Aurora Investment Trust

Update – March 2020

Share Price: £1.52 Net Asset Value: £1.42 Premium: 7%

Market Cap: £99m

Data as at 20 March 2020

Holdings >3% at 20 March 2020	(%)
Frasers Group (Sports Direct)	11.8
easyJet	11.2
Randall & Quilter	7.5
Phoenix SG Ltd (Stanley Gibbons)	7.1
Bellway	7.0
Hornby	6.9
Barratt Developments	6.9
Lloyds Banking Group	6.6
Ryanair	6.6
GlaxoSmithKline	6.4
Dignity	5.7
Vesuvius	4.4
Redrow	3.9
Others <3% (3)	4.7
Cash Position	3.3

Dear Aurora Investor,

We thought this is the right moment to provide an update, as there is still some time to go before the end of the month and a lot may happen between now and then.

As at 20th March, the Trust is down 39% for the year, versus 32% for the FTSE All Share Index.

Last week, before the government's employment package was announced, Gary Channon provided some thoughts about the present situation and its implication on valuations in the portfolio. These are summarised below.

Intrinsic Value

COVID-19 undoubtedly does damage to intrinsic values, but we have built what we think are reasonably robust models of what that damage is. We have stress tested all of the businesses in the portfolio, which we have been doing for two months, and we've been speaking to managements, and therefore we're confident all of our businesses will be there on the other side.

Our base COVID-19 scenario, is a scenario that looks something like this: nothing for two months of activity followed by a resumption of a third of activity in the third month, two-thirds of activity in the fourth month and then a resumption only at 85% of prior levels and next year at a 5% less than prior levels. So, it passes into a depression followed by recession. That's not what I think will happen, but it's a good modelling tool to work from to produce some wide potential outcomes. When we do that, we have a hit to intrinsic value. We have calculated we have had a 13% hit to intrinsic value.

Included in the intrinsic value is some buying we have just begun. Upside to intrinsic value, was circa 75% before the crisis and now it's 150% and growing as we act. We've been deploying capital with a 200% upside to the COVID-19 case and deploying it in businesses that we think are going to be safe and fine.

So, the summary on values is, it's done some damage, but it's created opportunity overall. When we're done taking advantage of the opportunity, we think the values will end up higher and obviously because of the price fall the attractiveness right now is extremely high.

COVID-19

What's important to share is how we think about COVID-19. It's important, at times like this, that you aim for what Drucker calls, intellectual integrity. So, seeing things as they are. And I suppose from our perspective, COVID-19 is not a surprise. In fact, there's a book in our reading room called '*Spillover*' and the reviews talk about zoonotic tick diseases and how the next pandemic will come, and it came out of the work we did on swine flu. So, this is not a surprise, but it's one thing to think about something conceptually, it's a completely different thing to be faced with it. It is a surprise, particularly for Western societies because they haven't experienced this in the modern era.

The epidemic has become a pandemic. But there is a lot of knowledge about epidemics and epidemics crossing borders, and there are plenty of case studies. So as scary and novel as this can appear, from a scientific point of view, a lot about it can be understood. However, as far as Europe or the Americas are concerned it's a new phenomenon for people and it's a new phenomenon for their leaders.

We're in a huge catch-up mode at the moment and there's some panic; there are two key variables for all epidemics and it's contagiousness and its deadliness and contagiousness is the RO, how many people that one person infects, and by this standard, COVID-19 is highly contagious. It will take years and years before we know the numbers properly because we don't know how many of the population who weren't tested actually got it.

R2, although that doesn't sound too deadly, compounding of that rate is quite meaningful. If one person arrived on the island of the UK and infected two and every one of those infected two, it only takes 17 steps for the whole population to be infected if everybody infected somebody different, but obviously they don't, you bump into people you have already infected and so the curves for epidemiology and contagiousness are well understood, and there's plenty of science on that, and the mortality rate looks like it's something around a per cent.

Some people want to talk about different interpretations of that, but I think there is reasonably good evidence to say it's around a per cent, so that's serious. When we were dealing with the last pandemic in 2009, it was highly contagious, but it wasn't deadly. The mortality rate then was 0.02%, therefore people didn't need to react to it and it just washed through. While many people caught it, it wasn't impactful for society.

One benefit is that we have those past modellings. Also, the UK is behind, timeline-wise, what has happened in Asia. I think that lockdown in the UK will probably intensify first and the lockdown modelling makes it possible, I believe, to have some idea what might happen in the future.

The problem we have is applying it to Western democracies. The modelling from the early data - from China and South Korea and Japan - we can use to build a model of expectation, which we have done, and then look at what happens as it gets applied first in Italy, then France, Germany and the UK and see whether or not what's happening in those societies fits to the predictions of the model. In our model, there are some key variables. When does the lockdown happen? Because from when the lockdown happens, within eight days, you can see whether it's working. What happens is the rate of new cases, the acceleration, it decelerates to steady, and then it decelerates and in all cases where this has been done you reach peak new cases within 14 days and you reach peak death rates in up to 8 days afterwards.

In terms of reasonable size models for this, China and South Korea are past those points, and Japan is just passed peak new cases and peak death rate, so we have those but what we don't know is whether or not that will work in Europe, and so we're watching Italy very closely, but I would say that the evidence coming out of Lombardy would say that it's working there and the evidence for the whole of Italy - you've got a real deceleration of evidence, so the deceleration is happening and so Italy is on course.

Now Italy has got a catch-up mode of a big infection to start with. You've got those cases but once you go to lockdown the rate of new infections slows down dramatically and it's in the numbers in the second week and by the end of two weeks, you've got peak and once you get past the peak then the health service knows the maximum of what it needs to cope with and you start to emerge on the other side. We've built models from all the countries that are going through this and that are publishing data and try to build a predictive model and then applying the predictive model to Italy and France and Germany. And so far, they're fitting the model.

If it works for the UK, by next week we'll have evidence of the deceleration of new cases; for the moment there's still an acceleration and by the 30th of March we should have reached peak new cases. So, we would say by the end of April beginning of May you will be getting to go back to some normality.

There's a lot of complexity about how that will happen and what will happen. One of the lessons from 2008 was that we moved before we knew how deep the valley would be and, in the end, too early and we didn't get enough capital for the worsening of the situation and greater opportunities. And this time we would wait until we could see the bottom of the valley.

I think that all the evidence we have at the moment and the government reactions that we've had, and the closedowns, this is what in our prior modelling of what a global pandemic would look like, we assume something more deadly, that would shut societies for three months. And you would shut down, and it would be an absolute shock to GDP. And so, what's happening is we've got something like that without a deadly pandemic. This is not particularly deadly at 1%. But actually, the way that it's been dealt with is as if it is a deadly one, and the economic effect is something similar to a deadly pandemic.

Outlook and Opportunity

On to the opportunities that have been presented. The market has reacted extremely quickly, there's a lot of uncertainty. People don't know what's going to happen, initially indiscriminate, suggesting just money being taken out of equity markets. We had holdings like Glaxo hammered when it's the world's biggest vaccine company. It's hard to see how this is bad news for them, but it's getting more nuanced. The companies that are in the eye of the storm like easyJet being hurt a lot and retailers.

So, we have started to deploy cash. The biggest area we've invested in is house builders. We've been buying Barratt. We're buying it at a third of what we think it's worth even in the scenario that we've imagined.

All the house builders now are ungeared. The amount they've moved is the peak to trough move in the credit crunch. They've come down something similar if you take out the effective gearing and undoubtedly there will be disruption and there may be changes in house prices and all those things. But Barratt has got nearly a billion of cash for all of its labour. Staff are pretty much contractors. At the moment when we're ringing around, actually they're still doing appointments and things are still ticking on. They're still building houses. But even if we've assumed a hiatus, if there is a hiatus post-virus, we're not expecting that people won't want to live in houses.

We've also put some money into Lloyds, and we put some money into easyJet. I don't know how long the value window will be there. There is a lot that needs to be figured out. Into our models, we've been able to allow for the change in the rates with that the government's done, but they haven't said what they'll do in terms of staff. So, we've had to assume no help on staff costs for businesses like Wetherspoons and Sports Direct, the ones that have been having to potentially close premises. But we are expecting something soon from the government on that and if we do, we'll incorporate those in our models.

As we get more evidence, we can flesh it out, but we've tried to use very negative assumptions so far. It could be that within a couple of weeks, when the peak of cases has occurred and people have an idea of how bad it's going to be, that the market, not necessarily the world, but the market will be able to see through the crisis to the other side. We will have all the government measures and you'll know which businesses are going to survive and what they are likely to be worth and you'll have opportunistic capital coming into the market as well.

The fact that we are buying is not any kind of prediction of the future, but it gives you a measure of just how cheap things are, and it's cheap in businesses that we know extremely well. We've spoken to managements. We've spoken to managements right in the eye of the storm, like the easyJet's, to get proper confidence that we're seeing the world as it is. I suppose that that's how it is.

We see this as an understandable overreaction to a negative event but actually we're getting to the point soon where the market and society will have figured out what this is and adapted, and then the second order effect of this is that there are businesses that will not survive without a change of capital structure. There are some businesses that are unviable and will go out of business, but there are some good businesses that just have too much debt and they will need to refinance and is not an easy time to refinance and there will be probably further opportunities to participate in maybe capital raises for those type of businesses.

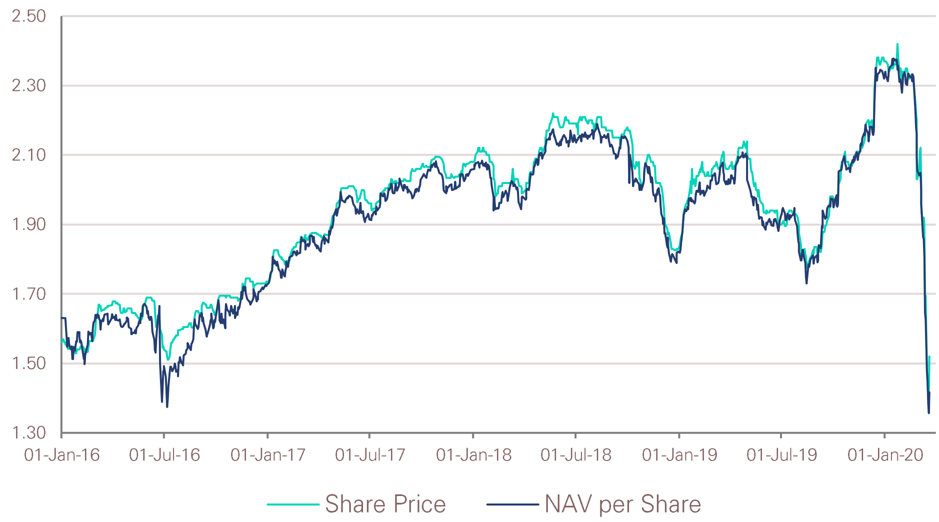
So, we are we are working on those, readying ourselves for those opportunities, and I suppose that's what we expect. That will come in subsequent months. Governments can help and give assistance. They can provide liquidity for large companies and loans, but loans don't help companies who already have too much loan. So, how that plays out? What opportunities? I don't know. We're just making sure that we are prepared.

Aurora Track Record

Performance	NAV Return %	Share Price Total Return** %	All-Share Index %**	Relative NAV to ASX %
2020 (to 20 March)	-39.0	-35.9	-31.7	-7.3
2019	29.7	31.9	19.1	10.6
2018	-10.3	-10.9	-9.5	-0.9
2017	20.4	21.2	13.1	7.3
2016	6.6	12.0	16.8	-10.1
Cumulative*	-8.6	2.4	-2.7	-6.1
2015	-2.3	4.3	0.9	-3.2

* Since 1 January 2016
**Share price return with dividends reinvested; All Share Index returns with dividends reinvested.

Aurora Share Price & NAV per Share – 20 March 2020



Aurora shares are eligible to be invested in an ISA. Neither the Aurora Investment Trust nor Phoenix Asset Management Partners run such a scheme. You should consult a financial adviser regarding a suitable self-select ISA provider.

Investment Objective

We seek to achieve long-term returns by investing in UK-listed equities using a value-based philosophy inspired by the teachings of Warren Buffett, Charlie Munger, Benjamin Graham and Phillip Fisher. Our approach, combined with thorough research, invests in high quality businesses run by honest and competent management purchased at prices that, even with low expectations, will deliver excellent returns.

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Listing: London Stock Exchange

Inception Date: 13 March 1997

ISIN: GB0000633262

Bloomberg: ARR

Fees

Management: None

Performance: One third of returns in excess of the market

Regulatory Notice: