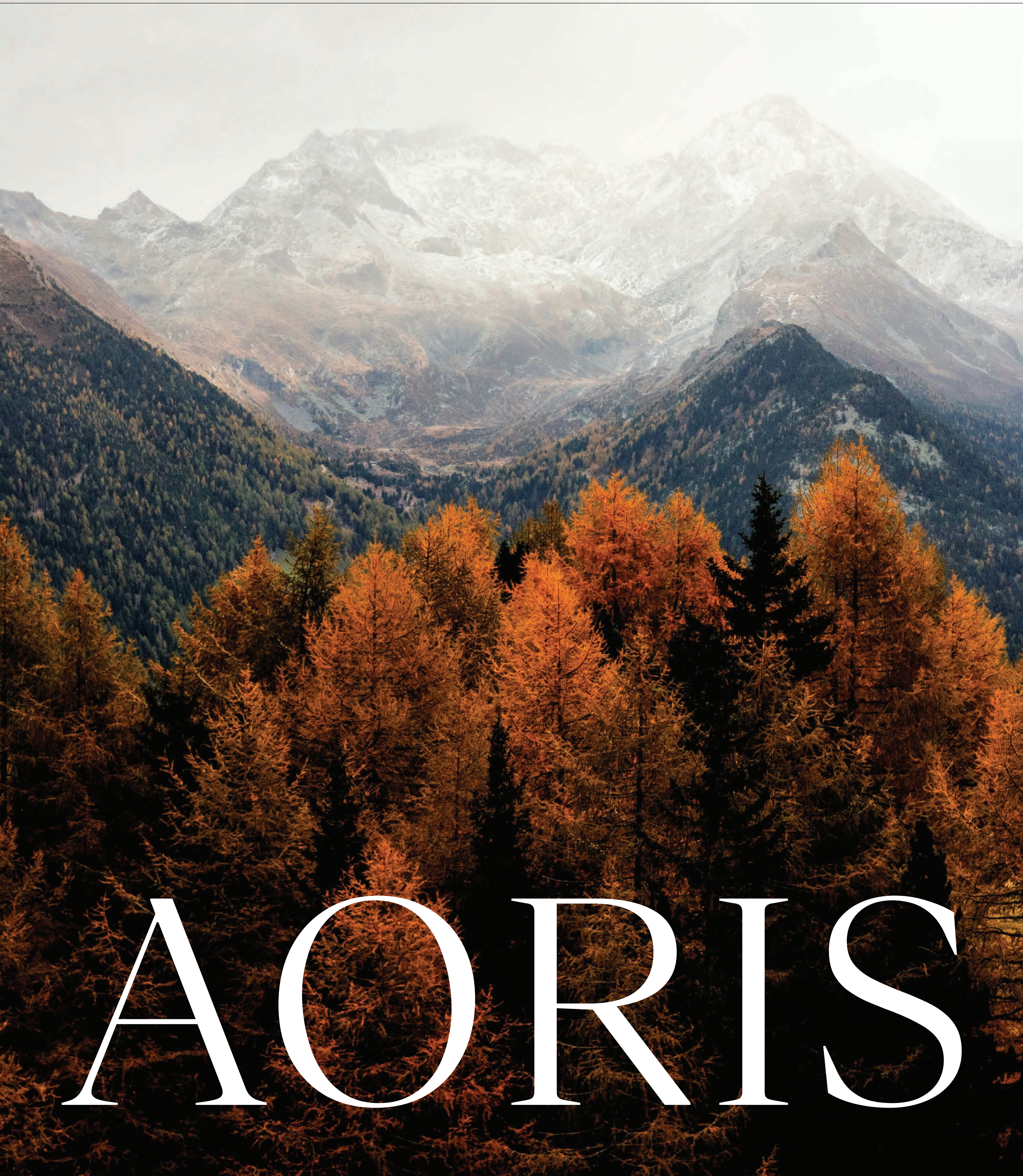
2024 Annual Letter to Investors



AORIS

Dear fellow investor,

The investment performance after fees in 2024 for our Class A (Unhedged) fund (the Fund) was 22.9%, which compares to 29.8% for its benchmark. Our Class C (Hedged) fund returned 12.3%, which compares to 19.7% for its benchmark.

Performance – Class A

	Aoris	Benchmark	Difference
2024	22.9%	29.8%	−6.9%
2023	30.8%	21.6%	9.2%
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	**16.6%**	**13.4%**	**3.2%**

* Inception 26 March 2018

I'm pleased with the absolute return we delivered in 2024. I'd be more pleased if our return had exceeded that of our benchmark, but I don't expect that to be the case every year. I do expect we will outperform our benchmark over a 5–7-year market cycle, which is very much our investment time horizon, and hopefully yours too.

As well as measuring our performance against our benchmark, it's also appropriate to compare our results to those of our peers. We operate in a highly competitive market, which offers investors many choices. The Fund has ranked in the 13th percentile over the last five years and 7th percentile since its inception, against a broad peer group of international equity funds available in Australia.

Of the stocks that were owned for the whole year, there were three notable contributors to performance in Amphenol, Halma and RELX.

Amphenol +55.7%

Amphenol is a leading manufacturer of electronic connectors. These are small devices used to join electrical circuits, and are present in all manner of products, from mobile phones, to cloud computing data centres, to vehicles and aircraft.

Amphenol's management works to ensure the business is well balanced across many end markets, and that it's flexible and responsive to demand surges in a particular market when they occur. In the last year, the company benefited from rapid growth in data centre construction, a market that accounts for around a fifth of its sales, which helped drive healthy revenue and earnings growth for the group.

Halma +28.5%

Halma is a leading supplier of specialty products to three broad end markets: safety, environmental, and medical. Two examples of the many niche applications it serves are gas leak detection devices, which protect workers in manufacturing plants; and air- and water-quality monitoring devices used by government departments.

Halma has a remarkable record of growth and profitability, having increased its dividend by 5% or more for 45 consecutive years. The company enjoyed another strong year in 2024, with earnings growing by more than 10%. What gives us confidence in the durability of Halma's growth is its strong culture and organisational purpose, its emphasis on adding value to its customers, and its desire to invest to support sustainable earnings growth.

RELX +28.6%

RELX is a leading global provider of data, decisioning tools and analytics to users in professional markets, including legal, academic, banking, and insurance underwriting. RELX has transitioned from a provider of simple data and content, to increasingly being a supplier of productivity enabling analytic and decisioning tools, thereby becoming more relevant to its professional users. This became more apparent in 2024 when RELX's growth accelerated notably in several key end markets, and we expect growth will continue to gradually accelerate for a number of years.

As well as the good operating performance from these three portfolio companies, their attractive valuation at the beginning of the year contributed to their strong share price performance in 2024.

The two primary detractors from performance in 2024 were L'Oréal, which was held for the whole year and declined by 20%, and CDW, whose share price was flat up until its sale from the Fund in October, underperforming our benchmark by 22%.

In investing, as in life, it's easy to attribute outcomes that don't go to plan to anything other than oneself. Rather than pointing to our own misjudgements when it comes to investment shortfalls, it's behaviourally more comfortable to attribute them to some unexpected negative information from the company, stock market factors, or adverse changes in the macro economy.

Of course, a poor investment outcome doesn't necessarily mean the decision was wrong. This is where it can get tricky to be objective. At Aoris, we try hard to reflect on what was knowable at a certain point in time, and whether we could have made a different decision than we did.

L'Oréal's share price appreciated by over 40% in 2023, and at the beginning of 2024 it was trading moderately above our fair value. We had trimmed the position in 2023, and to that extent we were true to our process and valuation discipline, but in hindsight we should have exited completely. Our decision not to was influenced by L'Oréal management's optimistic comments regarding the prospects for strong growth in demand from China in 2024 as travel and consumer spending recovered. As it happened, sales in China failed to recover as expected, contributing to the share price decline. Our error here was not being as disciplined with valuation as we should have been.

Our confidence in the long-term upwards trajectory of earnings and intrinsic value for L'Oréal remains high. We believe the softness in China this year overshadowed L'Oréal's strong growth and broad-based market share gains across the rest of the world. Over the last few years, the company has reinvigorated its business in Western Europe and achieved very strong revenue growth there, continued to take market share across all beauty categories in the US, and built strong foundations for the long-term in India, the Middle East and Latin America.

As L'Oréal's valuation became increasingly attractive in the second half of the year, we added to our portfolio position.

CDW is the largest IT reseller in the United States, helping more than 250,000 small to medium-sized organisations with their technology needs.

CDW enjoyed a period of strong growth over 2021 and 2022, as many of its customers invested in their IT infrastructure to support working from home, with this spend skewed towards hardware. This was particularly favourable for CDW as hardware accounts for over half of its profit, with software and services making up the balance.

I wrote in last year's Annual Letter about the challenges we face as investors in making good judgements regarding the sustainable level of earnings and competitive strength of companies that experienced abnormal growth during or after the COVID-19 pandemic.

In CDW's case, the surge in profits over 2021 and 2022 masked an underlying issue of declining relevance to its customers. CDW's bias to hardware means it is less well positioned for the growing needs of its customers in areas such as cloud computing, software and security. The company has been adapting its offering through acquisitions and hiring, but less effectively than we had previously thought.

Our learning here is to be more vigilant in looking through cyclical strength for any evidence of a company's structural weakness. It also serves as a reminder to not place too much store in its management's positive assertions regarding its competitive position, market share gains and success in integrating acquisitions.

We recognised CDW's waning customer relevance and sold it from the portfolio in October. CDW was a successful investment for us, but in hindsight we should have sold it earlier.

Lest you think my glass is always half empty, allow me to turn my attention to some of the many investment decisions we made last year that I'm pleased with.

Firstly, I think we exercised good valuation discipline in our sales of Costco and Cintas. The share prices of these two companies had increased by more than 60% and 40% respectively in the year prior to our sale. It can be difficult as investors to remain objective and not 'fall in love' with an investment when it is performing well. A higher share price doesn't make a business more valuable!

Similarly, we were disciplined in responding to valuation in our purchase of MSCI. The company's March quarterly earnings result was negatively impacted by the merger of two of its very large European banking customers. Its share price fell by 15% on the day it was reported, making its valuation attractive. We felt that client consolidation is a normal event for MSCI, even if this was an unusually large one, and it didn't change what we thought the business was worth. We initiated a position in MSCI immediately after the result, and the share price has performed very well since.

In judging LVMH's 2023 earnings to be significantly above normal, we made a commensurately large change to what we felt the business to be worth. Often as investors it feels more comfortable to make *incremental* changes to our estimate of earnings and fair value of a business, or to our assessment of its management quality and competitive strengths. We tiptoe to a change in view. Sometimes, though, we need to take a 'logical leap' and make a more profound change in our appraisal, and we did that with LVMH.

In the case of CDW, while we were slow getting there, we also made a logical leap in our assessment of the strengths and direction of the business. Like LVMH, it was a large position in the portfolio at the time of sale, which can make changing one's mind even harder. For both companies, what we've seen in their operational performance since our sales suggests we made the right decision. Furthermore, the share price of both companies has since declined significantly.

Lastly, we've stayed true to our process and our circle of competence by ignoring the excitement around EVs, AI, and weight-loss drug companies. As investors, it can be difficult to not get drawn into the big winners of the day, especially as there's usually a compelling narrative that makes their future success seem assured. Fast growth in nascent industries is exciting, but brings with it investment risks that we seek to avoid. We look to own leading businesses in established industries, where market share does not move easily and the government doesn't play a material role.

We replaced five stocks in the portfolio in 2024

We expect to make around four portfolio changes a year on average. In 2023 we made two changes, while 2024 was higher than normal with five.

	Sold	Bought
January 2024	TSC Tractor Supply Co	Compass Group
March 2024	Costco	VISA
May 2024	LVMH	MSCI
August 2024	Cintas the uniform people	Diploma PLC
October 2024	CDW	Sherwin-Williams

Sales

Tractor Supply is the leading farming supplies retailer in the US. Early in the year we grew concerned about its ability to continue to grow successfully in the face of rising competition from both online and offline peers. Tractor Supply's long track record of market share gains is a good one and this extended through 2024. We will continue to reassess its growth prospects and competitive resilience going forward.

We exited **LVMH** in May after concluding that 2023 earnings were materially above normal. Over 2021 to 2023, LVMH benefited from a period of unusually strong demand for its luxury wares. The boost to LVMH's earnings from this top-line growth was amplified by significant expansion in its profit margin, such that 2023 earnings were more than double what it earned in 2019.

We sold both **Costco** and **Cintas** simply for reasons of valuation. These are exceptional businesses that we'd love to own again if valuation permits. Their sales allowed us to recycle portfolio capital into more attractively valued businesses.

As discussed earlier, we sold **CDW** in October, having formed the view that the company is not as well positioned to serve its customers and their IT needs as we had previously believed.

Purchases

Compass Group is the world's largest contract catering firm. It benefits from an ongoing shift of organisations across many end markets to outsource their catering services, and Compass has been a consistent market share gainer in this growing market. While its largest and strongest market is in the US, Compass has made considerable strides over the last few years in strengthening and improving its operations in Western Europe and the UK.

Visa is the world's largest payment services company. We've been impressed by the way in which Visa has made consumer payments easier, faster and more secure over time, as many of us experience when we use a smartphone or watch to pay for our morning coffee or commute, or benefit from the rapid and frictionless process at the Amazon checkout. By making consumer and business payments easier, faster and more secure, we expect Visa will benefit from growing usage of its payments network for many years to come.

MSCI Inc. is a leader in equity indices, benchmarking and portfolio analysis tools, especially for global investors. You can see from our performance table at the beginning of this letter that Aoris uses MSCI to benchmark our performance. We bought MSCI in May, taking advantage of a sharp sell-off in its share price.

Diploma is a collection of value-added distribution businesses across a range of specialty industrial and healthcare niches. Among the many customers that rely on Diploma to deliver critical components at the right time in the right quantity, often with essential technical support, are most of the Formula One racing teams.

Lastly, we bought **Sherwin-Williams**, which is the world's largest paint and coatings company. Yes, paint does sound dull, but Sherwin-Williams excels at serving demanding customers with often highly technical products. In the US market for professional painters, Sherwin-Williams has a share around 10x the size of its closest peer. It also has exclusive supply arrangements with 23 of the 25 largest home builders in the US. Remarkably, given its dominant position, its market share continues to rise.

At the end of 2024, seven of the Fund's 15 holdings were domiciled in the UK and Europe, while eight were based in the US, down from 11 two years earlier. It's important to note that we don't own our UK businesses out of any view of the UK economy or stock market. All five of them are global in scope, and leaders in their respective market specialties.

I wrote a year ago that investing is more about judgements than knowledge. This got me thinking a lot about investment *misjudgements*.

At Aoris, we want to own businesses that are becoming progressively more valuable over time. That's part one. Secondly, we need to assess this path correctly. That's where judgement, and the scope for misjudgement, comes into play.

We can make investment misjudgements where:

1. A business is on a perfectly attractive upwards path, but we've viewed it less favourably. That may result in a missed investment opportunity.
2. We've judged the path of the business too favourably. This may result in us owning a business we shouldn't have, or not selling a business that we should have sold.
3. We had correctly judged it to be on a rising path but changed our mind. Consequently, we may sell a stock that still represents a sound investment.

There are certain **types of businesses** where I've found over time the likelihood of investment misjudgements to be higher. These include those that are:

- **Cyclical** – big swings in its earnings can make a business look better or worse than it really is, depending on whether it's at the peak or trough of its business cycle.
- **Narrow** – businesses that have a single product or operate in a single, small geography are narrow and the range of future outcomes is wide.
- **Regulated** – government policy is inherently unstable. Earnings prospects for companies in regulated industries can change materially at the stroke of a pen.
- **New** – new industries are often exciting, but making judgements about market structure, growth and profitability is difficult.

For these reasons, we look to own businesses that aren't buffeted around by the vicissitudes of the economic cycle. We like businesses that are broad, serving many end markets across diverse geographies. In our portfolio you'll find 15 businesses that are to a very large degree in control of their own destiny and not subject to moving government policy goalposts. Our portfolio holdings are businesses in established markets where we can make confident judgements about future growth, profitability and market leadership.

I've also found **management** and how they communicate has a significant bearing on the quality of our investment judgement. Glowing outlook statements from management can cause us to view a business and its prospects more favourably than the facts warrant. We naturally view management as experts in their own business, but sometimes forget that they don't have perfect foresight. Further, they're human just like the rest of us, and see their own business through rose-coloured glasses.

For these reasons we favour businesses run by management that are grounded and talk openly about the areas that are falling short of their expectations, what they've learned and how they are responding. We also accept that, being human, grounded individuals will occasionally feel the glow of their own success and get a little too optimistic for a period. The really good ones, like L'Oréal's management, soon recognise this and self-correct. We like management teams that treat us like owners, who we feel want us to understand their business and their priorities. Lastly, we like management who balance healthy, competitive ambition with a sense of realism and a long-term mindset.

I've found over time that **share price performance** can compromise our objectivity. A period of strong price performance for a business we own can feel like validation or social proof and positively skew our judgement. Similarly, a period of negative price performance can cause us to question ourselves, perhaps amplifying our focus on the inevitable imperfections in a business. This can cause us to sell when the right cause of action may instead be to buy more. Alternatively, we may choose not to buy a new business for the portfolio when its valuation has become attractive and consequently miss an opportunity.

We have a structured process for valuing businesses that we apply consistently to all portfolio companies and candidates. We strive to be objective in responding to widening or narrowing valuation gaps, by buying into weakness and selling into strength. One initiative we introduced in the last few years that helps us in responding to material share price weakness is a 'thesis review'. Through this team discussion we ask, first of all, how we might be wrong. If we can't validate the negative case for the business, then we can more confidently use the price weakness to buy more.

Our process seeks to minimise the frequency and severity of investment misjudgements. If it is working well, it should be evidenced in two ways:

- **Success rate** – this measures the percent of stocks we've owned that have outperformed our benchmark over the period we've owned them. Since the inception of the Fund, we've owned 42 stocks. Of these, 27 have outperformed over the period they've been held in the Fund, giving us a success rate of 64%.
- **Bottom 20% participation rate** – this measures the percent of stocks we've owned that have performed in the bottom 20% of the market over the period we've owned them. Since the inception of the Fund, only one of the 42 stocks we've owned has been in the bottom 20% over the period it was owned. That's a participation rate of just 2.5%.

Statistically, both these outcomes are very good and a source of pride for the team.

At Aoris, we target a return of 8–12% p.a. after fees for our investors through ownership of 15 high-quality, growing, wealth-creating businesses. I find the framework below useful in understanding how we expect to achieve that outcome.

- **Growth in intrinsic value** – we participate in the growth in the intrinsic value of the businesses we own, which we expect to be at a rate of around 10% p.a. This is the bedrock of our expected investment return.
- **Valuation** – by owning these businesses at prices below what we consider to be their true worth, we expect valuation to contribute about 5% p.a. as their share prices appreciate over time to more fairly reflect their growing intrinsic value.

  Dividends – we expect a dividend yield of about 1.5%. This essentially offsets the management fee we charge.
- **Mistakes and shortfalls** – we make an allowance of 2–3% p.a. for the expected negative impact of investments that fall short of our expectations and our own investment errors.

In 2024, we believe the intrinsic value of the businesses we owned rose on average by about 12%. While the valuation gap ended the year about where it began, replacing fully valued stocks, notably Costco and Cintas, with more attractively valued ones contributed an additional 3%. On the other hand, our ownership of CDW and L'Oréal detracted about 3% from performance. Lastly, the weakness of the AUD added 10% to our Class A return.

After the Fund's strong return in 2024, you may be wondering if we can reasonably expect to achieve our 8–12% p.a. target return over the coming 5–7 years. We believe the 15 businesses owned in the portfolio today will continue to grow in intrinsic value at a rate of around 10% p.a. The average discount to intrinsic value across the portfolio was 20% at the beginning of 2025. As share prices converge on fair value over the next few years, we expect valuation will contribute a further 5% p.a. Allowing for dividends, fees and our inevitable investment mistakes and shortfalls, this leaves us confident we can achieve our 8–12% p.a. after-fee return objective over the coming 5–7 years.

A brief note on ESG

A few years ago, it became popular for investment managers to incorporate environmental, social and environmental (ESG) considerations into their stock selection process. In 2024 the winds changed, and there was somewhat of a backlash against ESG and values-based investing, particularly in the United States.

For Aoris, we've always attached high importance to how a company conducts itself. That includes how the company treats its customers and employees, its compliance with rules and regulations, and its environmental stewardship. In today's highly transparent world, corporate behaviour is more visible and, I believe, more important than ever. You can find Aoris' third annual Responsible Investing Report on our website.

The year 2024 for Aoris as a business

For Aoris, 2024 was another year of growth and progress. The value of our funds under management (FUM) increased from $1,057 million to $1,813 million over the 12 months. Contributing to this was our Active ETFs (ASX:BAOR and ASX:DAOR), which we launched in May 2023 and have surpassed the $150 million FUM milestone. I'd like to thank everyone who became a client of Aoris for the first time in 2024, as well as those who've been investing with us for longer.

While great client outcomes are how we wish to be recognised, it was pleasing during the year to be named best International Equities product at the IMAP Managed Account Awards, and to receive a 'Highly Commended' mention for Best ETF Product at the Financial Newswire/SQM Research Fund Manager of the Year Awards 2024.

To support our growing client base, we are planning to expand our team in 2025, adding new members to both our operations and business development teams.

To meet the rising interest from overseas investors, particularly family offices, we'll be launching a Cayman Island-registered version of our strategy in the coming year.

I'm proud of the ways in which we strengthened the operational side of our business during the year. This includes enhancements to our cyber security protection and trade execution, and creation of alternatives to all our critical service providers. We are a boutique investment manager, but aspire to have operational rigour on par with the very best of our large peers.

In the second half of the year, our team had the opportunity to give back to the community by preparing breakfast for children and families staying at the Ronald McDonald House in Randwick. This meaningful experience served as a reminder of the power of community to support those in need.

At this time of year, you may be reading investment outlooks from financial market commentators. It's human nature to try to optimise financial outcomes over short periods, and to seek comfort from feeling like we know what lies ahead.

I don't have any view on the political realm and likely policy changes, the direction of interest rates and the economy, or indeed the equity market. I do believe that durable, resilient, market-leading, competitively winning businesses run by prudent and capable management will prosper and become more valuable over time, and that their share prices will reflect that.

If we do a good job of identifying these businesses and owning them at attractive prices, and focus on long-term rather than short-term results, I'm confident we'll deliver on our 8–12% p.a. after-fee return objective over the coming 5–7 years.

I thank you for your interest in Aoris, and wish you and your loved ones a happy and successful 2025.

Sincerely,

Stephen

Stephen Arnold
Chief Investment Officer

Get in touch

AORIS

Suite 27.04, Level 27
25 Martin Place
Sydney, NSW, Australia
+61 2 8098 1504
info@aoris.com.au
www.aoris.com.au