Marcus Today On the Couch with James Hawkins L1 Catalyst Fund

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**SPEAKERS**

James Hawkins, Henry Jennings

**Henry Jennings** 00:00

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**Henry Jennings** 01:07

Welcome to another episode of on the couch with myself, Henry Jennings from markets today. It seems a bit of a time since I last did one of these but I'm really happy today to have James Hawkins from L1 Capital on the couch. It's fantastic to get him here. He's a busy man, very busy man and a great investor and great fund manager. So I'm really happy that we finally managed to tee this up. James, for those of you who don't know, runs the Elven Catalyst Fund. And he's been around a long time. He's been an ex Macquarie guy as well. He was there for a decade. And he spent the last 20 years advising boards and management. And prior to joining L1 Capital, which has only recently I think in 2021. James spent nearly 10 years at Flagstaff partners where he was the MD and a bit of an m&a specialist. So of course we have a lot of m&a going on at the moment. So I'm looking forward to talking to him about that as well. So welcome, James. It's great to have you on the show.

**James Hawkins** 02:01

Thank you, Henry. It's a pleasure to be on the show this morning.

**Henry Jennings** 02:04

It's good to have you here. Now, just before we kick off, as usual, just the general advice. Disclaimer, this is general advice only. So please do your own research, contact your own financial advisor etc. Before acting on any of the insights or ideas on this podcast. So it is general advice. So welcome again, James. First up, let's let's get this one out of the way. Well, what is the L one Catalyst Fund? What does it do and how does it operate?

**James Hawkins** 02:29

The Catalyst Fund is a best ideas fund with an activist overlay. It's long only. It doesn't short. It has no leverage. And it has a hard cap of 10 stocks. And it's really been brought into being in order to leverage off the best ideas that the L1 Capital's long and short funds team generates. And we being the catalyst team whose job is really to enact to accelerate the catalyst to bring forward equity returns for investors.

**Henry Jennings** 03:01

Cool. What attracted you to run the funds because you were obviously one of the founders of Flagstaff partners, and you came across only last year, what attracted you to do this with the L1 Capital.

**James Hawkins** 03:12

it was really the market opportunity. We saw a real, you know, real opening and real market opportunity for a fun, which was the best ideas fun, but also to have a bit of an activist overlay, which leveraged off my 20 years in investment banking. And when we looked at the market as a whole, we saw less than $2 billion of dedicated activist strategies in the Australian marketplace. And that's in a $4.3 trillion market. So it's a very well accepted and very strongly performing strategy offshore. In fact, it's been the best performing strategy offshore the last three years. And we just saw an obvious market opportunity in Australia. And we thought that investors would benefit from having the opportunity to invest in this fund, which was exposed to the Australian equity market.

**Henry Jennings** 04:04

James, when you talk about an activist fund, what is an activist? do how do you look at the stock as an activist I guess, where these high conviction plays are these what I used to do at Macquarie was was a lot of takeover arbitrage and those kinds of situations is that what you're looking for.

**James Hawkins** 04:22

We're looking for stuff. So I have three attributes Henry, the first attribute is it needs to be good value. The second attribute is that it needs to be high quality. And the third attribute is that it needs to have catalysts and those catalysts can come in many different forms. They can be financial catalysts, they might involve buying back stock, they might be unlocking latent value through a sale and leaseback they might be through, you know, divesting and underperforming and undervalued part of the business the markets ascribing no value to but still has some value to some potential buyers. So it's a whole large range of possible initiatives that our funding can can undertake.

**Henry Jennings** 05:08

In the past, I know that we see some activist funds coming to Australia, the one that springs to mind, I guess, for me is Elliott, which we're very active in bhp in terms of getting them to change. Will a lot of bhp, they were very keen to get into change the duellist structure, for instance, is that the sort of thing that you push companies to do and you get actually involved in in trying to precipitate those catalysts? Or do you leave that for for others to do?

**James Hawkins** 05:37

Now, that's an example of the types of initiatives which we want to take. And I think, if you look at many of Elliott's ideas in relation and suggestions in relation to BHP, they've ultimately, albeit a few years subsequently been undertaken by the company. So you know, that is an example of one of the initiatives which, you know, if we thought it made strategic and financial sense for a company and would result in an appreciating share price, as a result, that is something that we would undertake.

**Henry Jennings** 06:06

It's funny, isn't it? There's, I know, people in previous jobs in previous careers, I guess, you know, you give them an idea. And they said, No, that's ridiculous. And then they go away and think about it for six months, and then it becomes their idea. And they come back south had this fantastic idea. It's a bit like that with bhp, isn't it, they didn't want to be seen to be bullied by Elliott, to do it. But as you say, they implemented most of the things that they said they just gave a little bit of a pause a little bit of time to make the optics look better, I suspect?

**James Hawkins** 06:35

Yeah well, much of the dialogue that we have with companies is behind closed doors, and you know, the market will never hear about it. And we're very happy for companies to be you know, the initiator in the public sphere for the ideas, because obviously, if it's been led by the company, it happens in in a quicker timeframe than if the company is opposed to it.

**Henry Jennings** 06:58

So, you know, this is a very tough market. Man, this is a very volatile market. How have you guys been going? What what sort of performance have you been achieving?

**James Hawkins** 07:08

We have our performance as at the end of April was close to 25%. of net of fees since the first of July in calendar 2021. So we've been pleased with the performance since inception, but it's obviously early days. And we're very focused on continuing to make alpha for for our investors going forward.

**Henry Jennings** 07:36

That's pretty impressive. James, congratulations on that. Thank you. How big is the team? How many people have you got in the team?

**James Hawkins** 07:42

So the catalyst team has a team of three that are dedicated to enacting and accelerating the catalyst, but we very much work hand in glove with the long short equities investment team. And they're a team of eight. So there's a team of 11 in total that, you know, generate ideas for the Catalyst Fund.

**Henry Jennings** 08:02

I've been a long term fan of L1 Capital in the long short fund and had mark on this show before and it's, it's been great. It's been a big winner for us, we identified it quite early, I guess, when the custard hit the fans back in COVID times, added it to our small cap portfolio is still one of our biggest holdings there. So it's done pretty well. But when we look at, you know, you've only got 10 stocks in your portfolio. I mean, that's pretty concentrated this, does this high conviction come with high risk as well as is this part and parcel of getting 25% Since last until July 1 2021? Is this part and parcel of that, that performance?

**James Hawkins** 08:44

Oh, we don't, we're very cognizant of risk. Whenever obviously, within a 10 stock portfolio, it tends to our portfolio by definition will have some volatility. However, we think of it as a private equity light fund. And if you have a look at a private equity like fund, they would not have any more than 10 portfolio companies in their fund. And there will be volatility within their valuations. They just aren't marked to market daily. But we think by definition of being a best ideas fund, I think once you start getting north of 10 stocks, it starts to become debatable as to whether a stock idea actually constitutes the definition of the best idea. From my perspective.

**Henry Jennings** 09:29

Yeah that's a good point. I must admit that that is a good point. And he tend to, I know from my own experience, running the small cap portfolio was only a model portfolio which I've been running for the last four or five years. It's easy to kind of get carried away and drift into stocks. And before you know it, you've got to enlist as long as a shopping list of woollies online to contend with and then it's a question of pruning them. So 1010 is a great discipline. Now, as far as discipline goes, How do you what do you look for when you're putting these these these 10 stocks together? I guess then All in one go. But what is your sort of investment process that you're looking for you you've run through good value, high quality and catalyst. Is there anything else? Or is there a is there a process that you can share with, with our listeners about the way you choose your stocks.

**James Hawkins** 10:14

We have those three key dates that stocks must get through in order to get into the fund, we then have a look at the actual total portfolio and have regard to when we're not going to have you know, five or six property sector exposed stocks that are exposed, obviously, to cap cap rates and bond yields. So we have a, we have some consideration to diversification within the portfolio. At the end of the day, Henry, we are looking for those stocks, which we think are going to give our investors the best economic return over the next, you know, 12 to 18 months having regard to you know, the risks associated with the investment. And you know, at the end of the day, we're looking for investment opportunities that have asymmetric upside relative to downside potential. And we also have a look at those stocks, which we think can we can have the most meaningful impact in order to enact and accelerate the catalyst because even if there may be a catalyst there, but you know, the company may it may be of a size on scale or the register may be of a particular composition such that we can enact and accelerate the catalysts and can influence through the L1 Capital funds investments. That obviously means it goes down the priority order in terms of likely investment for the Catalyst Fund.

**Henry Jennings** 11:36

So are there any themes at the moment they're standing out for you as a great place to be than the thing that stands out really?

**James Hawkins** 11:45

There is a couple of themes out there? I think one is the embedded property value within listed companies and probably Case in point there is ranty healthcare. Ramsay health care Yeah, as most of your listeners would be well aware, is a very high quality Australian listed hospital provider, but it's also got northern hemisphere operations as well. You know, we thought prior to the KKR approach, close to two thirds of the market cap was backed or underpinned by the value of the Australian hospital, land bank and land land book. So we think that is an example of where the public markets were not truly recognising the the underlying property values of a listed entity and Ramsey's property book is so attractive because in Australia, its assets are irreplaceable. And you know, its property assets are ESG friendly. And, you know, those two attributes make the sort of cap rate that could be achieved through a sale and leaseback transaction of the Australian property assets very attractive. Now, there has been an issue with the Ramsey property assets in saying that there has been a very low tax cost base for those property assets. Now, under a under a takeover zone scenario, of course, the tax cost base will be reset to the takeover price. And then if a sale and leaseback was subsequently done, there will not be any tax leakage, you know, that would otherwise be done if that tax base was not reset. So there's some advantages that are KKR led consulting would have but that's that's one example. Another example or another theme that I'm seeing out there is just the wave of private capital, that still needs to be deployed. And I think you're gonna see more public to private, particularly with the volatility out there. So, you know, as of today, there was the announcement from brambles that they received an approach from CVC. Obviously, Sydney Airport was taken private, and we've just talked about ramsI has had an approach from KKR. These deals are, you know, typically backed by long dated patient capital. And each of these deals are of a scale that, you know, we wouldn't have wouldn't have deemed likely, you know, a few years ago in the public markets. Ramsey, for example, as a $28 billion enterprise value, including the control premium. That's a significant transaction.

**Henry Jennings** 14:28

Yeah, I guess brambles is 20 billion as well. This is another significant transaction. And as you say, through all this volatility, private equity is very cashed up still, and looking for those homes, for their for their markets for their money. So I did have one member asked a question about channel infrastructure. He wanted to know why you liked this one.

**James Hawkins** 14:50

You're sure so channel infrastructure has a 10 year take or pay contract with three Key oil for oil providers in New Zealand been BP ExxonMobil and Zed energy that's forecast to do a dividend in Calendar. Calendar 23, once it gets on a normal run rate, or close to 10 cents per share, the current share price is $1 oh eight. So the dividend yield is, you know, little little shy of 10%. It also has, you know, a large amount of land at its Marsden point facility that can be used for solar, and other, you know, hydrogen and other new energy forms, as well as having a pipeline between Marsten point and Auckland Airport. And that's a monopoly asset. And it is, you know, I think the reality is that airline jet fuel is going to come back it through through the channel infrastructure facility much earlier than perhaps has anticipated a year or so ago. So, you know, I like the dividend yield. I like the fact that it's still good value, and it's a monopoly asset, and it's got some growth options going forward.

**Henry Jennings** 16:13

It's funny, I was listening on CNBC the other day, and they were saying that such appeal in the US is up 178% from a year ago. It's extraordinary. The rise in jet fuel, not only on the demand, of course, coming back strongly after COVID. But also because the US refineries sort of switched off producing jet fuel during COVID, and have now had to switch back to jet fuel, which is taking some time and forcing prices higher. So it's, it's a big, big issue, I guess, for these airlines going forward.

**James Hawkins** 16:46

You know, it will be you know, they will need to pass it on to consumers. And they will need to manage capacity when they fly to make sure that their planes are fuel. And I think we'll see more cancellation of flights going forward whilst the oil price remains high.

**Henry Jennings** 17:04

Now, James, we're going through a period, I guess, have some dislocation going on. We nearly had a bear market in the US a couple of days ago in in trade, and our markets come off substantially since Easter. What advice can you give to members out there about this volatility? You've been doing this a long time, you're very successful investor? What advice can you give our members and people listening to this podcast about investing? And especially I guess, investing through volatile periods?

**James Hawkins** 17:35

I think the first thing is that investors should have a diversified portfolio. And that means diversified across different markets. So if you look at the equities market, the Australian market is significantly outperformed the US equities market has got a very different composition, it's got 5% sort of it growth stocks, whereas the US market is 40%. So I think the first point is diversification, across markets, across across asset classes, not just equities, but bonds, property, and so forth. And then the other key point is have regard to your own risk return expectations and needs in terms of income, whilst also having regard to the duration that you're willing to invest for. Because if you have a six to 12 month investment time horizon, you know, you need to have a very different perspective than if you have a five plus year investment time horizon. And, you know, in equity markets, there's frequently pricing that, you know, is volatile, and, you know, the longer dated investment time horizon, the better it will be for you in terms of being able to sort of deal with the volatility within the in the markets.

**Henry Jennings** 18:59

I guess at the moment, there's a lot of a lot of volatility in the markets due to due to the Federal Reserve trying to get the soft landing underway to some extent is, do you think the Fed is going to be successful in getting this soft landing? Or are we going to see continued volatility, much higher interest rates, the Fed falling flat on their face, as opposed to providing the soft landing for the US economy?

**James Hawkins** 19:25

I think it's going to be pretty challenging for the Fed to ensure a soft landing because you know, there's a lot of external externalities that are outside their control such as geopolitical issues in in in Russia and Ukraine, and there's also significant supply chain issues. China is still have key cities in lockdown. So I think, you know, for the Fed to be coming off the risk free rate in obedience. close to the floor as it is, I think it's going to be pretty challenging for it to rein in inflation with all these other factors that are outside its control, wreaking havoc in sort of the the markets and economies globally. But we'll see.

**Henry Jennings** 20:14

Yeah, I guess you spent a fair amount of time working in New York. And you must have contacts over there still, how are they saying things are they've got the similar sort of view to your own.

**James Hawkins** 20:25

I think the great thing about markets is there's always different different views. But I think the consensus view is that it's, you know, calendar 2022 is going to be a volatile calendar year for markets across most markets, when the risk free rate is rising, and is forecast to rise as it is forecast to that there creates, you know, headwinds for most asset classes. And if you look at this year on the market was expecting the Fed to raise, you know, the raised interest rates three times this calendar year on the first of January, you know, and then recently has been up as expecting rises as many as many as 11 times, so the market has moved very materially and less than half a half a year. So I think the market is it does is probably overshot from my opinion, where the Fed will ultimately get to, but until we start to see inflation, get under control in the US, you know, the markets will remain pretty nervous, because I'll be worried about what the fates, right rising boss is going to be.

**Henry Jennings** 21:34

In these kinds of conditions? Do you have elevated cash levels? Or you're always 100% invested? Or do you use some sort of hedge index hedge or anything like that in the Catalyst Fund?

**James Hawkins** 21:45

We are nearly always fully invested. Because we are an equity markets fund, we can hold we do hold a small amount of cash to create or make the most of market opportunities when they present. But we're typically fully invested and we like we like volatility, because it provides us opportunities to deploy what is you know, we think is still attractive prices. And we were very, very bespoke with our investments, because we are only a 10 stock portfolio.

**Henry Jennings** 22:17

Okay, well, I'm going to ask you that the question I'm sure most people would like the answer to, is there any stocks out there at the moment, I know that you're not going to give away too much secret sauce, because you're in the business of the secret sauce, there's only stocks out there at the moment that you're looking at ago, or that one, kind of fancy that one, there's a catalyst in that one, maybe we should be looking at this. And any of those kind of on your horizon that you're thinking about at the moment that you can, you can sort of expand on for our listeners?

**James Hawkins** 22:47

Yeah there is one stock, which you know, some people, you know, happy to disagree with, but it's cuantas and quantities and interesting stock, because, you know, it operates, you know, against its major competitor, which is now owned by private equity. And in my view, you know, buying that owns virgin will be rational in their pricing. You know, there's the, his main risk, obviously, is oil, and the price of oil. However Qantas has hedged out is pricing or 90% of its fuel needs for first half calendar 22. And it's hedged. 50%, first quarter, FY 23, and 30%. Second quarter, fy 23. I think there's a significant, you know, desire from consumers to travel again. And there's a habit once a younger first holiday to think cheese. That's the first holiday I've been on in three years. And that was fun. I'm going to book another one and another one. And I think we, as people think, you know, why aren't I travelling both domestically and then internationally, even to a lesser extent, but, you know, if I can get COVID here in Australia, why would I not get COVID in in a different different state? And we've been in some form of lock downs, you know, for much of the last two and a half years, and there's a significant backlog of demand, I think, particularly from the leisure market, and we've seen that in the US, you know, leisures, close to 100% of pre pandemic levels. And, you know, we think there's a real backlog and I think quantas you know, has historically traded at a discount to the ASX, industrials index and even having regard to that continued discount going forward. And his aim is to say that it should try to elicit discount with a more rational domestic and international competitive environment. You know, we still see a lot of upside from its current current share price.

**Henry Jennings** 24:40

You're talking to a man who's just booked a number of flights to the UK having not seen my mum for three years due to COVID. So we are heading back in September and I stupidly said to my kids, because they're my best friend in Edinburgh has daughters getting married? Why don't we all go out? A and they said, Well, that's great. That's fantastic. But we can't afford to go. I said, don't worry, you know what, the flights are cheap at the moment. So why don't we, we lend you with the Buy Now pay later parents scheme. And we can we can all go to Edinburgh in September for a wedding, which was fine when airline flights were around 1500 bucks, but they seem to have gone up quite a lot recently. And it's interesting we've we've ended up booking, as you say with with Qantas. And the competition has dropped off dramatically because China is closed, effectively all that cheap competition coming out of China with their Chinese airlines and Asia to an extent have all dropped off the planet. So prices, and of course, the oil price is pushed up as well. So prices are pushed up big time. So I'm starting to regret my offer of for flight to London. It's, it's turned out to be somewhat more expensive than I anticipated. So we'll see how it goes. And then of course, there's the issue of I've got no money when I get there. Well, okay, well, that's not my problem. That's your problem. But anyway. So Qantas, that's an interesting one is Nancy, Alan Joyce just bought a new new house as well in Mosman. So he's obviously feeling pretty bullish about the environment out there?

**James Hawkins** 26:21

I think, you know, you know, the line Henry and wanting to visit friends and family overseas. You know, I haven't seen my sister lives in Alabama in the US for three years and haven't seen her, you know, for children. And so, Aquinas has very dynamic pricing. So, you know, as all prices rise, and as demand rises, they have very dynamic pricing that can be passed through to consumers. And I think, you know, they're coming up against not just a much more rational, domestic competitive, but if you look at the US airlines, they're unhedged to oil, and they also are very leveraged post COVID. So they're only going to fly to Australia, if it makes economic sense for them, and there's less of them that are doing that. So I think the competitive environment for cuantas is looked the best that you know, it has looked for some time, and I think it's, it's been, it's really lived the adage of never waste a crisis through taking out nearly a billion dollars of costs over the last couple of years. I think the management teams are very capable there. So I think they've done it done it done a good job of not wasting a crisis. So as well as realising some land values that mascot and the like. So they're, I think they're a very different company than they were, you know, pre COVID.

**Henry Jennings** 27:36

Yeah, I tend to agree with that. Now, a couple of final questions as we as we wrap this up, some of our listeners out there will be relatively inexperienced young guys, hopefully, that listen to this podcast, what advice have you got for anyone starting out on their investment journey? Because we have seen a flood of new investors come to the market? What advice apart from of course, investing in the one Catalyst Fund, of course, but what advice generally, would you give young guys out there just starting out young girls as well.

**James Hawkins** 28:06

And the first thing I'd encourage them to do is to be as big a reader as they can. Now that is a reader, you know, financial press. So they start to get a basic understanding, once they have that basic understanding, I'd encourage them to invest in a couple of stocks that they understand. And they can get their heads around and start to start to establish criteria before they invest as to why they are investing in that particular stock, that their whole period, you know, that they would like to have that stock is that a stock that they think is going to be higher in three years, five years, etc. And just I think that's the best way for them to take an interest in the market, to start to understand a particular stock and to start to understand markets, because markets, of course, are very much influenced by, you know, psychology and sentiment, not just by fundamentals, but getting an understanding of all of those factors, the earlier they start, the better they'll ultimately be. And I'd also encourage them to, you know, speak to people who are involved in markets to pick their brains because they'll get you know, wise and sensible learnings from or age or range of people.

**Henry Jennings** 29:24

Now James, this is a little unfair cuz this is a question without notice, but I think I'll ask it anyway. What what's been your biggest investment mistake? And what have you learned from it? Did it did it teach you a valuable lesson that you've been able to use elsewhere? Is Is there something that stands out for you anything? Stuff that went up? But I've learned a great lesson from Is there anything that sticks out in your mind I can see you on the on the on the video looking around? So obviously you probably haven't made any mistakes, but I know I have made plenty in my time. Is there anything that sticks out for you and you think, yep, stuff that went up, but I will Learn a really good lesson.

**James Hawkins** 30:02

No, no, I've made plenty of mistakes lately, I like everyone, I think the mistakes that frustrate me the most is when I've made a mistake. And then I've made a subsequent mistake, which with the benefit of hindsight, I realise I've made that mistake before and I haven't learned from making a mistake the first time. So that's when I get most frustrated, because no, no one, no one has a crystal ball. And, you know, we all make judgments, you know, with our investments in the market based upon our work, our analysis and our, you know, assessment as to what the future prospects of the company looks like. But I think, you know, I think we all need to learn from our mistakes. And when if we make a mistake twice, that's probably win, which is the same mistake, that's probably the one that you know, you don't want to make.

**Henry Jennings** 31:00

Yeah, that's a very good point. And thank you for my question with that those Finally, there any, any books or podcasts out there that you're listening to at the moment or reading that you think, Wow, this is fantastic. And I need to share this with with the wider community that they should be listening or reading these these things.

**James Hawkins** 31:19

I don't have a lot of time for books. But there has been one book that I've read recently that I thought was great. And that's called the happiest man on earth by Jackie. I think that's a great book and gives, you know, gives those who read the books from great perspective on life.

**Henry Jennings** 31:37

Yeah, I think that's a great choice. James, it's been an absolute delight talking to you. Thank you so much for your time. It's really been great to catch up and congratulations on our one catalyst. It's been a fantastic success so far, and I'm sure it will continue into the future. So thanks once again, for your time.

**James Hawkins** 31:54

Thank you, Henry. And thank you for having me. Really appreciate it.