain the previous highs from a year or two ago. We think the upside is relatively modest. And the reason is the large amount of supply coming out of places like Africa, the lepidolite supply in China. So even though there's pretty good demand growth, the supply growth is largely overwhelming.

CAROLINE GURNEY: Obviously, you've just given us some great stock picks there in terms of Capstone Copper and NextGen. What other companies do you like and why do you like them?

RAPHAEL LAMM: A few of the other names that we really like include Qantas (ASX: QAN). We think it's a great company. We know they had some challenges over the last 12 or 18 months. We think Vanessa, the new CEO, is doing a fantastic job getting on top of the issues. She's very focused on the things that were concerning to customers. We think she's fixed a lot of them already. We think she's going to address the balance of them over the next 12 months. And then you remain with a company on roughly six times earnings.

There's a genuine monopoly/oligopoly in a very attractive market.

CAROLINE GURNEY: Do you think prices are going to come down?

RAPHAEL LAMM: I think it's unlikely that prices are going to go down. That's both in Australia and globally. In some cases, international routes will see more capacity and prices will come off. But on the key domestic routes, we see ongoing price increases.

CAROLINE GURNEY: You also short stocks at L1. Tell us a little bit about that and what companies don't you like at the moment and why?

RAPHAEL LAMM: Sure. I think both in Australia and globally, consumer discretionary names are likely to be under some pressure. They've had a very strong couple of years in terms of earnings, but also had very large P/E re-rates over the last couple of years.

In many cases, they're kind of trading for perfection. But in the backdrop, we can see things are getting more tough for consumers. Higher interest rates for a longer period of time are pressuring consumer balance sheets and mean that discretionary spending will come down in some cases. Also margins are very elevated. They can come down over time also.

And so we see some de-rating potential across that space. Another space that we're a little bit less excited about in the broader market is the Australian banks. They're trading on historically high multiples, but if you look at earnings growth projected over the next couple of years it's modest, modest to zero.

CAROLINE GURNEY: So I'm going to come to some of my sort of more standard questions because I deal with more than 30 brilliant fund managers and I'm really fascinated in terms of how you actually select a stock. How do you look at that entire investable universe, narrow it down to, you know, 20 or 30 stocks? Talk me through your process and maybe we could use a stock as an example?

RAPHAEL LAMM: Sure. So for L1, the process is all about both the quality of the company and the management team, and also the valuation. We think there are a lot of great companies but it's all in the price. Conversely, there's some average companies, you know, that are really cheap and present a fantastic opportunity.

For us, our ranking sheet is determined 50 percent by discounts or valuation, 50 percent by the L1 Qualitative score, which is made up of three factors: management – and we're thinking not just about

the CEO and CFO, but about the board, senior management and the culture of the organization – secondly, what we call the “company and industry score”. That’s really about what is the long-term return on capital growth potential for the company and the industry.

And finally, the trend score. That's all about the different operating factors that are going to impact on earnings over the next one or two years. We want companies with very strong qualitative scores made up of those three factors, but also trading at a substantial discount to valuation.

When we take that all into account, you exclude a lot of the companies across the ASX 200, which is our key focus. And you narrow down to a smaller number of companies that are operationally going very well. They're good businesses, but trading at a reasonably substantial discounts to valuation.

CAROLINE GURNEY: And a stock perhaps that you could illustrate that process with?

RAPHAEL LAMM: One example might be BlueScope Steel (ASX: BSL) – excellent management team, excellent board, excellent balance sheet, trading a substantial discount to our valuation. We also test that valuation against peer valuations, whether it's EV/EBITDA multiples, P/E multiples or free cash flow yields. They're trading at a big discount to the North American and other global peers.

In terms of the qualitative scores, I mentioned management. The company/industry is very attractive, especially in a US position which is probably the best position across the peer group in the US. And finally, in terms of operating trends we see a number of positives coming through largely company generated through the investments that they've been making.

CAROLINE GURNEY: So you talk about your investment process. Tell me, is there any gut instinct there as well, in terms of how you feel about a stock? Or is it just a lot more in terms of the data driven side?

RAPHAEL LAMM: I think the gut instinct comes probably at two levels. One is in terms of the company interactions. Our best ideas all come through company meetings, meeting with boards, meeting with senior management, meeting with operational people.

And whenever you meet with people, there's what's said and then there's sort of what's behind what they're saying. And I think a lot of that is a gut feeling in terms of I've met them 10 times before when

they say things are going great, are they kind of spruiking it to the market? Or do they genuinely believe that things are going great?

Are they conservative people who always sort of understate things? And you can sort of tell that even though they're being very conservative in their language, in reality there is a level of confidence there. So I think that's a little bit, a bit of a gut feeling, a bit of an intuition thing. Secondly, in terms of when we make a decision to buy a stock or sell a stock, the question is always, "how do you execute that order?"

Do we go straight to the market and buy it immediately? Do we do it gradually over time? Do we wait for a quarterly result? Do we wait to see how the US inflation numbers are tracking? I think that's more of a gut feel. And we try to put an overlay in terms of our sense of how the market is going to react to all those factors to get the timing right.

CAROLINE GURNEY: I really enjoyed your answer in terms of meeting the companies. So did you find it hard during COVID when everything was online? Was it harder than when you actually meet them face to face?

RAPHAEL LAMM: I think it started off very awkward and it got gradually better over time, but you can't compare a face-to-face meeting with a Zoom meeting.

And just the general social interactions, the small talk, the words that you have with management on the way in, on the way out of the meeting. I think building the rapport is important over time. It's hard to do via Zoom. So, I think there's no question we get more value out of our one-on-one, in person meetings.

And that's still applicable in terms of a lot of our offshore holdings today. It's hard to run around the world all the time, but whenever we get the opportunity to travel overseas and see the companies in person, we find that more valuable than the Zoom interactions that we rely on a lot of the time.

CAROLINE GURNEY: What do you read and listen to and what investor do you most admire?

RAPHAEL LAMM: In terms of the investor we most admire, I think both Mark and myself would definitely be Stanley Druckenmiller. I think he's the perfect blend of macro thinking and company specific micro thinking. His track record is second to none and he just seems to know how to make money in all different market conditions.

So we love to follow what he does and what he says, even though our styles are quite different in general. In terms of who we listen to, we listen to everyone. We try to read everything we can get our hands on. However, our best ideas always come from our direct one-on-one meetings with companies.

CAROLINE GURNEY: What piece of advice would you give our shareholders? Obviously, besides investing in Future Generation, what would you suggest they do?

RAPHAEL LAMM: I think the most important thing is to not get sucked in by current fads.

Now, whether it's AI this year or EVs last year, or cannabis a couple of years ago, try to take a long-term perspective on what the cashflow generation is going to be for companies. And the most important question to always ask is "what is already priced into the stock?" It can be a fantastic company, but if everyone knows that information that's priced in, there's probably no opportunity.

We always ask that question., "what's priced in?" If we think we can see opportunities that aren't priced in, that makes us excited.

CAROLINE GURNEY: That's a really great answer. We are very grateful, obviously, because you are one of our pro bono fund managers. So why do you do it? I mean, you manage a lot of our money, but why? Why is this important to you?

RAPHAEL LAMM: We decided many years ago to support a lot of charities. We think your one is particularly special and you guys do a great job and we're very proud to be involved in it. The one unfortunate part of our business is that we're time poor. There's no such thing as a break from the markets.

There's always something happening in Australia, in the US, in Europe, global macro, company-specific... We just don't have that much time. And so, this is a great opportunity for us to make a small contribution back to the community within those time constraints.

CAROLINE GURNEY: Rafi, what piece of advice would you give to our listeners?

RAPHAEL LAMM: Just do what you're passionate in. You know, for us, markets are great because we love them. If you really get passionate about markets, there's unbelievable opportunities through all market conditions. If you don't really love markets, it's best to take advantage of listed funds like

this one, like LSF and others where guys who spend their night times worrying about the market can do it on your behalf.

CAROLINE GURNEY: Rafi, I've really enjoyed this chat. Thank you so much. It was fantastic to hear about your investment process, but also to hear your passion for what you do.

Thank you for your time today, and for all the work that you and Mark do, and L1 Capital, to make sure that Future Generation can keep on giving.

RAPHAEL LAMM: Thank you, Caroline. Thanks for all the great work that you do.

CAROLINE GURNEY: We hope you enjoyed hearing from Rafi and we will also continue to follow his stock picks, NexGen and Qantas.

We hope you enjoyed today's episode. Please join the Future Generation family, Australia's first listed investment company to provide investment and social returns. We are proud to have given more than \$75 million to Australian not-for-profit organisations. You can be part of this and gain investment returns while contributing to improving the lives of young Australians. For more information, please visit our website, www.futuregeninvest.com.au.

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