Aurora Investment Trust – March 2024

Share Price: £2.45 Net Asset Value: £2.72 Discount: 9.9%

Market Cap: £187m

Data as of 31 March 2024

Holdings >3% on 31 March 2024	(%)
Frasers Group	19.5
Barratt Developments	13.5
Castelnau Group Ltd	13.0
Lloyds Banking Group	7.8
Netflix	7.7
Ryanair	7.0
easyJet	4.6
RHI Magnesita	4.5
Bellway	3.9
AO World	3.1
Others <3%	10.2
Cash & Cash Equivalents	5.2

In March, the NAV was up 1.6% for the month, versus the FTSE All Share (incl. dividends), which was up 4.8%.

The strongest performer during the month was Lloyds Banking Group, which rose by 11.1%.

There were no significant fallers in the month.

In his recent quarter-end letter to Phoenix investors, Gary Channon made some observations in relation to the CMA investigation into the housebuilders. These observations are outlined below for Aurora shareholders.

Housebuilding

The Competition and Markets Authority (CMA) has been investigating the UK housebuilding industry since February 2023 at the urging of Michael Gove, the minister for Housing and Communities as well as Levelling Up, and it published its final report this quarter.

We are always interested in CMA investigations because it is a highly valuable source of knowledge and data. Given the CMA's powers to request information from the industry, and its general focus on matters that align with our own interests, such as assessing whether competition is benefiting consumers and whether market participants are earning excessive returns, these investigations hold significant importance to us. The CMA has the power to change the economics of industries where it thinks things are not working and shareholders are not stakeholders it is looking to protect. If you are ever studying an industry for the first time then the CMA (and its predecessors') reports, and all the evidence that accompanies them, are a good place to start.

This investigation seemed to be politically motivated and part of the pressure Mr Gove was putting on the industry to agree was to pay for past construction liabilities which were not of their making. The CMA was also asked to investigate why more houses were not being built despite the Government's avowed intention to raise construction levels.

It is not new to see the industry being investigated. The Barker Review in 2004 into Housing Supply covered all the same issues and there have been several similar ones since. Again and again, they find that the issue is the planning system and the accusation levelled against large housebuilders, that they use large landbanks to restrict supply and inflate prices, does not stack up. Again, the CMA did not find that to be the case, it found the large landbanks are a consequence of such a slow planning system.

There are some very interesting findings and consequences of the report that are of material interest to both investors in housebuilding businesses. The CMA did find that excess returns on capital were being made and this even after using a very high cost of capital, but it concluded that if they did anything to reduce profitability then it may reduce the number of houses being built which is ultimately to the detriment of consumers. This work can be found in appendices A and B of the report where it takes the top 12 housebuilders and aggregates their financial returns and calculates their cost of capital.

Without wanting to express opinion about the methodologies used by the CMA, we can say that the range of values used for the cost of capital is high for a number of reasons: largely due to the flaws in the whole concept known as WACC (Weighted Average Cost of Capital). As Charlie Munger said, *"I've never heard an intelligent cost of capital discussion"*. The CMA has a current range of 12.6% to 17.9%. We may not think much of the methodology but what is important is that the CMA does.

The 10-year average ROCE (Return on Capital Employed) the CMA has for the top 12 housebuilders is 23.7% to 25.6% (16.9% to 18.2% after tax), it also goes on to say that the top 5 housebuilders earned higher returns than the other 7, with which we agree.

In summary, this detailed industry study shows that for 20 years now large housebuilders have earned high returns on their capital and the report shows a lot of the reasons why; the restriction on supply of land from planning, the barrier to achieving scale, the benefits of scale, the power to price land based upon selling price after deducting profit margin, etc. The CMA decides that it will not try to reduce that excess return for fear of disincentivising output, and so any reader of the study and its recommendations would reasonably expect those returns to persist, and yet in the stock market you can buy these businesses for around the value of their land and cash, their liquidation value! So even without any re-rating in the sector, a long-term owner of all the large housebuilders should expect to earn an annualised return in the high teens plus inflation.

Barratt Developments / Redrow

Against this backdrop, Barratt decided to buy Redrow, a company we have previously owned. The combination of these two businesses, in the way they plan to merge, should create considerable value through the elimination of duplicated management structures, reduced costs and from a higher throughput of house sales from large sites by deploying all three brands to serve different demographic markets (Barratt, David Wilson and Redrow). By our estimation, more of that value goes to Redrow shareholders than Barratt ones because Barratt has agreed to pay a premium for control and is paying using its own undervalued shares.

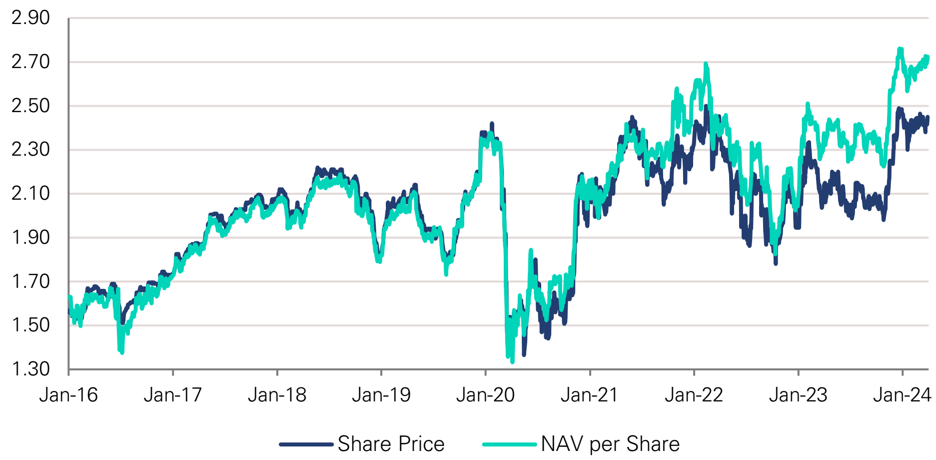
When the dust has settled, we will have a marginally more valuable business per share, but one so well capitalised that we expect it to start buying back shares and returning capital in a much greater way than previously. Barratt Redrow will be the market leader in an industry that has more demand than it is able to serve, and where it is able to earn consistently high returns on its capital. If they then apply share buybacks to a sector that has spent most of the past 25 years undervalued, then the returns to shareholders will exceed the returns on capital.

Aurora Track Record

Performance	NAV Return %	Share Price Total Return** %	FTSE All-Share Total Return Index %**	Relative NAV to ASX %
2024 (to 31 March)	-0.3	-0.8	3.6	-3.9
2023	33.2	28.8	7.9	25.3
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
Cumulative*	84.8	74.0	70.5	14.3

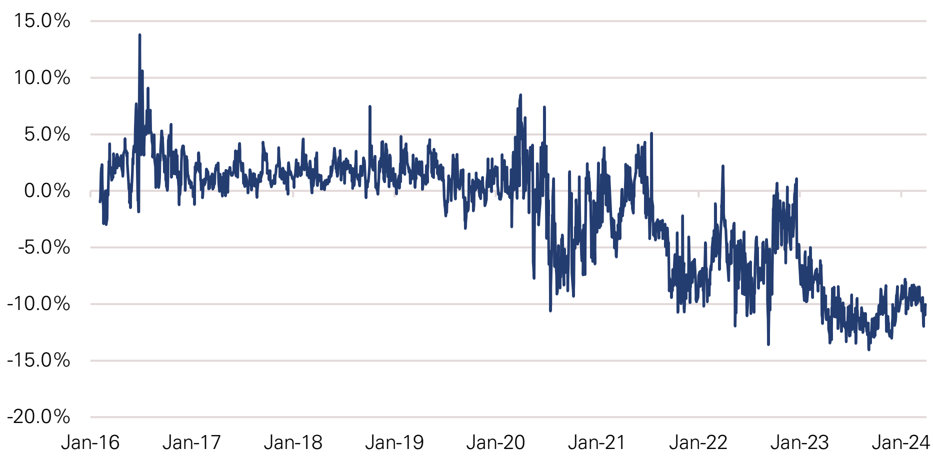
* Since 1 January 2016
**Share price return with dividends reinvested; FTSE All Share Total Return Index with dividends reinvested.
Past performance is not a reliable indicator of future performance.

Aurora Share Price & NAV per Share – 31 March 2024



Past performance is not a reliable indicator of future performance.

Aurora Premium / (Discount) – 31 March 2024



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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.

Target Market

The Aurora Investment Trust is a long-term investment vehicle, appropriate for those making investments with at least a three year time horizon. It is aimed at investors looking for a manager with a business and value orientated approach, achieved through investments in predominantly UK companies demonstrating a high return on capital and control over their profitability through the strength of their business franchise. Aurora's portfolio is typically concentrated in a small number of deeply researched stocks, which can result in above average volatility. An investment in Aurora may be best suited to investors with at least an underlying knowledge of equity investments. The Trust is measured against a benchmark but does not follow the benchmark in its portfolio construction. It is intended for investors looking for capital appreciation rather than income, and while it does distribute a dividend, this is not the strategic aim of its investment approach.

Contact

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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:

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