Aurora
INVESTMENT TRUST

Aurora Investment Trust – March 2022

Share Price: £2.37 Net Asset Value: £2.37 Premium: 0.2%

Market Cap: £182m

Data as of 31 March 2022

Holdings >3% on 31 March 2022	(%)
Frasers Group	17.9
Castelnau Group Ltd	12.4
Barratt Developments	10.2
easyJet	9.1
Ryanair	5.9
Lloyds Banking Group	5.1
Randall & Quilter	4.0
RHI Magnesita	3.5
Bellway	3.1
AO World	3.1
Others <3%	7.6
Cash & Cash Equivalents	18.0

In March, the NAV was down 6.7% for the month, versus the FTSE All Share (incl. dividends), which was up 1.3%.

The war in Ukraine continued to impact the portfolio, with our low-cost airlines coming under pressure. Additionally, our housebuilders were negatively impacted by ongoing dialogue with the Government on reparations in relation to cladding.

Whilst causing uncertainty, neither the war nor the cladding issue has lessened our conviction in those holdings.

Gary Channon, Phoenix CIO and Founder, has published his quarterly thoughts to investors, and they are outlined below. It has also been our historic practice to formally introduce new holdings when they exceed 3% of the portfolio. In recent months we have been building a holding in AO World and an introduction to that holding follows Gary's quarterly update.

Quarterly Update from Gary Channon

The war in Ukraine has replaced COVID as the primary concern in the market and its impact on commodity prices has added to the inflationary forces already at work. So far, the impact on businesses has been less disruptive than the shutdowns of the pandemic, but the war is ongoing and that could change. In our portfolio the most impacted so far are the airlines, easyJet and Ryanair, although due to their hedging strategies the rising fuel cost will have a delayed effect. It will improve their relative competitiveness due to their newer and more fuel-efficient fleets, but higher ticket prices will impact demand.

We closed the put option that constituted the inflation hedge in the quarter as the interest rate market priced in c.2% interest rates by September 2022 versus 0% when we bought the hedge. The average price we sold at was 17 times the initial cost. We sold before the start of the war but when it seemed inevitable. This leaves the portfolio with a high cash holding which, when including cash, T-bills and cash expected from takeovers (R&Q), is approaching 22% of the portfolio.

Share prices in the UK have been more impacted than the headline performance of the indices suggest because they contain a heavy weight in Oil, Gas and Commodities (21.3% in the FTSE 100). Outside of those sectors there has been more turbulence and we have made some modest investments so far. One new holding, AO World, is described below as it passed the 3% mark in the last month.

Forecasting the outcomes and impacts of wars is difficult and doesn't lend itself well to the processes we use to improve our estimation of company values, which in essence are a forecast of the future. When we considered Brexit, we could use a game theory concept called the Nash equilibrium to try to estimate where things would turn out, and that worked fairly well. But the parameters and possibilities of war are far higher, and that game theory approach requires rational actors on all sides.

Applying it to the war, the Nash equilibrium would predict a "least bad" outcome where both sides accepted difficult compromises. The seeds of those have already been discussed in the negotiations. Ukraine gives up future NATO aspirations, becomes neutral and potentially cedes some territory and Russia accepts Ukraine in the EU, a full withdrawal and potentially some territory. The likely territorial compromises will be impacted by the war on the ground and the political situation in both countries, especially who their leaders are. All these deliberations are fraught with error and there remains the chance of some much bigger overspills on global impact including if energy supplies from Russia are cut off or the war extends beyond the borders of Ukraine and Russia.

As always when tackling these types of challenges, we revert to the long-term factors of demand in our industries and consider how they might be impacted in the short and especially the long run. So far there is nothing likely to happen that we see having a long-term impact on any of those, but there are short term risks especially if energy and commodity prices remain elevated for a long time. None of those risks does material damage to our intrinsic values.

Our investment approach does not rely on being able to predict periodic macro developments like wars and pandemics. It does however rely upon our ability to forecast the likely economic performance of businesses over the long term. To make attractive long-term returns for you relies upon our success in this endeavour. We have talked a lot in the past about how our working methods are designed to reduce psychological bias in our assessments, but there are two forms of error that come into play: bias and noise. Much has been written and studied about bias but much less about noise.

To clarify the definitions, imagine that you try to throw 10 darts at a dartboard all attempting to hit the bullseye in the centre. If they have landed generally to the left of the bullseye then that deviation is called bias but the extent to which they didn't all land on the same spot is called noise. The wider spread they are the greater the noise; someone who hits a few on the floor and ceiling has greater noise than someone whose darts are in a tight cluster on the board. Bias distorts things in predictable ways, noise is a measure of how much variance there is around the average.

Carl Friedrich Gauss figured out the way to measure errors 250 years ago with what is called the Mean Squared Error method. Without becoming mathematical here, the total "error" in our forecasting is, in a Pythagorean way, the sum of the squares of the "bias" error and the "noise" error. Predicting the future returns of businesses is fraught with noise error risk but there are things that can be done to reduce it. A consistent, methodical, scored and team-based approach carried out by individuals with some competence contains nearly all the elements to reduce noise. We have been using it now for over 20 years.

(If you are interested in learning more on the topic then we would recommend a paper by Daniel Kahneman, Dan Lovallo and Olivier Sibony called *A Structured Approach to Strategic Decisions* published in the MIT Sloan Review in 2019, and to read Kahneman's book *Noise*).

The noise around a single assessment is high, like our latest investment in AO World, but we revisit that assessment continually and check it against what is actually happening. More importantly, we apply this method over the whole portfolio and have been applying it over 100 times since we started. The impact of noise reduces

Aurora
INVESTMENT TRUST

substantially as you repeat the process on different subjects and by 100 the reduction is 90%. What this means is that our long-term portfolio result should be shorn of the vast majority of our estimating noise. This leaves the overall portfolio level Intrinsic Value as a reasonable guide to the underlying value of our portfolio.

A study of noise will also show how hard and how unlikely it is that we will make an accurate forecast of the war in Ukraine. The important thing is to have a portfolio that is not imperilled by potential worst-case outcomes.

The final bit of our process comes from the genius of Ben Graham. Having done all that work to estimate the value of the future cash generation of a business, we then knock off 50% to work out our maximum purchase price. That "Margin of Safety" is our ultimate protection against our errors and the source of all our excess returns.

Catastrophic events often cause the market to price a higher margin of safety as investors lose their risk appetite and place too much weight upon short term considerations. These are attractive conditions for the prepared value investor and as we showed at the Annual Investors Meeting in March, they are the times when we do the most to add long term value.

Introduction – AO World

John Roberts who grew up in Bolton, Lancashire wasn't good at school, and in his sixth form said he didn't want to go to university; instead, he wanted to be a double-glazing salesman. The teacher was dismayed and told him he wouldn't succeed if he didn't go. John then managed to fail all his A-Levels and was unable to get hired into double glazing and ended up in a warehouse, and warehouses by and large have been the essence of what made him one of the country's richest men.

At the height of the dot.com bubble in 1999 he had a pub discussion with a friend about businesses that would succeed online, which ended up with John winning a £1 bet that he wouldn't leave his job and set up on his own. He did, setting up Appliances Online (DRL Limited initially and ultimately AO World). Just as the internet bubble burst and whilst the world was just getting used to books being delivered online, John chose the inauspicious field of large domestic appliances.

The concept from the beginning has been an online only customer focused supplier without retail premises. That customer focus permeates everything they do, combined with a continuous improvement ethos.

Over the next 14 years, John and his team built a business that they floated on the LSE at a valuation of £1.2bn. John retained a 29% stake and pocketed £86m. By that time, AO had become the biggest online retailer in the UK for domestic appliances; sales had grown to £275m, which was 25% of the online market and 11% of the overall market. AO were growing strongly on the back of high customer satisfaction, reputation and reviews.

By 2019, before the pandemic, UK sales had reached £750m, serving 6.5 million customers, then COVID hit and sales reached £900m in 2020, and over £1.4bn in 2021 as consumers were forced to stay at home and physical retailers were closed.

Throughout all that explosive growth, AO managed to retain very high levels of customer satisfaction whether measured by NPS (Net Promoter Score) or Trust Pilot reviews. They executed to a very high standard, which drew our attention to their underlying culture and operational excellence.

John had stepped away from the business in early 2017 and then returned in 2019 as CEO. Like a number of great entrepreneurs that we have observed over the years, stepping away after realising enormous wealth only to return when money is clearly not a motivator, is a sign of someone realising where their true love lies and is often followed by a golden era of business performance.

John had been drawn back by the problems too. AO had gone into Europe, especially Germany, in 2015 and in 2018 they bought a mobile phone business; these businesses were losing and using money. AO has always operated leanly and at low margins putting gains in productivity and purchasing power back into improving the price and overall customer proposition, continually building what Warren Buffett calls the moat, the competitive advantage.

An example of AO's combination of customer service obsession and continual process improvement is when they realised that lots of customers were still calling them on the day of delivery to check times even though they emailed and texted them beforehand with the times. AO invested a few million pounds in a system that recognises the phone number calling, checks to see whether there is a high probability it is about a delivery, checks also where the current location of the delivery vehicle is, and then gives an automated message to the customer telling them in detail about their delivery and when it is happening. It also says to stay on the line if you want to talk about something else. Most customers are wowed, delighted and hang up, thereby saving time in the call centre.

AO has a mantra to treat every customer like your gran, and that you conduct yourself every day so that you can have dinner with your parents that night, tell them what you've been doing and have them be proud of you. These are emblematic of a strong culture that we think is AO's biggest competitive advantage and the primary reason why from a standing start they have built the no.1 business in 20 years. Even more so than their outstanding logistics expertise and unrivalled service levels. AO also has a unique commitment to recycling and operates its own recycling operation. They have recycled 5 million fridges in the past 5 years and found innovative new uses for the recycled materials. Increasingly, this matters to customers.

The shares are depressed this year as the unwind of COVID means there is a return to some retail shopping, the boom in work from home is receding and so, on a comparative basis, AO's performance is declining. This is in our opinion irrelevant for a proper assessment of the long term. Their business in the UK is 50% bigger than before COVID and millions of new customers have experienced AO for the first time. Domestic appliances are not frequent purchases, and so that goodwill does not show up immediately, but past experience suggests it will do. In the meantime, AO have pushed into smaller electrical items including phones and are looking to find a model that would make them the go to supplier for all electrical items.

We have a long-term demographic view that spending on electrical appliances in the household will grow faster than GDP as internet technology finds its way into domestic

appliances and robotics starts to have an impact. AO is the best positioned business to serve that need and the best led.

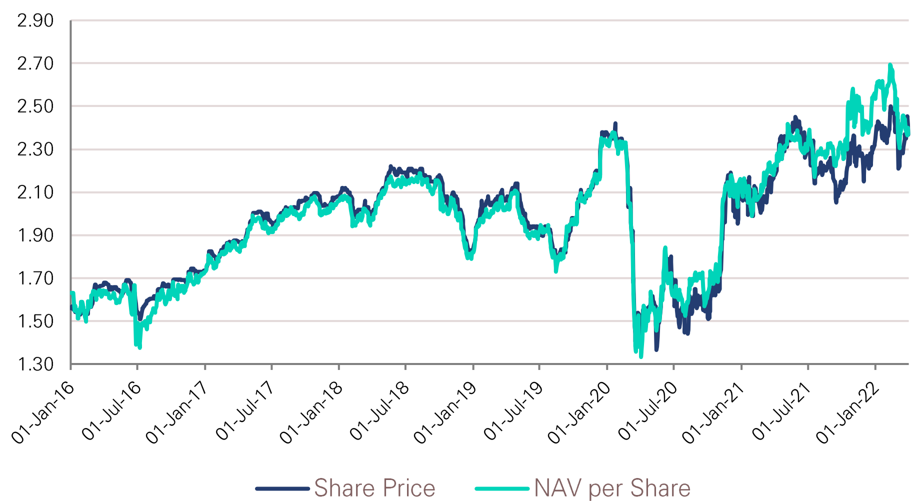
We value the business in our central case at £1.5 billion and we were able to purchase our stake at a £446m valuation.

Aurora Track Record

Performance	NAV Return %	Share Price Total Return** %	All-Share Index %**	Relative NAV to ASX %
2022 (to 31 March)	-6.6	1.1	0.5	-7.1
2021	19.1	13.5	18.3	0.8
2020	-5.5	-10.0	-9.7	4.2
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
Cumulative*	57.3	64.5	52.7	4.6

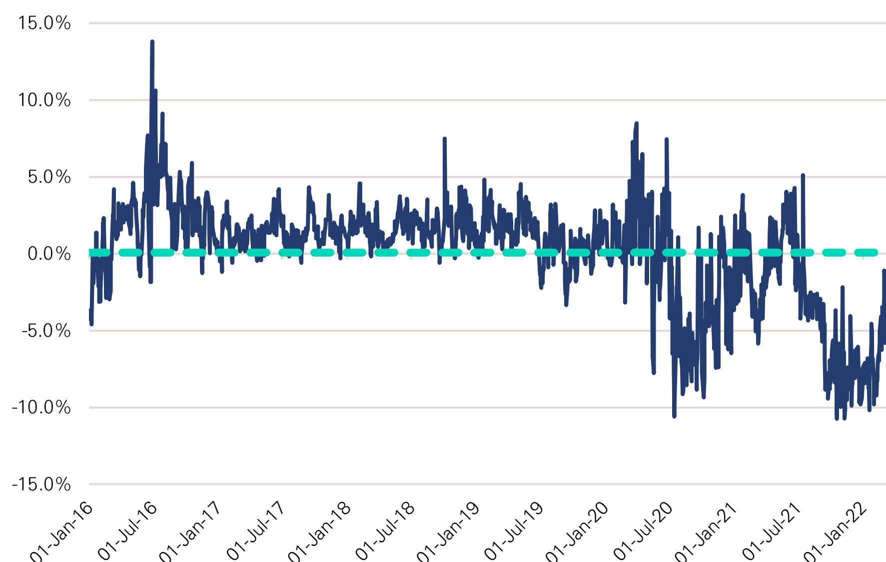
* Since 1 January 2016
**Share price return with dividends reinvested; All Share Index returns with dividends reinvested.
Past performance is not a reliable indicator of future performance.

Aurora Share Price & NAV per Share – 31 March 2022



Past performance is not a reliable indicator of future performance.

Aurora Premium / (Discount) – 31 March 2022

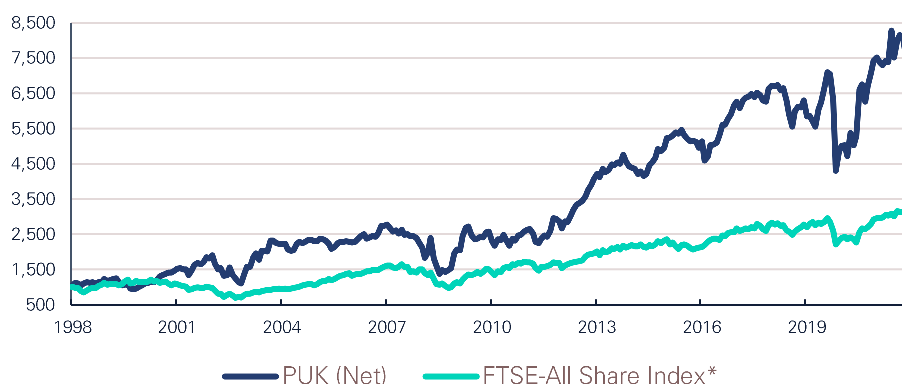


Phoenix UK Fund Track Record

Fund Performance (%)	Gross Return	Net Return	FTSE All-Share Index*	Relative NAV to ASX
Cumulative Since Inception**	1,257.4	655.1	234.2	420.9
Since Inception Annualised**	11.5	8.8	5.2	3.6

The investment strategy of the Aurora Investment Trust is the same as that of the Phoenix UK Fund.

Phoenix UK Fund
Value of £1,000 invested at launch to 31 March 2022



PUK (Net) FTSE-All Share Index*

* All-Share Index Returns with dividends reinvested

**From May 1998 to 31 March 2022

Past performance is not a reliable indicator of future performance.

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.

Contact

Phoenix Asset Management Partners Ltd
64 – 66 Glentham Road London SW13 9JJ
Tel: +44 (0) 208 600 0100
Fund Manager since 28 January 2016

Portfolio Manager: Gary Channon
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:

This advertisement is issued by Phoenix Asset Management Partners Limited (PAMP), registered office 64-66 Glentham Road London SW13 9JJ. PAMP is authorised and regulated in the UK by the Financial Conduct Authority. Aurora Investment Trust Plc ("the Trust") is a UK investment trust listed on the London Stock Exchange. Shares in an investment trust are traded on a stock market and the share price will fluctuate in accordance with supply and demand and may not reflect the underlying net asset value of the shares. An investment trust may not be suitable for retail investors with only basic knowledge of investments. The value of investments and any income from them may go down as well as up and investors may not get back the amount invested. There can be no assurance that the Trust's investment objective will be achieved, and investment results may vary substantially over time. Past performance is not a reliable indicator of future performance. Prospective investors should consult their own advisors prior to making any investment. The Prospectus and other regulatory documents can be found at can be found at: www.aurorainvestmenttrust.com