Aurora Investment Trust –March 2023

Share Price: £2.14 Net Asset Value: £2.38 Discount: 10.1%

Market Cap: £163m

Data as of 31 March 2023

Holdings >3% on 31 March 2023	(%)
Frasers Group	21.9
Barratt Developments	15.4
Castelnau Group Ltd	10.1
easyJet	8.7
Ryanair	6.8
Netflix	5.7
Lloyds Banking Group	5.3
Hotel Chocolat	3.9
Bellway	3.8
RHI Magnesita	3.3
Others <3%	12.3
Cash & Cash Equivalents	2.9

In March, the NAV was down -2.0% for the month, versus the FTSE All Share (incl. dividends), which was also down -2.8%.

There was no material trading activity for the portfolio this month.

The upside to IV for the portfolio currently sits at 130% upside, we believe this is an attractive entry point for the Trust.

Please see below the outlook and other write-ups from CIO, Gary Channon. This includes last year's newly initiated position in Hotel Chocolat and a comment on Dignity.

Outlook

Magic is one of the most captivating forms of entertainment, it is enjoyed all around the world and has been for a long time. A trick still performed today called "Cups and Balls" dates back nearly 5,000 years. Yet magic involves deception, illusion and trickery. We don't really believe the magician has supernatural powers, we know there is a logical explanation for what we just saw. It's just that we are more entertained when we can't figure out what just happened.

Despite the intellectual and cognitive nature of the craft, magic has largely been ignored by academia but recently that has changed and it is now being studied by psychologists and neuroscientists.

The way that we invest, or more accurately, the way the effect of how we invest shows up, has a lot of similarities to a magic trick. If it works it ends up delivering investment returns that are much better than owning all stocks, i.e. indexing, and also well ahead of the performance of the average fund manager. Over time the effect can be seen and measured, as the long term track record table we include in this report shows, but actually how it happens is much harder to discern.

Before it was studied properly, magic was thought to work by an effect called misdirection from method, in other words by getting the audience to be looking somewhere away from where the method of the trick was occurring, but studies using eye tracking technology have shown that in the very best magic that is not the case.

In a paper called "Magic and Fixation" by Kuhn and Tatler (2005), they discuss the surprising discovery they made when conducting an experiment using eye tracking technology on a simple trick of a disappearing cigarette where the viewers attention was drawn to a different hand whilst the cigarette is just dropped into the magicians lap in full daylight. Although they expected to find that viewers were looking away in the wrong place, they instead found that they were staring right at where the cigarette was dropped but didn't notice it. It is a phenomenon that has been labelled "inattentional blindness". Our eyes might be seeing but our brains don't notice.

One of the most famous psychological experiments is the one performed by Chabris and Simons (1999) in which participants were asked to watch a basketball game and count the amount of times the ball is passed between players. While this is going on, a man in a gorilla suit walks onto the pitch and walks between all the players before leaving. 46% of people viewing that video for the first time never notice the gorilla and they are shocked when it is played back because it is so obvious.

It was thought this happened because participants were focusing on the ball and not seeing the gorilla, but the eye tracking technology mentioned above shows that not to be the case. Those who miss the gorilla are looking at it. Again, this is a case of inattentional blindness. (For those whose curiosity is piqued the magician turned academic Gustav Kuhn has written an interesting and informative book on the topic, Experiencing the Impossible (2019)).

Although we can see the effect of our investment approach showing up in our long-term results, we can't actually see it happening even though we watch every aspect of it. We write about how we choose which businesses to invest in, the prices we pay and the values we expect, we report on how those businesses have performed and how their share prices moved but none of that shows the effect of persistent underlying outperformance in action.

Other managers from all disciplines, not just value investing, report on their investments and why they are buying them. No one ever describes an investment at the outset as anything other than being done with a positive expectation.

In our own portfolio we describe what end up being our successes and our failures in the same way when we buy them and there is no evidence of the outperformance to come or not in those. If we knew what our failures looked like from the outset then we wouldn't buy them.

Part of the problem is the amount of noise drowning out the effect. A long term outperformance of 5% is a highly improbable outcome and compounds into a very big difference over the long term but it equates to less than 0.002% per day, which is imperceptible when market prices fluctuate daily by whole percentage points.

We are not magicians, and unlike magicians this is not a deliberate trick. When we draw your attention to what we have bought and why and update you on the twists and turns of those businesses, we are not trying to misdirect your attention away from the method. The truth is we don't really know how the trick works; we certainly don't know when it is going to work except over the long term.

One of the inadvertent misdirection's that does occur is that we talk about what we own and not what we don't own and yet, long term outperformance is a relative measurement. Part of our long term success must be due to what we don't buy, which we almost never discuss. Our detailed research and our analytical framework are designed to reduce the chance of investing in failures and the long term data suggests it achieves that.

Long term outperformance comes from having an edge, i.e. an approach or method that has an advantage over the average outcome. We think ours largely comes down to three things; the price we pay, the quality of what we buy and our error rate.

Our purchase price requirements are rarely met and we spend most of our time watching and waiting and not investing. When we do buy, we pay a price that most businesses don't trade at except occasionally, and therefore our starting point is better than that of the average investor or the overall index.

We buy businesses that at their core earn a higher return on capital than the average business and have some sustainable competitive advantage that increases the chance that it will be persistent. Having your capital in businesses whose own capital is earning high returns and is re-invested at rates higher than the average business is an ongoing source of performance edge.

As we discussed before, our approach built through years and years of continuous learning from mistakes reduces but doesn't eliminate the rate at which we get our assessments and judgements wrong. Again, we do know from our data that our error rate is markedly low for our field.

There are other smaller factors that contribute to the edge, like the ability to hold cash, and not everything that we do gives us a positive edge; our past selling judgments have been a negative factor. But overall, our approach gives us a positive edge. Since we started, the overall market return has been 5.1% and that assumes no commissions and no stamp duty paid. Our returns after paying those costs have been 11.0% implying an edge of 5.9%. Over what has now been almost 25 years that has been the difference between 244% cumulated for the market and 1,260% for the portfolio before fees. You and we care mostly about absolute returns, not relative. The edge gives us an uplift from the market return, but we have chosen to ply our trade in one of the worst performing major markets in the world.

The US stock market has returned more than twice that per annum and had we achieved our edge in that market then we would have returned well in excess of the 15% absolute target we set ourselves. However, what might look like a mistake of choice 25 years ago might be a positive for the future. That long term underperformance of the UK which has been widely reported now as being in part caused by the long-term disinvestment by local pension funds of UK equities means that we own a cheap portfolio in a cheap market and as our experience and many studies show future returns are a product of starting price. The UK won't always be cheap, disinvestment can only happen once and so what may have been a drag on the past 25 years could be a great tailwind for the next 25.

We will keep applying and improving our approach and building our edge so that we are worthy of your trust in us. We think our best work is yet to come, that the past 25 years has been a formative apprenticeship and that right now we have a very attractive starting point to deliver you excellent long term returns. It's not magic; its persistent hard work, clear thinking, and rational actions, but the results if we get it right are magical.

New Holding – Hotel Chocolat

Many of you will be familiar with our newest investment, Hotel Chocolat. You may have sent their boxed chocolates as gifts, or perhaps you have developed a taste for Velvetised hot chocolate. Hotel Chocolat manufactures premium chocolate and cocoa-related products and sells these directly to its customers. The Company sells its products online and through its network of stores, primarily in the UK. Hotel Chocolat also owns a cacao plantation and luxury hotel, restaurant and spa in St Lucia, called the Rabot Estate.

In 1988, Angus Thirlwell and Peter Harris left the tech company for which they had been working to set up the Mint Marketing Company, selling branded mints as corporate gifts. By 1993, the Mint Marketing Company had evolved to sell boxes of chocolates delivered by post, known as ‘chocograms’, and the business was rebranded to ChocExpress. In 1998, ChocExpress launched the Chocolate Tasting Club, a subscription service that saw members receive unique selections of chocolate each month. This not only enabled the business to develop new ideas and recipes, but also to build a relationship with their customers and to get an insight into what the British public liked in their chocolate.

In 2003, ChocExpress rebranded as Hotel Chocolat, after customers kept commenting that the chocolates were ‘surprisingly’ good. Hotel Chocolat better conveyed the idea of escapism through chocolate, juxtaposing the English word ‘Hotel’ with the more onomatopoeic and luxury-evoking French ‘Chocolat’.

The first physical Hotel Chocolat shop opened in Watford in 2004. Today, there are 122 Hotel Chocolat locations across the UK.

Hotel Chocolat listed on the London Stock Exchange in 2016, with both founders retaining a significant stake in the business. As of December 31st 2022, they each own 27.1% of the Company. We have known both Angus and Peter for a long time and hold them in high regard.

We believe that the key moat for the business is its strong brand and resulting customer loyalty, which it has cultivated through a combination of innovation, creativity, disciplined pricing, and direct distribution. In so doing, it has also avoided the pitfalls that led to the downfall of one of its competitors, Thorntons.

One of the Company’s great recent innovations has been the Velvetiser hot chocolate machine, which is increasingly becoming a staple household appliance and has formed the foundations of an effective subscription model. As a product, it creates loyal, repeat-customers who repurchase the chocolate sachets. The repeat purchases and subscription service also provide the Company with a steady revenue stream in an industry where consumer purchases are usually very seasonal (Christmas, Easter and Valentine’s Day are the main chocolate-shopping opportunities).

The differentiated taste of Hotel Chocolat’s chocolate, stems from its “More Cacao, Less Sugar” mantra. Cacao is around five times more expensive than sugar, but the Company is committed to cacao always being the number-one ingredient in its chocolate, even in milk and white varieties. This differentiates the product from those of many of the Group’s competitors, in which sugar is frequently the primary ingredient. The high-cacao content within Hotel Chocolat’s chocolate, also enables them to justify a higher price-point and enables them a higher degree of price-elasticity as their consumer is likely to be more driven by quality than price.

The Company navigated the challenges of Covid admirably, succeeding in not only switching from being a primarily store-based to an online business during the lockdowns, but managing to grow sales by 21% between FY20 and FY21.

We have long admired Hotel Chocolat, so much so that at the time of the IPO we were considering investing in the business. Although this didn't happen because the price was above our limit, we continued to keep a close eye on the Company. Last year, following the announcement of the closure of the Japanese and US businesses, Hotel Chocolat's share price dropped, opening an opportunity for us to invest. This is a company built on experimentation and innovation and it is inevitable that not every experiment will lead to success. However, we believe that the market had over-reacted, that the underlying strength of the UK business remained, and that the doors to overseas expansion had not permanently closed. Indeed, earlier this year Hotel Chocolat announced that it had found a new partner for its Japanese joint venture.

In some ways, the shock of the drop has had a positive cathartic effect, with the business rationalising and cutting back on areas into which it had perhaps strayed too far (such as coffee machines & pods and beauty products). At the same time, we believe they haven't lost the innovative skill upon which their hitherto success has been built, and which will enable it to continue to grow in the future.

We have modelled out a range of potential scenarios to determine Hotel Chocolat's intrinsic value. A central scenario values the UK business alone at £3.50 per share. The bottom of that IV range is around £2.00 a share. We invested at £1.35, which, based on the central case, would result in an upside to IV of c. 160%.

Dignity

As we wrote in January, the bid for Dignity was close to becoming public and then a share price move prompted a public announcement on 4th January of a possible offer, and then on 23rd January, the agreed offer was announced. We are restricted during the offer period from saying anything that is not already in those public documents and we hope that you have been able to hear from us in the series of webinars or at the AGM in March, the recordings of which are available to investors (please contact Maraki maraki@pamp.co.uk).

Although we are not able to give the details, we can say that it is a deal that firstly, we have entered into with a large margin of safety, and so in the event of failure we don't expect to lose any of your money and even in a central case outcome we expect a very high return, much higher than our average historical portfolio return. It is an opportunity that utilises everything we've learned in the past 25 years about what makes a great business and investment and combines that with what we've learned about how to do that in practice, whilst making the most of our network of highly capable practitioners that we have accumulated through our business based approach to investing. But it is a big undertaking, and so that is why partnering with Sir Peter Wood and his team gives us the bandwidth and experience to help us deliver the strategic plan that we started last year and shares the capital requirement.

The generally low pricing of businesses on the London Stock Exchange is the backdrop that gives us the window to buy which, even after paying a fair premium for control, is at a highly attractive entry price. We expect to multiply your money a number of times and will be reporting on our progress through our Castelnau reports. By the time of our next report, the deal is likely to have closed. Once Dignity is no longer a public company, we will be able to be a lot more open about our plans and progress. We will be valuing the business on a monthly basis and that will be contained in the Castelnau NAV.

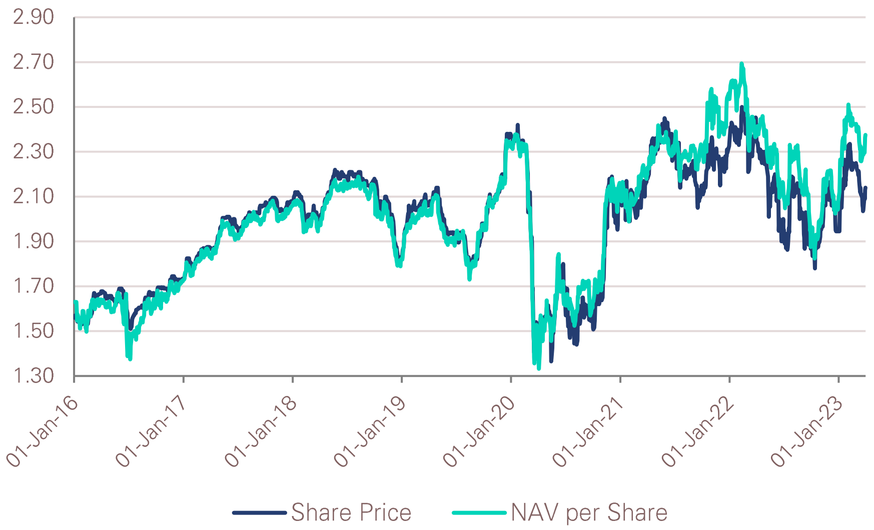
If we have this right then buying Dignity will accelerate the overall performance of the Phoenix portfolio. We expect our ownership of businesses to deliver high returns through time for you and at a higher rate than our minority holdings in public companies. However, as we discussed at the AGM they are all driven by the same core business based research, insights and expertise of the Phoenix Investment Team, which we are applying for the same goal that is to invest your money in businesses that will give great long term returns and outperformance.

Aurora Track Record

Performance	NAV Return %	Share Price Total Return** %	All-Share Index %**	Relative NAV to ASX %
2023 (to 31 March)	14.4	10.0	3.1	11.3
2022	-17.4	-16.3	0.3	-17.7
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
Cumulative*	65.9	52.7	64.8	1.1

* 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 2023



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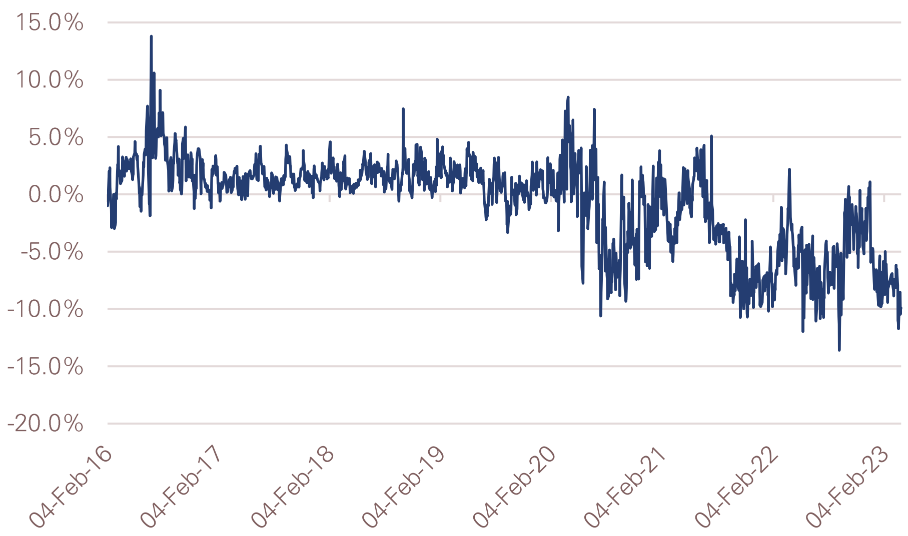
Aurora Premium / (Discount) – 31 March 2023



Past performance is not a reliable indicator of future performance.

Aurora shares are eligible to be invested in an ISA or SIPP. 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 or SIPP 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.

Contact

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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: