Conscious Investor® Fund
Interim Letter to Members: December 2019

Dear Fellow Fund Member:

Welcome to this interim letter. Deliberately brief, it an opportunity to touch base with you through covering several topics that we think will interest you. The first topic is based on the surprising fact that only a few percent of listed companies make it through to being a long-term prosperous business.

These are the companies we home in on for you through our time-proven approach. Otherwise, as these statistics show, it is hard to avoid companies that will fall by the wayside. We want Wealth Winners® while avoiding Capital Killers™.

The topic on performance contains a chart showing that growth of investments held by members of the Fund for the past five years grew by an average of 14.4% per year. This means an investment of $500,000 would now be worth almost $1 million after expenses and assuming dividends are reinvested.

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Hidden Benefits of Investing in the Conscious Investor Fund

There are two sides in choosing investments for the Conscious Investor Fund. The one that is top of mind for most people is what companies do you invest in? This means how does the Capital Allocation Team go about identifying Wealth Winners®. Over the years we have regularly discussed the methods in these letters as well as in the Information Memorandum.

The other side is avoiding Capital Killers™. This does not get the same publicity, though in the long run is probably more important. Capital Killers are those companies that can have sudden drops in their performance as businesses. Often liquidating or going bankrupt. As a consequence, their prices drop precipitously destroying the capital of shareholders.

High profile examples of liquidations are Qintex (financial services, traded as ASX:QNT, collapsed 1991), HIH (insurance, traded as ASX:HIH, liquidation 2001), ABC Learning (early childhood education, traded as ASX:ABS, liquidation 2008), Babcock & Brown (investment and advisory, traded as ASX:BNB, liquidation 2009), Allco (financial services, traded as ASX:AFG, liquidation 2008), MFS (diversified investment (renamed Octaviar), ASX:OCV, liquidation 2009) and Timbercorp (managed investment scheme in agriculture, ASX:TIM, liquidation 2009).

Others may not have gone bankrupt, but they took actions that badly affected them for years to come. MMA Offshore (formerly Mermaid Marine) is a good example. MMA overstretched itself financially and operationally in 2014 by buying the Indonesian company Jaya Holdings. As it tried to integrate this purchase almost immediately it started losing money resulting in a drop in price from over $3.00 to 15-20 cents today.

These are all well-known collapses. They are only the tip of the iceberg, though. Recently Ashley Owen in his article *99% of Listed Companies Disappear Worthless* estimated that 37,000 companies have listed on an Australian stock exchange since the early 1800s. Of these, only 580 are listed today and are profitable. This is less than 2%. The following chart outlines what happened to them.

Even considering the roughly 2,300 companies listed today, as the chart shows, only 470 are profitable and paying dividends and 110 are profitable, although without dividends.

Turning to the Conscious Investor Fund, we have avoided investing in Capital Killers since it was formed and the likelihood of putting any Capital Killers into the Fund is minimal. This is because it uses the filters from Conscious Investor as a starting point. Companies selected must be, at least, profitable, have reasonable (or no) debt and indicators that earnings will continue growing.

This is one of the hidden benefits of investing in the Conscious Investor Fund: peace of mind by avoiding the prevalence of Capital Killers. Another way we take very seriously the stewardship of investing your precious capital.

World's Best Performing CEOs in the Fund

Each year Harvard Business Review provides a list of who they believe are the best performing CEOs in the world. They take into account financial performance as well as environmental, social, and governance (ESG) ratings.

I am pleased to report that five of the CEOs chosen by Harvard run companies we already held in the Fund. They are: Paul Perreault (CSL), Ajay Banga (Mastercard), Mark Parker (Nike), Tim Cook (Apple) and Alfred Kelly Jr. (Visa).

We don't regard it as accidental that we had already chosen to invest your capital in companies run by such outstanding CEOs. Looking at management of companies is part of our selection process for choosing companies for our Fund.

The following table shows the 12-month total return and the 12-month dollar contribution for these companies including grossed-up franked dividends and foreign exchange gains where applicable. Of course, 12 months is too short a time to evaluate properly the performance of a company. Also, the CEOs were chosen in part based on price performance, so it follows that companies in this list will all have high return over the past 12 months. Just the same, it is pleasing to see just how strong the performance was.

More importantly, though, is how well earnings per share have been growing and whether there are clear signs for this to continue. So I have included the growth of EPS over the past five years for these companies and the stability of this growth measured by the proprietary tool STAEGR®. The higher the STAEGR (its maximum is 100%), the more confidence we can have in the growth continuing.

Company	EPS Growth 5 Years	STAEGR 5 Years	Total 12-Month Return	Contribution
CSL	15.4%	88.5%	54.7%	$926,417
Mastercard	13.7%	93.4%	64.4%	$1,126,284
Nike	5.1%	77.3%	34.9%	$662,823
Apple	12.0%	90.0%	98.7%	$1,036,971
Visa	19.6%	88.5%	46.5%	$748,405

Of course, sometimes short-term performance can let us down. The biggest loss for the Fund in terms of return and dollar contribution over the past 12 months was Blackmores: down -23.1% for the year with a loss of $708,575. Certainly not the sole reason for this loss, but a mitigating factor would be the numerous recent changes of the CEO for Blackmores. The company had Christine Holgate as CEO until October 2017. Richard Henfrey was next but was quickly replaced by Marcus Blackmore, chairman, largest shareholder and son of the founder, as an interim CEO. The incumbent is Alastair Symington who, according to Marcus Blackmore, has strong business acumen, passion for natural health and was "the perfect choice" to be CEO. With this appointment it looks like everything is in place so that, over time, Blackmores will return to its former levels of success.

Berkshire's MidAmerican Investing in Wind Energy

Our largest holding in the Fund is currently Berkshire Hathaway. So we are particularly interested in what it is doing. MidAmerican, a fully-owned Berkshire subsidiary, has been investing in renewable energy since the early 2000s. It plans to be the first investor-owned electric utility in the USA to generate renewable energy equal to 100% of its Iowa customers' retail use on an annual basis. So far it has invested approximately US$9.9 billion in wind projects, creating construction and permanent jobs across the state. And, as always, Buffett only invests in companies where he is confident returns will be highly attractive.

Warren Buffett has been quoted as saying that he wants to make Iowa 'the Saudi Arabia of wind'.

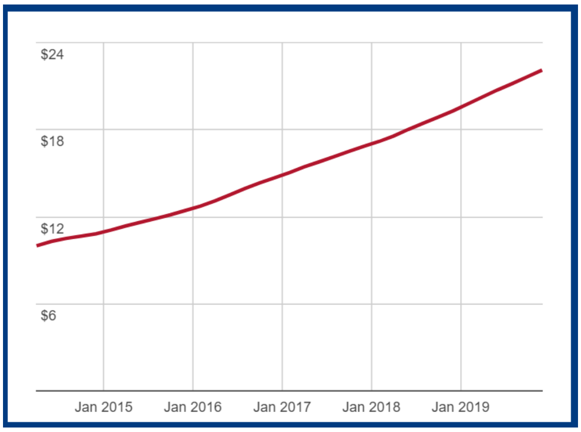
Another Berkshire subsidiary, BHE Canada, is planning to build a large wind farm in Canada.

Earnings During 2019

During 2019 the weighted average of the growth of earnings per share for the companies in the Fund grew by 14.6%. Over time, provided this growth is maintained, this should translate into healthy growth of dividends and share price.

The adjacent chart shows the month-by-month growth of the average earnings per share for companies in the Fund to December 2019.

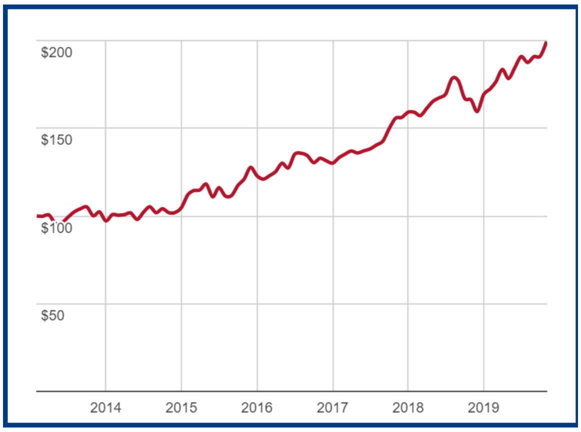
Return on equity is also vital. In 2019, managers of the companies in our portfolio earned for their companies an average of 22.8% on the equity in their companies. This, too, augurs well for strong growth of their share prices over time.



Performance

As expected from the previous chart for the growth of EPS, members of the Fund will notice similar growth in the net asset value of their holdings. The adjacent chart shows the growth of $100 after all fees since the inception of the Fund in February 2013. Over the past five years it has averaged 14.4% per year.

Notice how the upward trends of the two charts strongly match each other.



Conscious Investor® and the Teaminvest Methodology

The starting point is our investment software, Conscious Investor®. It filters and analyses companies listed in markets around the world 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 margins-of-safety calculations in Conscious Investor based on stress testing the investment assumptions.

Once this is done, the Teaminvest Methodology takes centre stage and focuses on the following five areas. Whenever possible the Capital Allocation Team scores these areas to increase the precision of the decision process.

1. How does the company make money? Is the business expected to grow? Are there clear signs it will have a growing customer base?
2. 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.
3. 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 occur.
4. Does the company have a clear mission statement or noble purpose? Is there strong evidence that the company uses it to guide its decisions, appointments, acquisitions and remuneration policy?
5. Is management honest, open and rational? As part of examining the business, evaluation is made of the board and senior management: are there any signs that they are not 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 final steps involve calculating buy and sell prices, and the checklist. You can find details in the Information Memorandum together with all our processes that ensure we are investing in Wealth Winners and making it extremely unlikely of putting any of your capital in potential Capital Killers.

We hope you enjoyed reading this Letter. We chose the topics to help you better understand our philosophy and what motivates us in choosing investments for your money. Please let us know if there are any other topics you would like us to include.

It is always our aim to be outstanding stewards of your precious capital you have entrusted with us.

We wish you the very best health and well-being for 2020,

Kind regards,

(John Price and the Capital Allocation Team)

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: cifund@consciouscapital.com.au

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