Conscious Investor Fund

Annual Letter to Members: 2014 -2015

Your Capital Allocation Team has been busy looking for secure investments for your money. Our role has three parts:

- Identifying great businesses in which we have confidence that earnings will continue to grow
- Ensuring that their management is trustworthy and acting in the best interests of shareholders
- Buying at a price that offers a reasonable return with safety

For each company that meets these criteria we set prices that we believe would result in at least a satisfactory return. As investments come into the Fund, we will wait until these prices are met before making any significant purchases.

Who is Phil?

Warren Buffett wrote: "I am an eager reader of whatever Phil has to say, and I recommend him to you." And then later: "A thorough understanding of the business obtained using Phil's techniques…enables one to make intelligent investments commitments."

Who is the Phil that Buffett is referring to? It is Philip A. Fisher, a famous investment advisor now best known for his book *Common Stocks and Uncommon Profits,* first published in 1958. His book is a collection of essays of varying length in three parts: *Common Stocks and Uncommon Profits, Conservative Investors Sleep Well*, and *Developing an Investment Philosophy*.

As our Members know, we try to follow Warren Buffett as closely as possible. But it is interesting to go back from time to time and look at the methods of other great investors and see how they support Buffett's principles. This is what I will do here with the ideas of Phil Fisher. Even though Fisher's ideas were written down almost 60 years ago, it quickly becomes apparent that they are just as relevant today as they were back then.

I am going to focus on his essay in the first section of the book called: *What to Buy: The Fifteen Points to Look for in a Common Stock*, probably the most well-known section in the book.

I will run through each point one at a time and briefly describe how they match what we do today.

POINT 1 Does the company have products and services with sufficient market potential to make possible a sizeable increase in sales for at least several years?

Fisher makes the point that it is not enough to understand the current services and products of a company and their past growth, but we also have to have confidence that they will generate a sizeable increase in sales in the future. We ask this about the products and services of all the companies in the Fund. We view sales as the bedrock of profit: without dollars coming into the company, it cannot be profitable. An excellent example of a company that is likely to keep growing its sales at a healthy rate is Ramsay Health Care.

POINT 2 Does the management have a determination to continue to develop products or processes that will still further increase total sales potential when the growth potentials of currently attractive product lines have largely been exploited?

Putting it simply, is the management determined to keep introducing new products and services. CSL is a prime example of a company that satisfies this criteria.

POINT 3 How effective are the company's research and development efforts in relation to its size?

Fisher makes the point that the proportion of revenue that a company spends on R&D varies considerably between companies and industries. On top of this, there is large variation between how valuable the R&D results are for each company. Again CSL is an excellent example of a company that spends a large proportion of its revenue on R&D and has the results to show for it. Another point we look at in the Fund is whether or not a company fully expenses its R&D or capitalises it.

POINT 4 Does the company have an above average sales organization?

This point is not so easy to evaluate form the outside. But with a bit of nosing around (including visiting the stores, talking with personnel, and so on) and reading all that you can on a company, it is possible to get a good idea. For example, here are a few quotes from Graham Turner, the Founder and CEO of Flight Centre, which gives you an idea of why Flight Centre has such dedicated staff:

"The company's Family, Village, Tribe structure of decentralised teams—with each separate team accountable for its own profit and loss accounts—was central to its success."

"Incentives were based on rewarding simple outcome-based results, usually profit or commission, or sometimes sales growth."

"Give people responsibility and accountability, and a share of the profits, and you are guaranteed success."

POINT 5 Does the company have a worthwhile profit margin?

As Fisher said above, sales are important. But if the sales margin is small, then the risk is generally too high that it could end up at zero. There is no buffer to allow for unexpected changes in business conditions or poor decisions by the management. The Fund likes to check both the level of the Net Profit Margin and any trends involved.

POINT 6 What is the company doing to maintain or improve profit margins?

Again this is not easy to judge from the outside. One thing we do in the Fund is examine any past trends in the Net Profit Margin. If it is trending downwards, we see this as a danger sign. Other questions we ask are how regular are they with new products, are they vigilant about cutting costs, and do they continue to strengthen their economic moats?

POINT 7 Does the company have outstanding labor and personnel relations?

Here is what Fisher says: "If workers feel that they are fairly treated by their employer, a background has been laid wherein efficient leadership can accomplish much in increasing productivity per worker."

A lot can be learned from about this area from a careful reading of the annual report. Also, a simple Google search will often show if there have been any labour difficulties. For example, it is straightforward to discover if a company has any union problems.

POINT 8 Does the company have outstanding executive relations?

Fisher writes: If having good relations with lower echelon personnel is important, creating the right atmosphere among executive personnel is vital." Some of the points we consider in this area are:

longevity of executives with the company; are the remuneration and inventive packages reasonable? Do they have skin in the game? Was it bought with their own money?

POINT 9 Does the company have depth to its management?

An immediate question we ask is what would happen to the company if the CEO was "run over by a bus?"

POINT 10 How good are the company's cost analysis and accounting controls?

Although not directly answering this question, one of the areas we look at here is the proportion of intangible assets such as goodwill in the financial statements. Other concerns are franchises, copyrights and trademarks, patents and brand names

POINT 11 Are there other aspects of the business, somewhat peculiar to the industry involved, which will give the investor important clues as to how outstanding the company may be in relation to its competition?

Putting it simply, what Fisher is talking about is what we call a sustainable competitive advantage or economic moat. What are features of the company and its products and services that make it hard for competitors while allowing the company to keep increasing their prices? As we say in the Information Memorandum of the Fund, "Investments should be like castles with deep moats." The stronger and more durable its moats, the greater confidence we can have that any growth of the company will continue.

POINT 12 Does the company have a short-range or long-range outlook in regard to profits?

Fisher explains: "The investor wanting maximum results should favour companies with a truly long-range outlook concerning profits." One way we can judge this is by the lengths of time frames for awarding incentives and bonuses. This seems to be a more reliable measure than any stated goals about time frames.

POINT 13 In the foreseeable future will the growth of the company require sufficient equity financing so that the larger number of shares then outstanding will largely cancel the existing stockholders' benefit from this anticipated growth?

Does the company have a history of capital raisings? What were they for? Did they add genuine value or were they more a sign that management don't really know what they were doing?

POINT 14 Does the management talk freely to investors about its affairs when things are going well but "clam up" when troubles and disappointment occur?

Whenever possible we like to go to the annual meetings or to presentations by the management. How do they respond to tough questions? Do they acknowledge their mistakes when they occur, an attribute for which Buffett is renown?

POINT 15 Does the company have a management of unquestionable integrity?

This point is so important, I will quote Philip Fisher at length:

> The management of a company is always far closer to its assets than is the stockholder. Without breaking any laws, the number of ways in which those in control can benefit themselves and their families at the expense of the ordinary stockholder is almost infinite… Regardless of how high the rating may be in all other matters, however, if there is a serious question of the lack of a strong management sense of trusteeship for

> stockholders, the investor should never seriously consider participating in such an enterprise.

I think this speaks for itself. We only want to invest in companies where we can be confident that management is honest, rational and acting in the best interests of shareholders.

A Mini Berkshire Hathaway

The Members of the Capital Allocation Team all understand and appreciate the investing principles of Warren Buffett. So much so, that right from the outset our goal has been to mimic Buffett's methods of running his early Buffett partnerships and later running Berkshire Hathaway. For instance, all the selection procedures for companies in the Fund have been based on his principles.

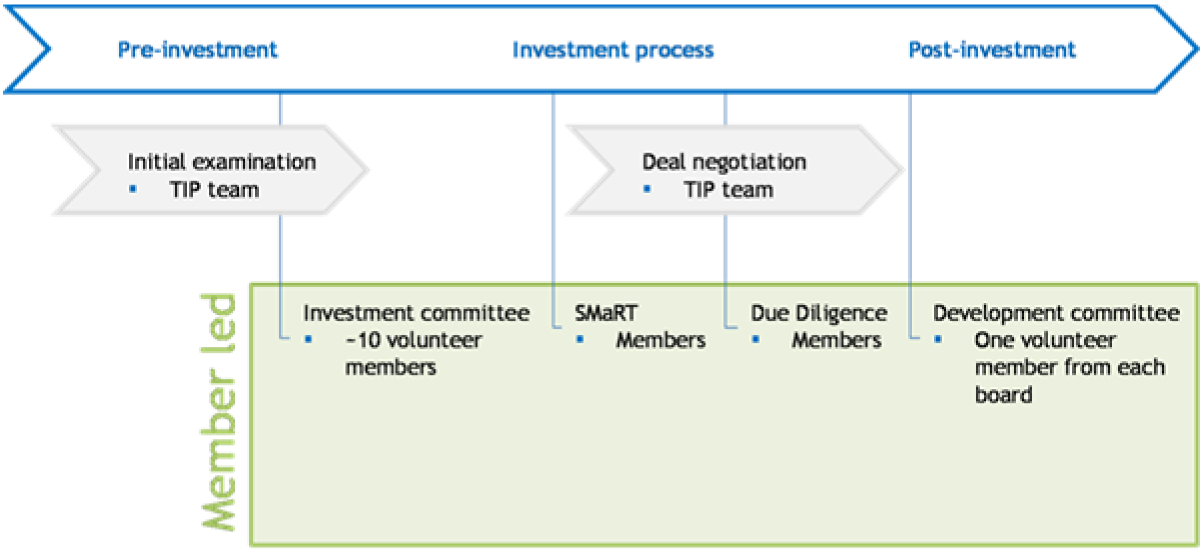
Fortunately, we are now in a position to take two more steps to bring us more closely aligned with Buffett: overseas shares and private companies.

Step1: Overseas Shares: We know that Warren Buffett does not restrict himself to investments in US companies. For example, recently he invested in the Australian company IAG. For the Fund, we believe that it is now the right time to start some positions in overseas companies, particularly companies in which Berkshire Hathaway has large holdings. So far these are very small positions in four USA companies, including B shares in Berkshire Hathaway. The total holding in USA-based companies is just 1.3 percent. The main difficulty at the moment is the high level of the US dollar compared to the Australian dollar, but we are pleased with what we have.

Step 2: Private Companies: We know that Berkshire invests in private companies as well as listed companies. Over the years the proportion of funds in private companies has continued to increase so that now they make up approximately 49.5 percent of total equity.

Right from the start of the Fund, as stated in the Information Memorandum, we had intended to invest in private companies. However, we knew that we had to find the right time and the right vehicle to do it.

The recent formation of Teaminvest Private (TIP) has provided an excellent vehicle to start this process. For those who have not heard about TIP, you can get details on the website www.teaminvestprivate.com.au. TIP looks to invest in private Australian businesses with significant, long-lasting economic moats, and quantifiable and manageable Risks. TIP investors decide on which companies to invest in through an exhaustive vetting process. Investors seek to have a majority stake. This protects the TIP investors by ensuring major capital and strategic decisions require their approval. Moreover TIP seeks to add value to the businesses by having a subset of its investors on the board of the company. This ensures our investors are able to influence the success of the business.



Investments in each company are done by setting up Fixed Entitlement Trusts for each company as follows:

Type of trust:	Fixed Entitlement Trust
Tax status:	Tax flow through
Trustee:	Valuestream Investment Management (3rd party provider)

As the trusts are Fixed Entitlement Trusts, each investor, in this case, the Conscious Investor Fund, will hold what are deemed to be fixed entitlements to a set dollar amount. By virtue of being a Fixed Entitlement Trust, the investor has no right of redemption and the trustee cannot issue new entitlements in the trust. This has the effect of fixing the proportional share of the investor, and its value at book value. Dividends paid to each trust will flow through to the Fund in the same way that as the dividends of listed companies.

Members of the Capital Allocation Team have attended the different steps of the analysis process for a number of possible investments. However, to date none of met our requirements. As always, the safety of your investments is our highest priority.

If you would like to know more about Teaminvest Private, they are having a tradeshow on Thursday 1st and Friday 2nd of October 2015 in the Brisbane Convention & Exhibition Centre (Phone (02) 9955 9540 for an invitation and more details.)

Largest Holdings in the Fund

The following is a discussion of the ten largest holdings in the Fund in alphabetical order. They cover a broad range of industries (including food and staples, automotive supplies, banking, sporting goods, travel, pharmaceuticals and health care), geographical location (some are just in Australia and others are truly global companies), and market capitalisation (ranging from $222 million for My Net Fone to $126 billion for the Commonwealth Bank). What they have in common is a proven record of growth in earnings and sales, strong economic moats, and management who understands and respects the ownership of shareholders.

ARB Corporation

ARB is a great Australian success story. In 1975 company founder, Tony Brown, completed a 4WD trip through the top end of Australia. Back then, 4WDers relied on homemade or ill-fitting equipment that was not designed for extensive Outback expeditions. Endless corrugated roads, extreme temperatures, and the heavy loads carried by Australian travellers were extremely punishing on vehicles that regularly tackled these kinds of conditions.

Upon his return to Melbourne, Tony began working in the family garage to address some of the product deficiencies he had encountered on his trip. It was exactly what Australian 4WDers had been waiting for, and ARB, the initials of Anthony Ronald Brown, was founded.

Some of the highlights of FY15 were:

- Sales for the year grew in each category by an overall 10.7% (Australian aftermarket 7.65%, Exports 17.8%, Original equipment 18.5%)
- Percentages of sales: Australian aftermarket 67.6%, Exports 24.9%, Original equipment 7.5%
- National store network is pivotal to the Company's strength in the Australian aftermarket.

ARB has a continuous development program for new products with regular releases to ARB's markets worldwide. In Australia ARB has 52 stores (24 company owned). Company expects to open at least 3 new stores during FY16.

Some of the reasons why the Capital Allocation Team has ARB Corporation in the Fund:

- Every 4 or 5 years it pays a special dividend
- Management known to be shareholder focussed (eg. modest salaries with no bonuses)
- Strong growth of export sales, an area where there is enormous upside
- Management understands that a key element in maintaining its long-term competitive advantage (economic moat) is product development.

Commonwealth Bank of Australia

The Commonwealth Bank was founded under the Commonwealth Bank Act in 1911 and commenced operations in 1912 as both a savings and general banking business. In July 2012 CBA celebrated the centenary of the opening of its first branch in Collins Street, Melbourne on 15 July 1912. Today CBA is a business with more than 800,000 shareholders and 52,000 employees. The bank offers a full range of financial services to help customers build and manage their finances.

Today CBA has branches in Indonesia, Japan, Singapore, India, Vietnam, Mainland China and Hong Kong. It also has representative offices in Beijing, and Hanoi. Other branches are in the United Kingdom, New Zealand the US.

Many investors have strong opinions about banks, particularly the CBA. Some believe that no Australian portfolio is complete without a reasonable size holding in CBA. Others don't want anything to do with any banks. "Too dependent on an overheated housing market and insufficient capital adequacy," some say about CBA.

However, putting it simply, the Capital Allocation Team recognises that as society becomes more complicated, and more financially sophisticated, banking in general is going to be increasingly important. Around the edges there are various disintermediation companies such as RateSetter for peer-to-peer loans and PayPal for making small payments. There are, also, a whole range of housing loan companies. But at the core for the foreseeable future will be the main Australian banks. They are not all the same, and at different times some will be growing faster or be more profitable than the others.

But the CAT believes that overtime, CBA will be the best of the lot, and the safest.

Some of the highlights of FY15 were:

- Bank revenue from ordinary activities up 2% to $43.3 billion
- Profits up 5% to $9.1 billion.
- EPS only went up 1%
- In FY2015, they spent around $1.2 billion on tech and productivity initiatives

It is interesting to note how far the US is behind in some aspects of banking. For instance, because the US has so many small banks, it is rare to use bank transfers to pay invoices relying, instead, on cheques.

Some of the reasons why the Capital Allocation Team has CBA in the Fund:

- Banking will become increasingly important as society becomes more complicated and financially sophisticated
- CBA is the leader in banking technology and will continue to drive down costs and add customer-oriented products
- One of a limited number of global banks in the AA- category
- CBA is in the APRA top quartile for Basel III CET1 compared to listed commercial banks with total assets in excess of A$700 billion. Its ratio is 12.4% and after the current capital raising it will increase to 14.3%
- Number one in retail and business customer satisfaction among major Australian banks
- Determined to continue to drive down costs using technology

CSL Limited

CSL Limited is a global, specialty biopharmaceutical company that researches, develops, manufactures and markets vaccines and products to treat and prevent serious human diseases and medical conditions. Its origin was the Commonwealth Serum Laboratories established in Australia in 1916 to service the health needs of a nation isolated by war. CSL Limited was then incorporated in 1991 and listed on the ASX in 1994. Since then CSL acquired a number of businesses, in particular CSL Behring which traces its corporate roots back to Emil von Behring, an innovator with serum therapies who won the first Nobel Prize in Physiology and Medicine.

Some of the highlights of FY15 were:

- Sales up 2% to US$5.4 billion (up 7% in constant currency)
- R&D investment US$463 million
- EPS up 8% to US$2.92 (up 13% in constant currency)
- EPS converted to AUD up 33%
- Acquisition of Novartis global influenza vaccines business.
- This acquisition will allow CSL to integrate the influenza vaccines division with its subsidiary, bioCSL, creating the second largest influenza vaccine business in the US$4 billion global industry

- Manufacturing plants in the US, UK, Germany and Australia, with a commercial presence in approximately 20 countries.

Some of the reasons why the Capital Allocation Team has CSL in the Fund:

- High level of R&D and large number of patents and licences
- Wide range of products from specialty to broad demand
- Sales spread around the world (North America 41%, Europe 28%, Asia 10%, Australia 10%, ROW 11%);
- Globally 128 plasma collection centres
- Benefits from growing requirements for vaccines and products to treat serious medical conditions
- Regularly buys back shares (but would prefer that they did not use debt for this)

Domino's Pizza

Domino's Pizza Enterprises Ltd (Domino's Pizza) is the largest pizza chain in Australia in terms of both network store numbers and network sales. It is Domino's largest franchisee outside of the USA. It holds the master franchise rights to the Domino's brand and network in Australia, New Zealand, France, Belgium, The Netherlands and Japan. Currently DMP has a network of 1,506 stores, including 670 stores in ANZ, 452 stores in Europe and 384 stores in Japan.

With 75% of the stores franchised, Don Meij says this is the heart of the operation and a large reason for its success. "We can be agile, stay ahead of the curve, innovate and improve because our franchisees are world-class. Our goal is to continue to make a material difference to their bottom line and the value of their overall business."

The strength of Domino's lies in its ability to use different apps and web sites to facilitate the ordering process. Australian online sales are at the 57 percent level. Recently the company added the ability to design and name your own pizza (Pizza Mogul). You can then promote it via your own mailing lists and social media earning a small commission on each sale.

Some of the highlights of FY15 were:

- Net profit after tax up 40% to $64 million.
- EPS up 36%
- Same store sales up 11.3% (Australia), 6.4% (Europe); 1.8% (Japan)

Some of the reasons why the Capital Allocation Team has Domino's in the Fund:

- The drive and business ability of the CEO, Don Meij
- Australian model successfully exported to five other world areas
- Over 40 new digital projects in the pipeline for FY16
- Recent IT innovations: Pizza Mogul in Australia (ability to design and market your own pizzas); pizza tracker (watch the route of the pizza delivery)

Flight Centre

After starting with one shop in the early 1980s, Flight Centre has grown to become a $13.5 billion business consisting of more than 30 brands. One of the world's largest travel agency groups, it has company-owned operations in Australia, New Zealand, the United States, Canada, the United Kingdom, South Africa, India, China, Hong Kong, Singapore and the United Arab Emirates. Its travel management network spans more than 75 countries. It employs more than 15,000 people globally and has 2,500 stores.

According to the company, its vision is: "To be the world's most exciting travel company, delivering an amazing experience to our people, customers and partners."

Some of the highlights of FY15 were:

- Record sales: total transaction value (TTV) increased 9.7% to $16.6 billion
- Diversified earnings: the UK and Ireland, USA, South Africa and Singapore achieved record earnings before interest and tax(EBIT)
- Strong cash generation: strong balance sheet with $564.7 million in cash and minimal debt
- FLT's corporate brands increased turnover by 16.3% globally.

Flight Centre Brands

Even though Flight Centre is most well-known for its familiar small stores in malls and shopping precincts, recently it has also been opening what it calls hyperstores. In FY16 new hyperstores will open in Australia, the USA, the UK, Ireland and Asia.

A flagship hyperstore will open in Sydney, next to the Hilton Hotel on George Street, during the second half and will become FLT's largest shop globally. It will house eight leisure travel sales teams, plus teams of wholesale consultants and a network of corporate travel business development managers. New features will include an Explore Zone, an interactive area that will allow suppliers to showcase their products and for customers to experience aspects of their holidays in-store.

Recently CEO and Founder Graeme Turner said: "We believe we are at the beginning of a Golden Era of Travel and are building the foundation that will allow us to seize this opportunity." This Golden Era will be characterised by:

- Cheap airfares: flights are becoming more affordable in relative terms
- More choice: innovative new product ranges are being developed and launched
- Greater luxury and comfort: particularly evident in the air
- Less flying time: flights are now faster, more direct and more reliable.

Some of the reasons why the Capital Allocation Team has Flight Centre in the Fund:

- Flight Centre has the proven ability to continually develop new and successful approaches to marketing travel
- It also has the ability to roll these approaches out globally
- Ongoing network expansion: FLT aims to expand its global sales by 6%-8% in FY16, which will create more than 1,000 new jobs.
- IATA has projected 4.1% growth per year in passenger numbers through to 2034
- Airbus recently predicted that international traffic serving the Australian South Pacific region would grow at 4.5% annually to 2033

My Net Fone

This company is the odd one out in this list. Not only is it the smallest, but it is in an area that we can have least confidence about the future. Furthermore, since making the first purchases in August 2014 when it had zero debt, its debt to equity ratio has leapt to 132.9%. This is because of the loan of $25 million to purchase NZMI. The reason that it is in the group of the ten largest holdings is because the price has risen over 30 percent since it was first purchased, faster than most of the other companies

My Net Fone owns and operates Australia's largest VoIP network. The company provides broadband internet and cloud-based communication services to residential, business and government sectors.

The core brand My Net Fone provides a full suite of corporate voice, fax and data services, including its proprietary Virtual PBX phone system. The company also operates the following brands:

Symbio Networks: one of just four voice carriers in Australia, and provides IP voice carriage services and software to all levels of the Australian and New Zealand telecommunications industry.

TNZI: a global voice business servicing international carriage service providers, regional telecommunications networks and multi-national enterprise. TNZI currently delivers 3% of global wholesale voice traffic, with unmatched reach into the Asia-Pacific region.

Connexus: an Australian ISP that provides a suite of premium quality internet services: Metro Ethernet, Fibre, VPN, Hosting and Cloud-based webtools. The service suite compliments and extends the offerings of other Group brands.

CallStream: provides inbound phone numbers, specifically for organisations which are contracted with telcos outside the MyNetFone Group. CallStream delivers 13, 1300 and 1800 services 'over the top' of the underlying service provider.

iBoss: software-as-a-service (SaaS) platform which enables anyone to start and scale their own telecommunications business

TollShield: real-time toll fraud mitigation software for Networks and Carriers

Pennytel: 'no frills' VoIP home phone and ADSL internet service provider, targeting budget-conscious Australian families and households.

The Buzz: hardware that connects to any PSTN home phone, and delivers outgoing calls at a lower cost.

Some of the achievements for FY15 were:

- Revenue up 44% to $85.7 million

- NPAT up 24% to $7.2 million
- Earnings per share up 24%
- Purchase of Telecom New Zealand International (TNZI)

The company reported that the integration process for TNZI is on track, with finance, engineering, marketing and sales functions completed. The company has also invested in expanding its capacity in the UK, Hong Kong and Singapore.

Some of the reasons why the Capital Allocation Team have My Net Fone in the Fund:

- Nimble player in the fast moving area of telecommunications
- Track record of organic growth in the key areas of virtual PBX sales (SMEs) and managed services (domestic wholesale)
- Proven IP-based communication solutions for residential (claims to save consumers up to 60%), business (hosted phone systems, internet, 1300 numbers, virtual fax and number porting) and enterprise (officially certified to interoperate with Microsoft Lync Server in Australia).
- Past strong organic growth likely to continue in the near future

Ramsay Health Care

Paul Ramsay, the founder of Ramsay Healthcare, was an unassuming man who knew how to motivate people. As he built his company he also knew how to systemise his knowledge so that whenever the company opened a new hospital or medical facility, he and the board could be confident in the outcome. The overall procedure was contained in what he called “The Ramsay Way”. For instance, one way that Ramsay Health Care differentiates itself from other hospital operators is through its decentralized management structure, which allows its managers to develop productive working relationships with doctors.

Some of the achievements for FY15 were:

- Strong growth across the global portfolio
- Now the leading hospital operator in France
- In the process of acquiring a further nine hospitals in Lille, France
- Completed $190 million worth of expansions at existing facilities

The company is also looking to expand into China and will start with operating five hospitals (2,300 beds) in the city of Chengdu with Chinese health care operator, Jinxin.

For FY15, revenue was up 49.8% to 7.4 billion, core NPAT was up 19 percent to $412.1 million and core EPS was up 20.0% to 196.6 cents. Exceptional results.

Some of the reasons why the Capital Allocation Team have Ramsay Health Care in the Fund:

- Demand for better and expanded heath care around the world (ageing and more affluent population)
- Has a proven turnkey operation that works in variety of environments
- World operator that is no longer limited to Australia
- In terms of outlook, regularly exceed their guidance

Super Retail Group

Super Retail Group Limited started in 1972 when Reg and Hazel Rowe founded an automotive accessories mail order business. Now its brands are Amart Sports, Avanti Fitness, BCF Boating Camping Fishing, Goldcross Cycles, Ray's Outdoors, Rebel, Supercheap Auto, Workout World and Super Retail Commercial. The Group has operations in Australia, New Zealand and China operating through more than 600 stores with annualised turnover in excess of $2 billion. The Company operates through three divisions (EBIT percentage): Auto (50%), Leisure (17%) and Sports (33%).

The Company completed a review of underperforming businesses during FY15 leading to the following decisions: Restructure Ray's Outdoors, Integrate Workout World with Rebel, Close FCO Fishing Camping Outdoors business

Some of the highlights of FY15 were:

- Revenue up 7.1% to $2.2 billion
- Net profit down 25.2% to $108.4 million
- Maintaining 25% of range across stores to be refreshed each year
- Supercheap Auto Club has 1.3 million members (1.1 million active)

For the past three years the company has focussed on the ability to operate as a multi-channel retailer. Part of this process was to build a more efficient distribution centre network. The company indicates that the network was completed with the opening of the Brendale Distribution Centre in October 2014.

Some of the reasons why the Capital Allocation Team has Super Retail Group in the Fund:

- Sells wide range of products used by the average Australia, many of them quasi-essential (sporting equipment and clothes for children, car maintenance)
- Development as a multi-channel retailer and general restructuring should lead to improvement in ROE and EPS growth in the future. (The stated goal of the company is to grow EPS by 15% per annum.)
- Sells fairly low cost items that may sell even better in an economic downturn (increased home car maintenance, more camping and fishing, greater sport participation)
- Over the last few years spent a large amount of money on new SAP system: should now be able to benefit from it

Wesfarmers Limited

Wesfarmers is best known as the owner and operator of Coles Supermarkets. However, the company is really a conglomerate which buys and sells its component companies at suitable times. For example, in June 2014 Wesfarmers completed the sale of its insurance broking and premium funding operations to Arthur J. Gallagher & Co for a pre-tax profit of approximately $310 to $355 million. Later that month it announced the completion of the sale of its insurance underwriting operations to Insurance Australia Group for a pre-tax profit of approximately $700 million to $750 million.

Apart from Coles, the company covers the areas of home improvement (Bunnings), office supplies (Officeworks), department store retailer (Kmart and Target), Resources (open cut coal in Curragh and Bengalla), chemical, energy & fertilisers (mainly ammonia and ammonium nitrate production in

Western Australia and Queensland) and industrial & safety. Also Coles offers home, car and life insurance.

Some of the highlights of FY15 were:

- Revenue up 3.8 percent to $62.4 billion
- Net profit after tax up 8.3% $2.4 billion
- Earnings per share up 9.9%

The breakdown of earnings before interest and tax is as follows: Coles 46.1% Home improvement and office supplies 31.3%, Department store retailing 13.5% and Industrials 9.1%

Some of the reasons why the Capital Allocation Team has Wesfarmers in the Fund:

- Diverse businesses covering supermarkets, department stores, home improvement and office supplies, coal production and export, chemicals, energy and fertilisers, and industrial and safety products.
- The CEO, Richard Goyder, known to be an astute business person and leader; does not micro-manage.
- Lean operation with each division responsible for its own success: for example, each business is managed autonomously and drives their own recruitment and selection of candidates.
- Stated view from the board that the company takes a long-term view. The company has only had seven CEOs in 100 years.
- Brand Directory rates Coles as the fourth most valuable brand in Australia ($5.9 billion); other valuable brands owned by Wesfarmers are Bunnings ($1.1 billion) and Office Works ($546 million).

Woolworths Limited

Since opening its first single basement store in Sydney's Pitt Street in 1924, Woolworths now has a store in almost every metropolitan and regional centre in Australia and New Zealand. The company stared operating fresh food stores 60 years ago when advances in refrigeration technology revolutionised transport and storage.

Other brands of Woolworths are Big W, BWS, Dan Murphy's, Woolworths Mobile Wine Market, Cellarmasters, Langton's, Masters Home Improvement and Thomas Dux. Similarly to Coles, the company now offers home, car and life insurance. It also offers travel and pet insurance.

In partnership with Lowe's (USA) in 2011 Woolworths started a new chain of hardware stores called Masters. To date they are still losing money and it is not known when they will be profitable. For FY13 they lost $138.9 million and in FY14 they lost $176 million. It will be a few more years before they are profitable.

Some of the highlights of FY15 were:

- Sales down by 0.2% to $60.7 billion
- Net profit after tax down 12.5% to $2,146 million
- Earnings per share down 13.1%
- Return on average funds employed down 125 bps to 25.7%
- Australia's leading online grocery retailer with sales growth >20% in FY15

- Masters sales for the year were up 23.7% to $930 million but losses increased
- The first Masters store with new format and range opened in January 2015. Average store sales are 30% higher than original format. Starting to retrofit original stores

The Capital Allocation Team thought that, since probably less than 1 percent of Woolworths' revenue comes from poker machines, it was acceptable for the Fund.

Implementation of on-line methods such as ability to purchase through eBay and then collect via selected Woolworths stores. Method now accounts for between 20 and 50 per cent of online sales. Generates additional sales because between 30 and 40 per cent of online shoppers – some of whom are not existing customers – make additional purchases in-store when they collect online orders.

Some of the reasons why the Capital Allocation Team has Woolworths in the Fund:

- ROE 22.7%
- Managing online sales with specially built "dark" stores for such sales
- Increasing emphasis on more profitable generic or home brands on four levels: Homebrand, Select, Gold and Fresh; also Macro Wholefoods
- Increasing percentage of sales come from online.
- Increasing investment in supply chain, digital and big data
- Sell essential items (groceries, fruit and vegetables) to millions of people every day
- Strong brand name
- Brand Directory rates Woolworths as the most valuable brand in Australia ($8.7 billion)
- Many people prefer the better service and the range and quality of products you get at Woolworths irrespective of price

Role and Performance of Largest Holdings

The Conscious Capital Fund is a boutique fund which will remain small and true to its principles rather than include companies that do not satisfy its stringent requirements. The recommended time frame for investing in the Fund is five years or more to allow for the future success of the companies held by the Fund to be reflected in share prices and dividends.

The companies just described are the largest ten holdings in the Fund. The Capital Allocation Team decided that these companies should comprise around 60 percent of the fund. Currently they are at the 60.3 percent level.

The following table shows the dividend yield, the average EPS growth over the past five years, total outlay for each of the companies and the total value at the end of June as measured by the market value and cash dividends over the holding periods of this core ten.

Shares	Name	Div Yld (1)	EPS Growth 5 Yrs	Outlay (2)	Value 30 June 2015 (3)
12,000	Ramsay Health Care	1.5%	17.2%	$539,985	$754,098
7,450	CSL Limited	1.6%	11.2%	$508,150	$656,046
7,400	Commonwealth Bank	4.8%	10.3%	$572,437	$670,062
17,000	Domino Pizza Enterpr	1.2%	20.0%	$196,330	$624,255
16,000	Flight Centre Travel	4.4%	20.0%	$735,253	$577,224
55,000	Super Ret Rep Ltd	4.0%	16.0%	$590,790	$541,396
36,278	ARB Corporation	2.3%	10.1%	$419,543	$548,216
17,000	Woolworths	5.1%	5.8%	$594,408	$505,365
10,221	Wesfarmers	4.5%	5.4%	$427,783	$439,564
100,000	My Net Fone	1.3%	76.7%	$222,518	$389,143
	Subtotal			$4,807,198	$5,705,371
	Others			$2,015,282	$2,326,495
	Total			$6,822,480	$8,031,867

(1) The dividend yield assumes that the shares were held for a full 12 months.
(2) The Total Outlay is the total amount paid for the position in each company starting in March 2013 up to the end of June 2014 less any capital returns because of sales.
(3) The Value column includes receipts from cash dividends over the lives of the holdings. The dividends do not include franking credits.

The average dividend yield for these companies is 3.1 percent. Over the last six months we have taken what opportunities we can to build the holdings of our core 10 businesses. In time we anticipate capital and dividend growth through the increases in earnings.

War Chest

As at the end of June 2015 we held 4.57 percent of our portfolio in cash. While the returns on cash are low, we view this as a war chest we have ready to deploy the moment Mr Market falls out of love with one of our favourite companies – as we can expect to happen from time to time. While this may cause other investors to panic, we're overjoyed when we see great businesses sold down to bargain prices. Your Capital Investment Team stands ready to act quickly to deploy cash when Mr Market obliges. We are also looking for the right opportunities to invest in Teaminvest Private Companies.

Conscious Investor® and the Teaminvest Methodology

The investment process used by the Capital Allocation Team 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 a 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. Wherever possible the Capital Allocation Team scores the areas to increase the precision of the decision process.

- How does the company make money? What is the business of the company? Who are its customers?
- Investments should be like castles with deep moats: What are unique features of the business that separate it from its competitors? These "economic moats" are scored in terms of depth 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. The Capital Allocation Team scores remuneration in terms of clarity, alignment and quantum.

The Capital Allocation Team prepared this report 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:

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