

March 2022  
Quarterly Report



# Aoris Investment Management

Aoris is a *specialist* international equity manager founded in 2017.

We are a *focused* business and manage a single international equity portfolio.

Our investment approach is *conservative*, fundamental and evidence-based.

## The Aoris International Fund

Our portfolio is long-only and highly *selective*.

We own a maximum of 15 stocks, each of which has considerable breadth or *internal diversification*.

We aim to generate returns of 8-12% p.a. over a market cycle.

## Our Quarterly Reports

We are *business owners*, not economists.  
As such, our reports focus on the performance of our investee companies.

We report on portfolio performance and changes with candour and transparency.

Each quarter, we include a thought piece or feature article on a topic area with direct relevance to our investment approach.

About the cover image: The Torii (gate) in front of the Itsukushima Shrine in Japan was originally erected in 593 and took its current form in 1571. The shrine is listed as a UNESCO World Heritage Site. In Japanese, Itsukushima translates as 'island dedicated to the gods'; the Torii can thus be seen as a gateway to the gods.

Torii Gate of Miyajima, Japan, by Korkorkusung  
File ID: 70621214; Adobe Stock Images.

# Aoris International Fund

Performance to 31 March 2022	March Quarter	1 Year	Since Inception p.a.*
<b>Class A (Unhedged - base fee option)</b> Inception 26 March 2018			
<b>Portfolio return (AUD) - Net of all fees</b>	<b>-12.8%</b>	<b>18.5%</b>	<b>14.9%</b>
MSCI AC World Accum Index ex-Australia (AUD)	-8.6%	8.7%	11.6%
Excess Return	-4.2%	9.8%	3.3%
<b>Class C (Hedged - base fee option)</b> Inception 28 September 2018			
<b>Portfolio return (AUD) - Net of all fees</b>	<b>-9.9%</b>	<b>17.6%</b>	<b>14.7%</b>
MSCI AC World Accum Index ex-Australia 100% Hedged (AUD)	-5.2%	7.7%	9.9%
Excess Return	-4.6%	9.9%	4.8%

\*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, declined by 8.6% in the quarter (all returns are in A\$ unless stated otherwise). Equity markets fell by 5.3% in local currency terms, with currency changes detracting a further 3.3%.

The Aoris International Fund (Class A - Unhedged) declined by 12.8% for the quarter, 4.2% behind its benchmark, while the Aoris International Fund (Class C - hedged) declined 9.6%, underperforming its benchmark by 4.6%.

Reflecting the dramatic rise in oil and gas prices, Energy was by far the best-performing sector for the March quarter, returning 17.3%. This was followed by the Materials sector, which rose by 0.5% as the prices of non-energy commodities such as iron ore and aluminium were strong across the board. We avoid investing in commodity companies for a number of reasons, including their susceptibility to external variables such as supply shocks, geopolitics and changes in government policy, and their generally poor historical returns on capital through the cycle. We believe that eschewing these sectors in favour of businesses with more attractive profitability and growth characteristics will assist us in achieving our 8-12% return objective over the cycle. We recognise that there will be periods, such as the quarter just past, where our absence from these sectors harms our returns relative to the market.

Among the major underperforming sectors was Information Technology, which declined by 13.1% as investors questioned the value or indeed sustainability of many emergent technology businesses, which had been the subject of much enthusiasm through the pandemic.

The themes that dominated the second half of last year, namely rising inflation, ongoing supply chain disruptions and labour shortages, persisted into the first quarter of 2022. Inflation and supply chain disruptions have been amplified by Russia's invasion of Ukraine, which resulted in a 40% increase

in the US\$ price of crude oil in the quarter, sharp rises in the price of agricultural commodities and further lengthening of production delays of semiconductors (Ukraine accounted for about 50% of the world's semiconductor-grade neon, critical for the lasers used to make chips).

We have no view to offer you on the course this complex, challenging, evolving external environment will take. Our overarching premise is that the best businesses will manage through these challenges more effectively than their peers. We expect the best companies will:

- demonstrate long-term management thinking, making 'stay-the-course' decisions
- exhibit a healthy growth mindset, choosing to invest in their business even when the immediate payoff is not obvious
- deepen their bond with their employees, and
- improve their relevance and trust with their customers in ways that enhance their market share.

In this way, the best businesses not only preserve but also enhance their long-term earnings prospects and inherent value. During March, four portfolio businesses reported earnings for the quarter to the end of February, and in all four cases we saw validation of this premise. Accenture, Costco, Nike and Cintas all grew revenue, gained market share and improved their profit margins, drawing on the strengths that made them the leaders in their market in the first place, as well as the cultural characteristics listed above.

# Portfolio changes

## PURCHASES

### Copart

Copart is an auction platform for selling written-off vehicles on behalf of US insurance companies, car dealers and auto rental companies. When a vehicle has been damaged in an accident, the insurer will weigh up the relative cost of repair versus paying the owner the insured value, and then selling the vehicle for the best possible price. The number of written-off vehicles that require sale and disposal by insurance companies has been growing steadily for many years, a key reason for which is the increase in electronics that often make a vehicle too expensive to repair.

The business of selling damaged vehicles is a true network – sellers attract buyers, which attract sellers and so on. This network effect bestows an enormous advantage to the largest auction platform and creates formidable barriers to an aspiring new entrant. Copart has a single competitor of note in the US: IAA, Inc. However, Copart is 50% larger than IAA, Inc. and has consistently outgrown it in recent years.

Since it was founded in 1982, Copart has run with a culture of long-term management thinking. It has invested in growing the number of storage yards it owns years before they are actually needed, and moved the auction process to online-only 17 years before IAA, Inc. did the same.

Copart's revenue has grown at 16% p.a. over the last five years, while earnings per share has grown at a rate of 26% p.a. We consider Copart to be the dominant participant in an attractive market and expect it to continue to grow its earnings at an attractive rate for many years to come.

### Halma

Halma was a successful investment for the Aoris Fund from our inception in March 2018 until June 2021, when it was sold from the portfolio due to its valuation at the time. Since that sale, its valuation has become more attractive.

Based in the UK, Halma is a group of life-saving technology companies serving three broad end-markets:

- Safety – Halma's products are used in applications such as fire detection and suppression, elevator safety, detection of hazardous gases, and ensuring the safety of public transport systems.
- Environment – Applications include environmental-data recording, water-quality testing, and monitoring air pollution.
- Health – Halma makes products used in ophthalmology, monitoring of vital signs, and in general surgery.

Halma has a strong internal culture and a healthy growth ambition that gives us confidence in the repeatability and durability of its business model. It has a long history of GDP+ organic growth and consistently high profit margins. Bolt-on acquisitions typically add 3-5% each year to revenue growth. We believe Halma to be a strong, high-quality business that will continue to deliver attractive earnings growth for many years to come.

## SALES

### **Fastenal**

Fastenal is a US industrial distribution company and was a successful investment for the portfolio. At the time of sale, it was trading around our appraisal of fair value. An additional consideration in our decision to sell was the approach Fastenal has taken in a US labour market seeing material wage inflation. Famously frugal in how they approach all expenses, Fastenal management has chosen not to increase its wage rates in line with market increases, as a result of which headcount has not grown over the last 18 months. Fastenal is clearly not investing in a way that would make it an employer of choice within its industry. We have some concerns this may impact Fastenal's ability to grow its customer base, as well as effectively serve its existing customers, negatively impacting its competitive position and earnings growth.

### **Techtronic**

We removed Techtronic from the portfolio, having become uncomfortable with elements of its corporate culture. Techtronic has grown strongly in the do-it-yourself and professional tools markets in recent years, in particular in battery-operated tools, and its immediate future looks bright.

However, senior management has publicly disparaged its major competitors, as well as home centre retailers in the US who are not currently distributors of its products. In our view, this behaviour is unnecessary, unpleasant, and increases the risk that Techtronic's growth and competitive performance will fade over time. How might this happen? Talented employees may find the internal culture aggressive and choose to leave, prospective hires may be turned off by what they read, and prospective retailers may choose not to deal with salespeople who embody management's aggressive approach.

Techtronic management's actions demonstrate a lack of long-term thinking. Its growth ambition has become unhealthy as it behaves in a way that may undermine its standing with employees and prospective customers.

While elements of this behaviour were evidenced prior to our purchase in January of 2021, in our view it has worsened since that time to the extent it represents a risk to Techtronic's business.



This feature article was written by Alfred Tadros, Portfolio Manager

# The importance of corporate culture

## INTRODUCTION

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*As investors we can be seduced by the 'numbers', but they provide only part of the story.*

In researching quality companies, we are seeking to gain confidence that they won't become average businesses, the persistency of their returns is high, and they are consequently more durable, less risky propositions for investment.

As investors, when looking at businesses we can be seduced by the 'numbers', for instance, revenue growth and returns on invested capital, but they only provide part of the story. They tell us nothing as to how these numbers have arisen or whether they'll persist in the future, which is critical in making judgements on future returns of the business.

It is our belief that when a company exhibits strong corporate culture, it is more likely to prove a durable business. We have found the following elements of a strong corporate culture to be particularly useful in identifying durable businesses:

1. Customer centricity
2. Employers of choice
3. Healthy growth ambition
4. Long-term thinking

We fully accept that we are veering into the realm of unquantifiable soft concepts, but allow us to take you on a journey that is integral to our process. In this feature article, we illustrate aspects of corporate culture that have served us well. It's something the 'numbers' simply won't tell you.

### 1. Customer centricity

We believe that the best businesses put their customers first and at the centre of everything they do, to gain their trust, increase loyalty, increase market share, and become more durable businesses.

Companies can be customer-centric in myriad ways, but some examples come readily to mind:

- **Exceptional customer service:** The company's total commitment to give the highest level of product or service to every customer, irrespective of the circumstance.

- **Innovative, quality products and services:** The outcome of a continuous goal of producing the best products, which are built to last and supported by teams of high-calibre people.
- **Lowest total cost of ownership (TCO):** TCO considers all the direct and indirect costs of a product or service over its lifetime. Low TCO means the product or service creates efficiencies in its use of energy, materials and labour over its lifetime.
- **Measured approach to pricing:** A judicious and non-extractive approach, where price increases are struck on increased value given, or the simple pass-through of inflation that can't be mitigated.

In explaining customer centricity, we suggest it can then be most directly observed by high levels of customer retention and customer satisfaction, and enduring brand power. Within our portfolio, Cintas, which is the leading provider of uniform rental services and restroom supplies to businesses in the United States, is a great example of customer centricity.

*Cintas' customer-centric approach has been rewarded with a customer retention rate of 95%.*

Cintas has a 95% customer retention rate, meaning customers stay with them on average for 20 years. It uses Net Promoter Scores – a survey that asks customers how likely they are to recommend a company's product or service to others – to measure customer satisfaction rates, which are currently at all-time highs for this company.

Cintas offers an extremely efficient, indispensable and cost-effective service. Its value/cost ratio is high, particularly for industries that need cleaning to a certain standard, relieving staff of responsibility for uniform maintenance. The uniform rental service works out to be about \$1.50 per worker per day. For that, each customer's employee gets 11 shirts and pants, and each week Cintas will pick-up five dirty uniforms and drop-off five clean ones. All these aspects provide a low TCO for its customers.

Finally, when it comes to pricing, Cintas focuses on the lifetime value of a customer. This may mean forgoing price increases for periods, which is exactly what occurred during the pandemic, where it purposely did not increase prices but also decided to provide flexible service terms to customers during lockdown.

This customer-centric mindset deepens the company's bond with its customers and ultimately leads to better customer retention and satisfaction. In turn, this bolsters our confidence in the durability of the business.

*Employers of choice see their employees as an asset and not simply an expense item.*

## 2. Employers of choice

A cultural aspect that we find repeatedly among companies we invest in is that they take care of their employees. They don't simply see staff as an expense item but rather as an asset, and purposely elevate the wellbeing of their employees to a position of importance. In this way they become employers of choice.

That elevation is demonstrated in higher wages, more benefits, a focus on development opportunities and thus better career progression. The outcome is that happier employees are more productive, with higher retention rates creating less business disruption. This leads to greater customer satisfaction, higher customer loyalty, and consequently more durable businesses.

And in an environment of tight labour markets and wage inflation, these same companies are competitively advantaged to attract high-quality candidates because they are widely recognised as employers of choice. You can't grow if you can't hire the people you need.

Within the portfolio, Costco, the world's largest members-only supermarket, perfectly demonstrates taking care of employees and the positive impacts on its business.

Costco is known for paying well above minimum rates for hourly wages and providing full healthcare benefits and generous retirement plans, even for part-time and hourly employees.

Its US employees have an average tenure of over nine years, with 33% of employees having been with Costco for 10 or more years. As a result, employee turnover is 9.2% in any one year, well below industry norms and illustrative of its high employee retention.

However, the appeal of working at Costco isn't just better pay, but also career progression. The company almost exclusively promotes from within. All employees begin their Costco careers on the warehouse floor, including the current CEO. Costco is also a growing business, constantly requiring employees at all levels, highlighting the potential for career progression. The pandemic provided evidence of the company's employer-of-choice status, as in a tight labour market it managed to hire 19,000 additional staff in 2020 and 15,000 in 2021.

*Costco regularly leads its retail peers in industry surveys on customer satisfaction and service.*

The benefit of this approach to employees is that Costco regularly leads its retail peers in industry surveys on customer satisfaction and service. It has been ranked #1 by the American Customer

Satisfaction Index every year since 2016. We gain assurance that Costco's approach to its employees will enable it to remain a competitive, service-oriented and durable business.

### 3. Healthy growth ambition

*A healthy ambition to grow is part of an enduring business's DNA.*

We seek to own companies with a healthy growth ambition. We suggest this is a cultural value, as it goes to the heart of how an enduring company operates. To us that means a focus on growing the revenue line versus a mentality of harvesting profits at increasingly higher margins.

We rely on management teams to exhibit this healthy growth mindset by prioritising attractive, growing end-markets and seeking to become increasingly relevant and important to customers in those markets with the products and services they offer, outgrowing competitors as a result.

*You can't cost-cut your way to glory.*

Companies led by such management teams already have attractive margins. The counter is that companies that are aiming to aggressively increase margins are not for us. Typically, that ambition rests on cost-cutting – and we rarely find that you can cost-cut your way to glory.

For while a company is cutting costs to achieve higher margins, its competitors are investing in people, R&D, marketing and capital outlays, thus taking the opportunities that the cost-cutting company is leaving behind. It's this loss of competitive positioning that we're particularly attuned to.

Instead, the companies we are attracted to have ambitions of delivering greater innovation, value and service to their customers, and duly make the investments required. They might also increase margins, but it's the outcome of strong revenue performance after the foundations for growth have been laid and spent. In this way they become increasingly durable businesses.

Within our portfolio, Amphenol, a major producer of electrical, electronic and fibre-optic connectors and interconnect systems, is a great example of healthy growth ambition at play.

Amphenol runs a decentralised organisational structure of close to 130 business units, each headed by a general manager (GM), where the GM has full autonomy over their decision-making and execution capabilities (salesforce, R&D, purchasing etc.), enabling them to be agile to local conditions.

The CEO of Amphenol describes their operating model as follows: *‘The GMs are assessed only on what they can control. But we expect high performance. Their bonuses are determined by the growth in sales and operating income of their business. The hurdle rates are high, which keeps them looking for opportunities. We expect them to grow their business regardless of market conditions – they can seek out new customers, new product areas or adjacencies.’*

The company takes a consistent approach to investing in R&D and manufacturing capacity, and consequently it has shown very stable margins of 20% as they constantly reinvest for growth. The result has been consistent, organic growth above GDP rates and market share gains, with its growth 2x that of its peers. We believe that Amphenol’s healthy ambition for growth ensures the persistency of its returns and hence its durability.

#### 4. Long-term thinking

Another core value we want to see expressed and demonstrated by our portfolio companies is a management mindset of long-term thinking.

*Value creation over the long term requires management to make decisions with a long-term mindset.*

To us, the economic engine of a business, which is its ability to reliably grow revenues, profits and cashflow many years into the future, is what creates value. Accordingly, we want management teams to make investments that may have pay-offs far in the future, but also contribute to the business’s economic engine and thus to its durability.

A survey conducted by the National Bureau of Economic Research (NBER)<sup>1</sup> found that most executives would forgo making an investment that delivered an acceptable return if it meant missing their quarterly earnings. In fact, more than 80% said they would cut expenditures of R&D and marketing to ensure they hit their quarterly earnings target, despite acknowledging that to do so would sacrifice long-term shareholder value.

This type of short termism by management is a dynamic we strive to avoid. Hence, the consistency of executing a long-term plan to grow and take advantage of market opportunities is what we believe serves businesses and their shareholders best.

<sup>1</sup> John R. Graham, Campbell R. Harvey, and Shivaram Rajgopal, *The Economic Implications of Corporate Financial Reporting*, NBER working paper number 10550, 11 January 2005.

*Accenture has focused its business on all things digital: cloud, security and interactive since 2015.*

Within the portfolio, Accenture, the world's largest consulting and outsourcing company, displays this long-term thinking. Since 2015, the company has been focused on 'rotating to the New', New meaning everything digital – cloud, security and interactive. That strategic focus is entirely consistent with its customer-centric mission statement: *'To deliver on the promise of technology and human ingenuity. We help our clients become the next and best versions of themselves'*.

What we find impressive is the energy and investments that Accenture put behind rotating to the New, when the concept of cloud, security and interactive were merely buzzwords. Instead, management took a long-term view, understanding that this was the way the world was going, and it would be vital to have these capabilities if it was to remain relevant to clients and help them with impactful solutions.

Since 2015, Accenture has built multi-billion businesses in each of these verticals, both organically and through acquisitions, created the world's leading interactive ad agency, and seen its share of revenues from digital businesses increase from 40% of revenues to more than 70%. In 2017, the company began investing behind the concept of Industry X as its next leg of growth, which aims to digitise the very analogue manufacturing industry. In this way, Accenture exhibits long-term thinking and a deep desire to always be relevant to its clients, which are key to it remaining a durable business.

## INTERCONNECTEDNESS

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None of the corporate values we have described are independent of each other. The companies we are drawn to invest in demonstrate all the elements of corporate culture in an interlocking and synergistic way. A company may excel in one of the above four aspects of corporate culture but do the others poorly, becoming a one-legged stool prone to fade to the average. Because we are looking for high persistency of returns and hence durability, finding these values interconnected is essential to how we invest.

## CONCLUSION

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History is a useful starting point to assess whether a business is durable. And while we spend a lot of time assessing our companies for their historical consistency of financial outcomes such as revenue growth, profitability and returns on invested capital, we are also investing for future returns, and we cannot take it as read those historical returns will persist in the future.

Rather, when the elements of corporate culture as we've outlined exist, we gain increased confidence that businesses won't submit to the gravitational force towards becoming average companies. Where a strong corporate culture is in place, we believe we can make better judgements that the future returns of those businesses will persist, that those businesses will remain durable and hence the risk of future disappointment is low.

# Stock profiles

## AMPHENOL

*Amphenol is a major producer of connectors and sensors found in a wide range of end markets. Culture is at the heart of its success.*

Amphenol is a major producer of electrical, electronic and fibre-optic connectors, and interconnect systems and sensors. Think of these as the male/female ends of connectors we are familiar with in our mobile phones, for example. However, Amphenol's products go far beyond devices in our pockets, extending to an array of end markets including automotive, aerospace and IT data centres. The company has expertise in producing connectors and sensors that are used in 'harsh' environments, where environmental factors such as temperature, pressure, and moisture place stress on the components. Its products are used in applications where the cost of failure is much higher than the value of the component, such as connectors used in power units within aeroplane engines.

Three key end markets for Amphenol are automotive, industrial and data centres, each of which accounts for around 20% of sales and all of which have grown strongly in recent years.

In the automotive market, it has benefited from the rising electrical content in cars. This is driven by the increase in electronics involved in vehicle safety systems, entertainment systems and passenger comfort, as well as by rising volumes of electric vehicles. In industrial markets, the company is seeing strong growth from areas such as renewable energy, battery production and charging infrastructure for electric vehicles, factory automation and medical equipment. In data centres, Amphenol is benefiting from the vast investment in cloud computing and storage infrastructure from the likes of Amazon, Microsoft, Facebook and Google.

Much of Amphenol's success can be attributed to its culture of healthy growth ambition, which is expressed through a combination of decentralisation and accountability. The company's 130 GMs across the group are empowered to run their business as if it were their own: responsible for their own P&L, distribution and manufacturing. They are also held accountable to high standards and are expected to outgrow their industry each year. This breeds agility within the organisation where, due to the lack of bureaucracy and red tape, GMs can rapidly respond to changing customer demands.

Amphenol's revenue has grown organically at a rate of 7.5% p.a. over the past five years, with acquisitions adding another 4% p.a. A lean cost structure and entrepreneurial GMs, accountable for their own P&L, means the company operates at higher levels of profitability than its peers. These earnings are subsequently reinvested back into the organisation by way of organic investments and accretive M&A to fuel future growth. We are confident Amphenol can sustainably operate in such a fashion for many years to come.

## JACK HENRY

*Jack Henry excels in both customer service and investment in its technology.*

Founded in 1976, Jack Henry provides essential software to small banks and credit unions in the US. Unlike the concentrated Australian banking market, in the US there are many thousands of small financial institutions. While the large US banks have the resources to develop and manage their essential software systems internally, smaller institutions rely on outsourced providers like Jack Henry.

The company sells three types of products, each comprising about a third of its revenue:

- 1) The 'core' accounting system, which runs a bank's most critical functions such as keeping records of customer accounts, loan balances and transactions.
- 2) A suite of over 200 ancillary products used in conjunction with the core software, which include mobile banking, fraud detection, financial reporting and balance sheet management, and software used by bank tellers and contact centre staff.
- 3) Software that lets Jack Henry's customers process all manner of payments, including debit and credit card transactions, cheques and online bill payments.

When it comes to their critical IT infrastructure, financial institutions prefer to deal with established, reputable vendors like Jack Henry rather than unproven start-ups. They are generally reluctant to replace their existing software vendor for fear of disrupting their customers' ability to transact. So, this is a very sticky business, but periodically change is required. When banks and credit unions do switch providers, it's usually because they have received poor service from their existing provider, or they are running older technology that is no longer supported. Jack Henry excels in both customer service and investment in its technology.

*On average, Jack Henry keeps its customers for more than 50 years.*

Integral to the company's success has been its culture of customer centricity. Jack Henry was founded on the promise of industry-leading customer service and its customer satisfaction scores reflect this. Jack Henry's annual customer retention exceeds 98% and against a base of 700 today, it has lost only five credit union customers to competitors in the last 25 years.

Jack Henry has one core system for banks and one for credit unions, and no unsupported legacy systems. The company's two main competitors, Fiserv and FIS Global, sell a patchwork of software systems, many of which no longer receive updates or technical support. These strengths have allowed Jack Henry to win, on average, one new customer a week from these less-focused competitors.

Aside from winning new customers, the company's growth is also driven by increased spending from existing customers, who need to keep investing in their IT systems to remain competitive and to stay compliant with ever-changing regulations. For instance, the COVID-19 pandemic has required banks to adapt from serving customers in physical branches to online services, which necessitates further investment in their digital banking and online account-opening systems.

Jack Henry has a long history of 6-7% p.a. organic revenue growth at a healthy and consistent 25% operating profit margin. It has a leading position in its attractive niche of the enterprise software market, and we expect its best-in-class customer service and technology to translate to continued market share gains and earnings growth for many years to come.

## Get in touch

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**A COMMONSENSE APPROACH EXECUTED WITH UNCOMMON DISCIPLINE**

### 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 [aoris.com.au](http://aoris.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.