

AORIS

Quarterly Report



Dear fellow investor,

The investment performance after fees in 2022 for our Class A (Unhedged) fund (the Fund) was –12.2%, which compares to –12.7% for its benchmark. Our Class C (Hedged) fund returned –18.0%, matching the decline of its benchmark.

Performance

Class A (Unhedged)	Aoris ¹	Benchmark	Difference
2022	–12.2%	–12.7%	0.6%
2021	41.3%	26.0%	15.3%
2020	0.4%	6.0%	–5.6%
2019	36.5%	26.9%	9.6%
2018 – nine months to December	3.2%	0.1%	3.1%
Since inception – annualised	12.5%	8.6%	4.0%

¹Class A, inception 28 March 2018.

When evaluating our performance, as well as measuring ourselves against our benchmark, it's also appropriate to compare our results to those of our peers. For 2022, the Fund (Class A) ranked in the top 44% of a broad universe of international equity funds, as defined by Morningstar.

While 2022 is the subject of this letter, our focus is always on the longer term outcomes, meaning our since-inception returns. The significance of our performance record, when measured from the Fund's inception, grows with each passing year – in statistical parlance, the signal-to-noise ratio rises with time. Pleasingly, our performance since inception exceeds both our 8–12% p.a. objective and that of our benchmark, and ranks us in the top 2% of peer funds.

I believe our outperformance relative to our benchmark and most of our peers in 2022 can be attributed primarily to three factors embedded in our investment process:

- 1) our attraction to companies that exhibit competitive mean aversion,
- 2) our insistence on conservative balance sheets, and
- 3) our valuation discipline.

Why we own businesses that exhibit competitive mean aversion

In our 2021 Annual Letter I wrote about mean aversion, observing that the best businesses, rather than regressing to average, have a long history of gaining market share and outgrowing their peers; anti-gravity, if you will. I noted that during challenging conditions, such as 2021, the very best businesses pulled away from their peers at a faster than normal rate. When the going got tough in 2021, the tough – the exceptional businesses – really got going.

An analogy I find powerful is that of road cycling. When a group of cyclists on their morning ride are pedalling downhill, everyone is going fast, and the best cyclists are just a bit faster than the pack. But when going uphill, the stronger riders pull ahead and the difference in speed between the best and the rest is stark. In 2021, most businesses found themselves riding uphill. In 2022, the hill got steeper.

In 2022, as conditions became incrementally more challenging, we observed that the best businesses continued to outperform, both in revenue growth and profitability. In some cases, they meaningfully outperformed not only their peer average, but even their closest rivals. For example, Louis Vuitton, part of luxury goods company LVMH, grew sales in the first nine months of 2022 by more than 20%, far outpacing growth of 8% over the same period for its largest peer Gucci (owned by Kering). Similarly, over the first nine months of the year L'Oréal's sales grew by 12% compared to 7% for Estée Lauder. For its year ended August, Nike grew revenue by 7% versus zero for Adidas (year ended September), and Accenture grew revenue in the year to August by 21%, far ahead of Cognizant and CapGemini, up 10% and 15% respectively in their September year ends.

In difficult conditions, the best businesses increase their market share and improve their relative competitive position, thereby enhancing their long-term earnings power and intrinsic value. Appreciating this allowed us to face 2022 with a more constructive mindset than most investors. In 2022, as in 2021, owning only leading businesses helped our performance.

Conservative balance sheets proved valuable

For a roughly 15-year period, from the onset of the GFC in 2008 to the re-emergence of inflation in 2022, we have lived in a period of ultra-low interest rates. At some point we went through the looking glass into a strange world of negative interest rates for much of Europe's government debt, and even some corporate borrowers. This created the impression that debt is almost free, even to risky borrowers, and would be forever. The more of it, the better! Companies could take on large amounts of debt to make acquisitions or repurchase shares, increasing their per-share earnings, with no consequence to their financial risk in the eyes of the equity market.

We choose to own only companies with conservative capital structures. Every business will encounter bumps in the road from time to time, whether due to the economic cycle, competitive pressures or internal missteps. Debt, or financial leverage, is like the speed with which you hit the bump. At 20 km/hr your car will be fine, at 80 km/hr your car will get rattled but be okay, while at 140 km/hr you'll cause it permanent damage.

The rise in interest rates in 2022 was a reminder of the value of conservative financing. The ratio of debt relative to earnings before interest, tax and depreciation (EBITDA) averages just 0.4x for our portfolio. Of all non-financial companies globally, 18% have a ratio of debt to EBITDA of greater than 4x. This group of companies underperformed the broader market in 2022 by 14%.

Our valuation discipline mattered

Our disciplined approach to the prices we pay for high-quality companies also contributed to our investment success in 2022. From early 2020, when central banks sharply lowered interest rates in response to the onset of the pandemic, we went through a period when richly valued businesses markedly outperformed. As interest rates rose over 2022, that party ended and the importance of valuation reasserted itself. This benefited the Aoris portfolio, as we avoided the severe share price falls experienced by companies that a year ago were trading on what we'd term heroic price-to-earnings (P/E) multiples.

Companies whose P/E multiples exceeded 50x at the beginning of 2022, which accounts for about 20% of the broad universe of international companies, underperformed the market average in 2022 by 22%.

There were also valuation risks hiding beneath the surface in businesses trading on seemingly low multiples of earnings, but where the earnings themselves were bloated. Many companies that had enjoyed two years of extremely strong earnings growth, such as those in consumer electronics, housing and COVID-19-related health care, found the tailwinds of 2020 and 2021 abated last year, leaving an earnings air pocket. Once the COVID-19 bump to earnings disappeared, prices relative to earnings were much higher than they had appeared.

When a company's sales and profits are rising at an anomalous rate, as they were for so many businesses in 2020 and 2021 due to various COVID-19 tailwinds, management, being human, are reluctant to share the credit and attribute these exceptional results to exceptional conditions. They would have you believe, as they themselves no doubt believe, that it's all down to their talent and hard work. Rather than view their enhanced earnings as permanent, we took a sceptical view of businesses where profitability had risen rapidly, preferring to watch from the sidelines to see if the forces of mean reversion exerted themselves.

Companies whose earnings had increased by 100% or more over the prior two years accounted for 27% of all global companies at the beginning of 2022. This group underperformed the market average last year by 8%.

Why we prefer to own economically resilient businesses

During a year such as 2022, it can feel like the only thing that matters to an investor is the macro-economic environment. Stories of multi-decade-high inflation, tightening central bank monetary policy, supply chain challenges, geopolitical tensions, record energy prices and so on dominated the financial news throughout the year. However, the economy does not matter to equity investing nearly as much as the daily headlines would have you believe. While they create news, the ups and downs of these economic variables are not, in fact, what creates wealth and long-term investment success.

The economy does matter, though, when it comes to those individual businesses whose earnings move in a pronounced way with the broader economy, or with the housing market, commodity prices, consumer spending or interest rates. For those businesses, the problem for the investor is it's always difficult to judge where the company is in its earnings cycle at any point in time. As such, it's easy to make an investment error through under or overestimating their 'normal' level of earnings and therefore misappraising their valuation.

Businesses whose sensitivity to macro conditions is such that their earnings turn negative during periods of economic stress present investors with an additional risk. The underlying value of these companies may regress in such times due to management error. These unforced errors can happen when management chooses to cut headcount, investment or customer service levels to protect near-term earnings, but in a way that damages the company's long-term competitive position and earnings potential.

We seek to own growing, highly profitable, competitively winning businesses where the external environment plays at most a small role, and where the difference in earnings between a good year and a not-so-good one is modest. Take Halma, for example, which is a global speciality industrial business held in the Aoris portfolio. Halma has raised its dividend by 5% or more for 43 consecutive years, a remarkable record of growth through all manner of external conditions. Or Accenture, the world's largest IT outsourcing and consulting company. In 2009, during a period of acute financial and economic stress, Accenture's earnings per share declined by just 7.5%.

For the 3000 largest companies globally, the median worst annual decline in earnings per share over the last 15 years was 78%. For the 15 companies in the Aoris portfolio, the median decline in their worst year was just 25%. For the same universe of top 3000 companies, 25% have reported a loss in at least two of the last 15 years. Those businesses underperformed the market average in 2022 by 10%. Not one company in the Aoris portfolio has lost money in any of the last 15 years.

Our approach allows us to be 'macro agnostic'; aware of the economic challenges we all read about, yet confident in the resilience and long-term growth prospects of each company in the portfolio. In 2022, as the list of macro worries grew longer, this proved particularly valuable.



Our portfolio in 2022

Of the 11 stocks we held for the entire year, six outperformed our benchmark. Our best (Cintas) rose by 10.3% in AUD while the worst (Accenture) declined by 29.9%. We often talk about our primary objective being to stay out of the worst quintile of the market as measured by share price performance. Pleasingly, not one of the 18 companies we owned during the year returned a performance that placed them in the bottom 20% of the market for the period in which we owned them.

Accenture has been one of the top contributors to the Fund's returns since inception, and its share price underperformance during 2022 stands in contrast to its strong operating performance. In its financial year ending August 2022 the company grew its revenue organically by 21%, more than double the rate of its end market, and at slightly higher profit margins than in 2021. Its customers are relying on Accenture's advice to help them navigate the growing laundry list of challenges presented by technological change, inflation, supply chains and labour shortages. You can read a more detailed profile of the business in our accompanying *December 2022 Quarterly Report*.

Nike was the one company in our portfolio that fell short of our expectations in 2022 in terms of its operational and profit performance, which was also reflected in its shares underperforming during the year. Nike's earnings have been negatively impacted over the last year by a combination of elevated ocean freight costs, excess inventory in the US that requires discounting to clear, and suppressed demand in China due to lockdowns. We don't view these factors to be permanent. As such, we believe Nike's earnings will recover over the coming year or two and we've maintained our investment in the business.

The year 2022 for Aoris as a business

For Aoris, 2022 was another year of good growth and progress. The value of funds we manage for clients increased from \$604m to \$719m. I wish to thank everyone who became a client of Aoris for the first time in 2022, as well as those who've been invested with us for longer.

Early in 2023, we will make our unit trust available to invest in via the ASX. Our philosophy has always been to make our single strategy widely available and easy to invest in. For many financial advice firms, as well as individual investors, purchasing units in a managed fund via the ASX is much easier than doing so via a platform or a PDS.

We significantly increased the depth of material we publish on how we apply environmental, social and governance (ESG) considerations to our investing. These are all important dimensions to how we evaluate business quality, risk and longevity. I encourage those interested to visit the ESG section of our website, where you will find our first annual *Responsible Investing and Active Ownership Report*, as well as how we voted at company AGMs over the year to June 2022.

Labour standards are an important element of ESG, and in a world of outsourcing and offshoring, cheap labour may come at the cost of someone's safety, freedom or dignity. In addition to working to minimise the risk of poor labour standards in the businesses we invest in, we've done the same with our own business. We've asked all firms who supply services to Aoris or the funds we manage, to complete a questionnaire regarding their labour policies and practices, adherence to local regulations and audits on their work sites. While this is not a comprehensive solution to eradicating poor and abusive labour practices, it's a small step in the right direction.

After a two-year absence due to pandemic restrictions, in 2022 we were once again able to spend a day in the community helping people in need, preparing and serving meals for local people with Canice's Kitchen in Sydney's Kings Cross.

Lastly, you may have noticed a new Aoris logo and brand design. As we approach our five-year anniversary as a firm, it felt like the right time to update how we present ourselves to the outside world, on our website, and in our monthly reports, *Owner's Manual*, and documents such as the one you're reading. If you take a few minutes to visit our new site, I hope you'll find it reflects our principles of transparency and simplicity, and that it's easy to find whatever information you're after. I personally welcome any feedback you may have.

The year ahead

As I look at our portfolio today, the majority of businesses we own meaningfully improved their competitive position, earnings power and intrinsic value in 2022. They enter 2023 from a position of strength. The last few years have demonstrated that challenging conditions often act as a separator, amplifying the differences between the best businesses and the rest. Should 2023 prove to be another testing year, we expect the companies in our portfolio to further widen the gap with their peers.

So, we begin 2023 as we begin every year, feeling both cautious and confident. I am cautious, aware that the economic clouds have darkened and most businesses find themselves pedalling uphill. I am confident that through owning a concentrated portfolio of exceptional businesses, which we expect to become progressively more valuable over time and where the risk of disappointment is low, we will achieve after-fee returns of 8–12% p.a. over a market cycle.

I wish you and your loved ones the very best for 2023.

Sincerely,



Stephen Arnold
Chief Investment Officer



Aoris International Fund

Performance to 31 December 2022

Class A (Unhedged – base fee option) inception 26 March 2018	December Quarter	1 Year	Since Inception p.a.*
Portfolio return (AUD) net of all fees	6.1%	–12.2%	12.5%
MSCI AC World Accum Index ex-Australia (AUD)	4.0%	–12.7%	8.6%
Excess return	2.2%	0.6%	4.0%
Class C (Hedged – base fee option) inception 28 September 2018	December Quarter	1 Year	Since Inception p.a.*
Portfolio return (AUD) – net of all fees	9.5%	–18.0%	9.5%
MSCI AC World Accum Index ex-Australia 100% Hedged (AUD)	7.0%	–18.0%	4.5%
Excess return	2.5%	0.0%	5.0%

*Past performance should not be taken as an indication of future performance.

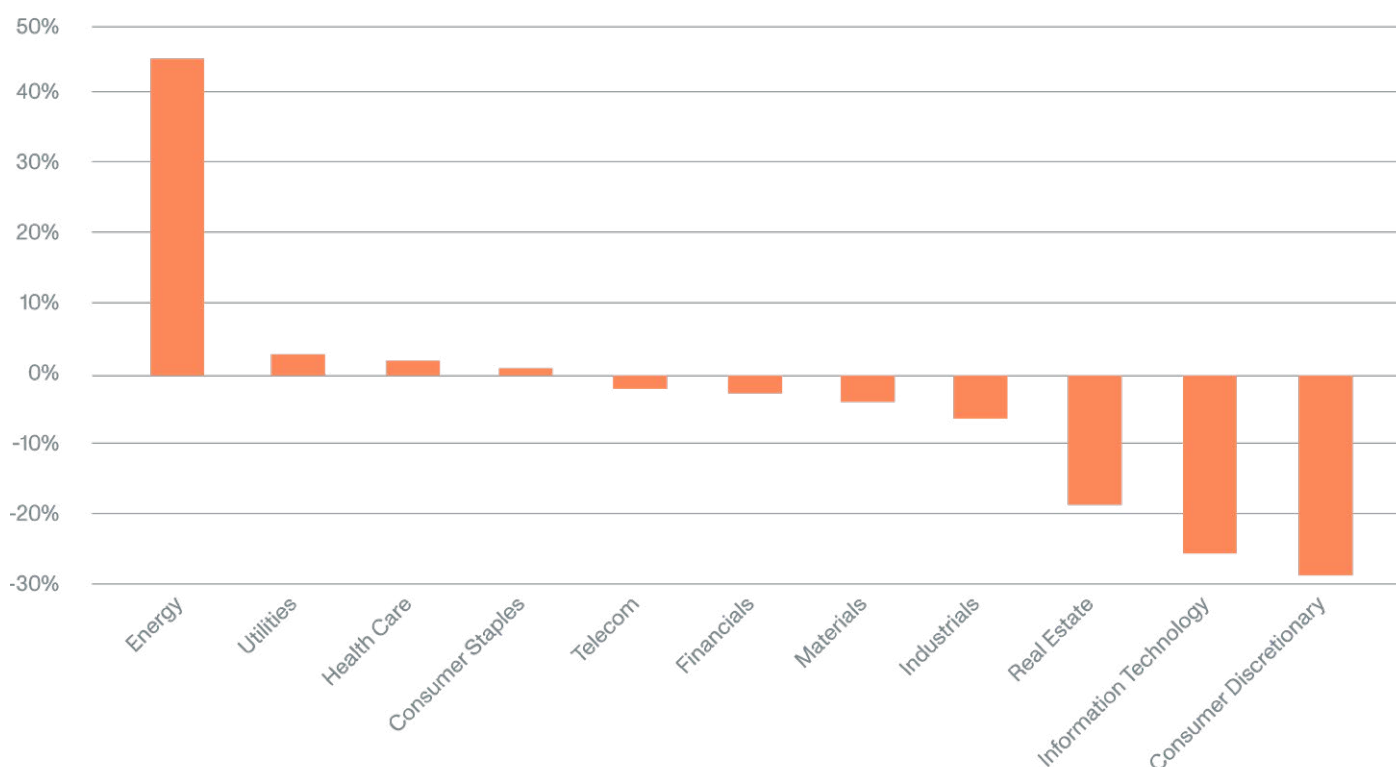
Market and portfolio performance

The international equity market, as measured by the MSCI AC World Accumulation Index ex-Australia, rose by 4.0% in the December quarter (all returns are in A\$ unless stated otherwise). Equity markets rose by 6.8% in local currency terms, while changes in currency values detracted 2.8% from the A\$ return. For the year 2022, the market declined by 12.7%, inclusive of a 6.0% positive contribution from currency changes.

As shown in the table on the previous page, the Aoris International Fund (Class A – Unhedged) returned 6.1% for the quarter and –12.2% for the year, outperforming our benchmark by 2.2% and 0.6% over these periods respectively. The Aoris International Fund (Class C – Hedged) returned 9.5% for the quarter and –18.0% for the year, exceeding its benchmark by 2.5% for the three months and matching it over the year.

It is notable that Energy was the best performing sector in 2022 for the second consecutive year. Making 2022 a particularly unusual year, Energy outperformed the second-best sector by an extraordinary 41.3%. This is starkly illustrated in the chart below.

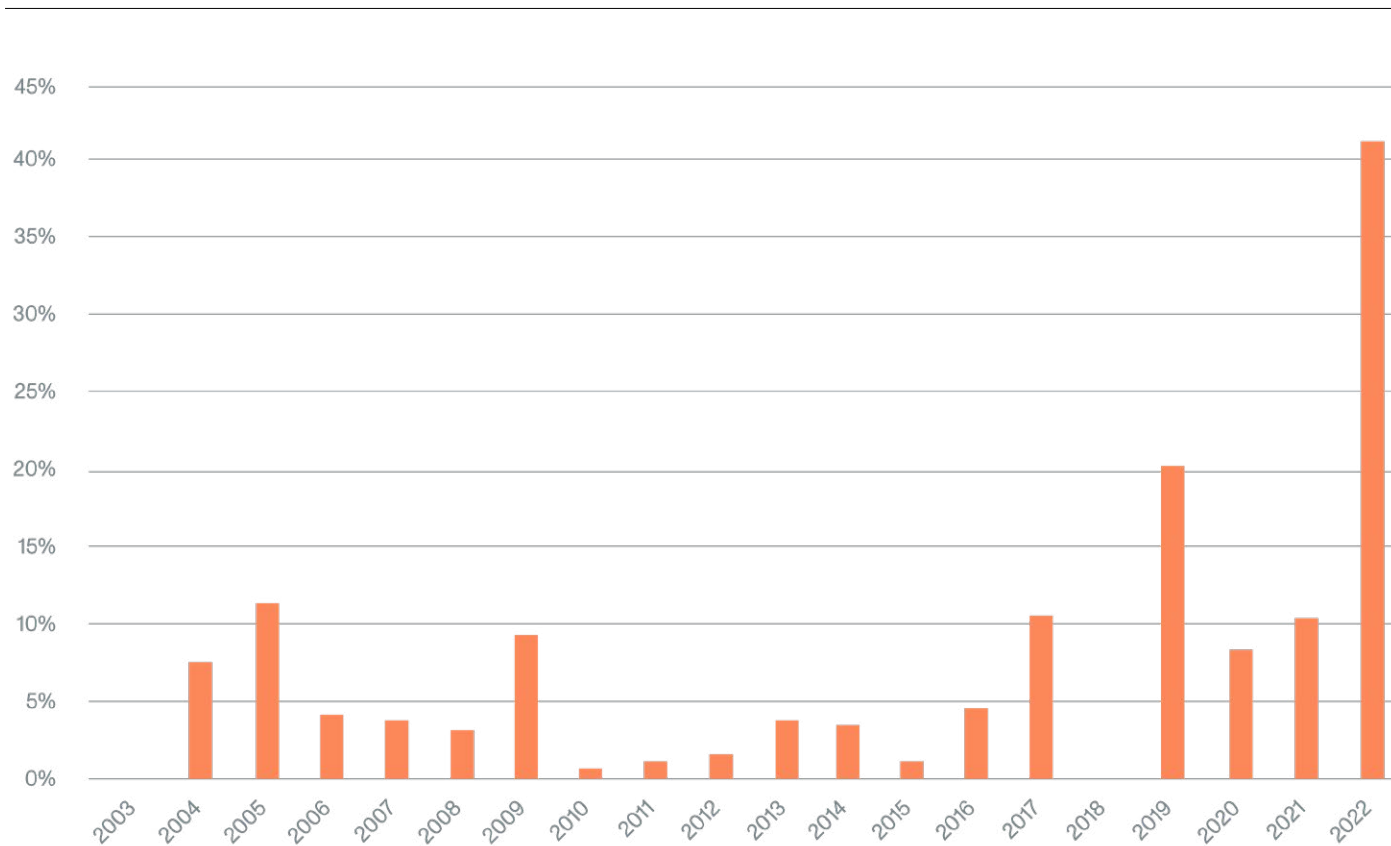
Sector performance 2022



Source – FactSet

Looking back over the last 20 years, the average gap between the two best performing sectors was 8.0%, and the widest gap before 2022 was 20.4%. For many investors, 2022 was all about Energy.

Gap between best and second-best performing sector



Source – FactSet

In 2022, as in 2021, the Aoris portfolio owned no Energy companies, nor did we own any companies from the second- or third-best performing sectors, which were Utilities and Health Care respectively. What I believe helped our performance was our ownership of durable, consistently profitable and competitively winning businesses with conservative balance sheets at reasonable valuations. The importance of these attributes is discussed at length in the accompanying *Annual Letter to Investors*.

In many ways, 2022 was a transition year. Through the year, supply chain challenges progressively eased, while challenges associated with inflation intensified for many businesses. Some businesses went from having a shortage of product to sell, to an excess; other businesses went from having too few employees, to too many. Through all this, the strongest businesses moved forward.

No doubt 2023 will bring further challenges: some we can anticipate with a degree of confidence while others will take many market participants by surprise. We believe the strongest, highest quality businesses will once again prove to be most resilient to those challenges, and best able to grow profitably and compound wealth over time. These are the types of businesses represented in the Aoris portfolio.

Portfolio Changes

Purchases

Fastenal

Fastenal is one of the largest industrial distributors in North America. It supplies essential products to manufacturing and construction firms, such as fasteners (screws, nuts, bolts), safety equipment and tools, which not only go into building the final products but are also used to maintain customers' facilities.

We sold our Fastenal investment in March of 2022 at what we considered a fair price. At the time of sale, we had some concerns regarding the company's ability and willingness to invest in growing its labour force in an environment of rising wage inflation. In September, two members of our investment team spent half a day with Fastenal's entire executive team. From this visit we learned that Fastenal's recruitment approach is university campus-based, and the return of students to in-person learning through 2022 has seen a significant increase in the volume of new hires at Fastenal.

In November, we were able to repurchase Fastenal with increased confidence in the company's growth prospects and did so at a material discount to our appraisal of intrinsic value.

Sales

Jack Henry

Jack Henry is a supplier of critical software for small banks and credit unions in the United States. Held since the inception of the portfolio, it had been a highly successful investment and we exited the position at what we considered a fair valuation.



Stock profiles

Accenture

Accenture is the world's largest IT outsourcing and consulting firm, with revenue in its August 2022 fiscal year of US\$62 billion. It helps its clients make their operations more efficient and to modernise their IT architecture, with particular emphasis on cloud, data security, e-commerce, and digital marketing.

Accenture's focus is on serving the world's 2000 largest organisations, across both the public and private sectors. These large and frequently complex organisations increasingly want to simplify their operations by dealing with fewer service providers, and Accenture's broad geographic presence and end-to-end offering is therefore attractive to them. Accenture's comprehensive offering means there are fewer hand-offs from one service provider to another, shortening the time that complex projects take, and reducing budget risk for its clients.

Accenture's choice to focus on the very large organisations not only plays to its own strengths, but also places it in a less competitive part of the market compared to small and medium-sized customers (SMEs). Large organisations have a handful of IT outsourcing and consulting vendors they could call upon, and the larger the project, the shorter the list. Of Accenture's new business, 70% is won on a sole-sourced basis.

Over 200 of its clients spend in excess of \$175 million each year with Accenture. More than three-quarters of the Fortune Global 500 list of large corporates are clients, and 98 of its top 100 customers have been with Accenture for more than 10 years.

Of its top 100 customers, 98 have been with Accenture for more than 10 years.

The nature of information technology is that it's evolving – and an IT-consulting vendor must evolve too, lest they find themselves solving yesterday's problems. Accenture has done an impressive job of remaining relevant to today's needs of its large clients, through hiring, training and acquiring companies that bring needed competencies. In turn, Accenture's growth and competitive success creates career opportunities, and has contributed to an unusually high retention rate in what is a competitive industry for human capital.

Accenture has a long record of growing at around twice the rate of its end markets, consistently taking market share by winning new clients and doing more business with its existing clients. It has done so at highly attractive and gradually rising profit margins. Accenture's rate of growth relative to its peer group has accelerated through the pandemic as it gained market share at a faster rate.

We believe Accenture will continue to be increasingly relevant to more organisations, providing solutions to contemporary, critical needs. We expect to see this reflected in growth in market share and earnings in the years ahead.



L'Oréal

Founded in Paris in 1909, today L'Oréal is the world's largest beauty company, with revenue in 2022 of close to €40 billion. Its brands include L'Oréal Paris, Maybelline, Garnier, Redken, Lancôme, Yves Saint Laurent, Giorgio Armani, Prada, La Roche Posay and CeraVe.

L'Oréal operates across all beauty segments, from fragrances to skin care to make-up and shampoo. It distributes through all channels, from pharmacies to department stores, to dedicated beauty stores like Sephora, and the retailers you find in airports. Lastly, its presence spans all geographies. This breadth has been enormously beneficial to the business through the pandemic period by creating robustness and balance in an otherwise turbulent period. Different channels and geographies closed and reopened at different times. For instance, skin care was buoyant during a period when people were not going out or wearing cosmetics, and so on.

There are considerable advantages to L'Oréal in being the industry leader, yet with a market share of only 14% globally there is plenty of opportunity for it to continue its long record of consistently gaining share. Brand scale brings mindshare with consumers, shelf space with retailers, and buying power with advertisers.

In e-commerce, scale and leadership matter even more. Consumers rarely scroll beyond the first few pages in the beauty section of an online retailer, and the brands on the first few pages are typically the premier global ones. This is one reason that L'Oréal has a larger market share in e-commerce than it does in bricks-and-mortar retailing, and the shift to online plays to its strengths as a leader. While e-commerce may seem to create a low barrier to entry for new beauty brands, it has created a high barrier to profitability and lasting success.

L'Oréal owns leading global brands in all geographies and distribution channels of the beauty market.

A key ingredient to L'Oréal's success is the decentralised approach to managing its global operations. While the overarching corporate and brand strategies are set centrally, the company empowers its local country managers around the world with a significant amount of autonomy to decide how to execute that strategy. As the company's CEO, Nicholas Hieronimus, says, the 'battles are won on the battlefield'. This decentralised model attracts driven, entrepreneurial managers who thrive on responsibility. It also proved highly valuable through the pandemic, allowing for much greater flexibility and faster responsiveness to changing local conditions than had the response been directed from head office.

L'Oréal's sales grew at twice the rate of the global beauty market in 2021 and for the first nine months of 2022, creating a significantly wider gap to its peers than it had achieved pre-pandemic. This reflects many of the benefits inherent in L'Oréal's size and leadership, as well as decisions management took to stay the course and invest behind its brands during a period when many peers were cutting their investment. We see many years of continued attractive earnings growth ahead for L'Oréal.

Portfolio companies

















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AORIS

Important Information This report has been prepared by Aoris Investment Management Pty Ltd ABN 11 621 586 552, AFSL No 507281 (Aoris), the investment manager of Aoris International Fund (Fund). The issuer of units in Aoris International Fund is the Fund's responsible entity The Trust Company (RE Services) Limited ABN 45 003 278 831, AFSL Licence No 235150. The Product Disclosure Statement (PDS) contains all of the details of the offer. Copies of the PDS and target market determination are available at auris.com.au or can be obtained by contacting Aoris directly. Before making any decision to make or hold any investment in the Fund, you should consider the PDS in full. The information provided does not take into account your investment objectives, financial situation or particular needs. You should consider your own investment objectives, financial situation and particular needs before acting upon any information provided and consider seeking advice from a financial adviser if necessary. You should not base an investment decision simply on past performance. Past performance is not an indicator of future performance. Returns are not guaranteed and so the value of an investment may rise or fall.