

## Conscious Investor® Fund

### Report for the First Six months: February 2013 to July 2013

With the money arriving in the Fund from February onwards and being available for investment from March, the primary aim was to invest the bulk of it as smoothly as possible into quality companies. At the same time, at each point some was to be kept in cash in case of any exceptional investment opportunities.

As Fund members will know, by quality companies we mean companies that pass (1) the requirements of Conscious Investor®, (2) the requirements of the Teaminvest Methodology, and (3) the final scrutiny of the Investment Committee. (Details are given in the Investment Memorandum of the Fund with a summary in the section *Conscious Investor® and the Teaminvest Methodology* below.)

In a period as short as 6 months fluctuations of share prices can be erratic with little or no relationship with the value of the underlying companies. From an investment perspective, we want companies that grow their earnings per share over time and pay reasonable dividends based on a rational dividend policy. Moreover, this should be done without too much debt. Also we want to make sure we protect the capital of our members.

Despite the shortness of the period, the results were reasonable. The capital gain over the period for the money invested in shares and not including cash or dividends was 1.31 percent. This is compared to a loss of -1.43 percent for the All Ordinaries Index over the same period.

The most successful investment in percentage terms was M2 Telecommunications (MTU), Australia's largest network independent telecommunications provider for retail and wholesale fixed-line. We started buying it at the start of March in the range \$4.26 to \$4.38. By good fortune, shortly afterwards MTU announced that it was acquiring DIDO and Eftel. This moved the price to over \$6.00. However, it moved the debt to levels that we are not normally comfortable with. For this reason we sold half the holding for \$6.28 per share. The current price of the shares is around \$6.40.

Ramsay Health Care, Australia's global hospital group, was another successful purchase. Shares were purchased in March for an average price of \$31.53 and they are currently trading at \$36.66.

A third successful purchase was 1300 Smiles, the dental practice amalgamator. Purchased for \$5.79 in March, the current price is \$6.58.

Our worst performers have been companies with a significant portion of their revenue coming from the mining services area. Consider Monadelphous, which provides extensive engineering construction, maintenance and industrial services to the resources, energy and infrastructure sectors across Australia with some activity in China and New Zealand. Over a period of months shares were bought at an average price of \$21.35 and the price is now \$16.60.

Not all mining services companies in the Fund have performed so poorly. For example, we purchased Mineral Resources at an average price of \$10.23 which is less than 5 percent below its current price of \$9.78. (For further information on the attitude of the Investment Committee to the mining boom and its effect on mining services companies, see the section *Comment about the Mining Boom* below.)

The following table shows the cost price and the current market price of the five largest holdings in the Fund as measured by the market price at the end of July.

**Five Largest Holdings in Fund**

Shares	Company	Cost	Market
17,781	Domino's Pizza	\$198,402	\$210,527
8,065	Monadelphous	\$160,067	\$133,879
3,644	Westpac	\$99,973	\$114,640
8,290	ARB Corporation	\$99,738	\$110,423
6,250	The Reject Shop	\$100,000	\$104,938
	Others	\$1,062,028	\$1,068,560
	<b>Total</b>	<b>\$1,720,208</b>	<b>\$1,742,967</b>

**Comment about the Mining Boom**

Your Investment Committee has spent considerable time evaluating ASX companies that support and service the resource industry. This is despite many articles in the press that the resources boom in Australia is coming to an end and that all companies associated with mining will no longer be able to grow and prosper.

We make the following comments:

1. All booms come to an end and your Investment Committee is well aware of this.
2. Even as it does come to an end, there will still be a massive requirement for iron ore and other minerals in many countries, particularly China as its urbanisation continues.
3. Whatever the decreased need for mining services, this decrease will not be spread uniformly over all mining services companies. In fact, the better companies with superior management, low debt, and strategic flexibility will likely have opportunities to acquire weaker competitors at bargain prices or to gain contracts from these competitors.
4. As a result of the mining boom, Australia has a much larger mining infrastructure that needs to be maintained and serviced.

As a consequence, your Investment Committee feels that a balanced investment in the best mining service companies will provide pleasing returns over time. There is the risk, however, that the market marks down their share prices in the near term.

We believe that the best of these companies are ALS, Lycopodium, Mermaid Marine, Mineral Resources and Monadelphous. Each of these companies gains all or a substantial part of their revenue from resource companies and have performed exceptionally well in the past. Furthermore, each of them occupies a special niche or has distinct qualities compared to its competitors. Finally, they either have very low debt to equity relative to the industry (in some cases zero) at levels considered prudent and manageable by the Investment Committee. For these reasons, we believe that as a group they will be Wealth Winners® in the future as a part of the Fund portfolio.

## **Conscious Investor® and the Teaminvest Methodology**

The investment process for the Fund consists of four steps: Filtering using Conscious Investor®; Applying the Teaminvest investment methodology; Calculating the price to pay and when to sell; and Investment Committee and the final checklist. Full details of these steps are contained in the Information Memorandum. Here we just give a brief summary of the first two steps.

Conscious Investor® filters and analyses all companies listed on the ASX in three steps: Filter, Research and Return. The main components of the filter stage zero in on companies with attributes such as strong and stable growth in earnings and sales, high and consistent return on equity and not too much debt. The research stage helps to limit the results to companies for which these attributes are likely to continue. Finally, the return stage calculates what maximum price to pay to be confident about getting the required rate of return over the long term. It uses automatic margin-of-safety calculations based on stress testing the investment assumptions.

The Teaminvest Methodology focuses on the following four areas:

- How does the company make money? What is the business of the company? and Who are its customers?
- Investments should be like castles: What are unique features of the business that separate it from its competitors? These are scored in terms of strength and durability.
- Risks need to be identified: All businesses face risks that could weaken the continuing success of their operations. These risks are identified and are scored according to the likelihood of their occurring over the next economic cycle and their potential damage if they do.
- Is management honest, open and rational? As part of examining the business, evaluation is made whether or not it is believed that the board and senior management are acting honestly, rationally and in the best interests of shareholders. Specific areas that are looked at include the number and type of related party transactions and the remuneration structure for the CEO and senior management.

*This report is prepared for members of the Conscious Investor® Fund. It does not take into account anyone's personal circumstances. Remember, what happened in the past is not always what will happen in the future.*

*Questions? Contact us:*

*Conscious Capital Limited AFSL 427 216 Level 7, 53 Walker Street, North Sydney 2060, ph 02 9954 4017.*