Conscious Investor® Fund
Annual Letter to Members: 2019 - 2020

Dear Fellow Members of our Conscious Investor Fund:

Welcome to our annual 2019-2020 letter. We hope you enjoy it and find it useful.

Most importantly, we hope you and your family are well and keeping safe in these challenging times.

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Introduction

Over the past few weeks I made a number of attempts to write an introduction for this newsletter. I kept thinking that I needed to say something wise or profound about the state of the world at the moment, particularly as to the effect of the COVID-19 pandemic. But what could I say that hasn't already been said hourly on TV and in our newspapers?

Then I thought: "What would I want to hear about my investments in the Fund?"

I would want to hear that:

- the principles that the Fund was founded on still hold (they do: see the section below Conscious Investor and Teaminvest Methodology),
- the Fund is not doing anything to give a sugar-hit to performance (it doesn't: no leverage, no shirt-term trading to artificially effect the unit price),
- the Fund has sufficient cash to meet any sudden needs or take advantage of particularly appealing opportunities (it has: and did make some attractive purchases in the first half of the year during the market turbulence), and

- the Fund will make no purchases simply because the stock price is “hot” (all companies must pass Conscious Investor and close scrutiny by the Capital Allocation Team).

Warren Buffett has already said clearly what we believe to be true:

“We're thinking — we want to be in the business that 10 years from now is earning a whole lot more money than it is now, and that we will still feel good about the prospects of the business at that time. That's the kind of business … we try and buy part of."

This is our aim, too.

Next I would want to hear that this approach has been successful. This you can see explained in the next section from the perspectives of safety, earnings growth and growth of the dollar value. For now, I will only say that over the past five years the Fund has outperformed the market by 6.52% per year.

Performance: Safety, Earnings and Net Asset Value

We use three indicators for long-term performance. The first is safety: protecting your precious capital is paramount. The second is earnings: we want to see the steady growth of weighted earnings per share, the main driver of dollar performance over all the holdings. Finally, we look at the dollar growth of actual investments in your Fund. As I just wrote, you will see that the dollar growth outperformed the accumulation index by an average of 6.52% per year over the past five years.

1. Safety: Protecting your capital: peace of mind

Over the long-term the Australian market trends upwards. There are times, however, when average market returns are negative. One of the aims of the Capital Allocation Team is to ensure that when this happens, the effect on the Fund portfolio will be minimal.

Looking at rolling three-month periods starting each month since our Fund’s inception, the S&P/ASX 200 Accumulation Index lost money 9 times out of a possible 29. However, in 70% of those times, Fund members lost less money or actually made money. On average the Fund outperformed the Index by 3.6% over those adverse quarters.

Recently, over the 12 months to June 2020, the ASX / 200 accumulation index dropped by -7.7%. Over the same period the Fund increased, growing by 8.1%, an outperformance of 15.8%.

We feel pleased with this result and hope you are, too.

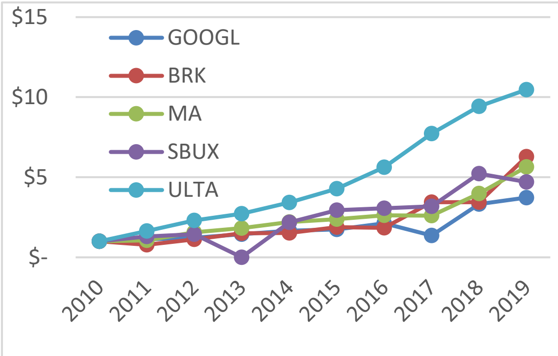
2. Performance: Growing the Earnings

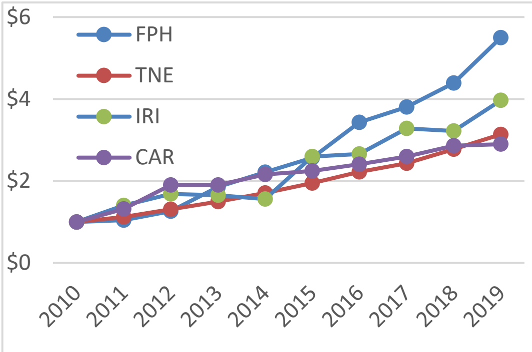
We focus our Fund on great companies that have strong and consistent growth in their earnings per share (EPS) with all the signs that this growth will continue in the future. A stated purpose of our Fund is growth with peace of mind.

Sometimes this growth in earnings will outstrip the share prices of the companies. In this case the performance may not look appealing in the short-term. Other times, the share prices will outstrip the growth of the earnings making the performance look better in the short-term.

Whichever the case, in the long term the growth of earnings will drive the share price.

The following two charts show the growth of EPS for major companies in the Fund. The first chart covers five major US investments: Alphabet, Berkshire Hathaway, Mastercard, Starbucks and Ulta Beauty. The second chart covers four major Australian investments: Fisher & Paykel, Technology One, Integrated Research and Carsales. In both cases the data is normalised to a common scale for easier comparison between companies.



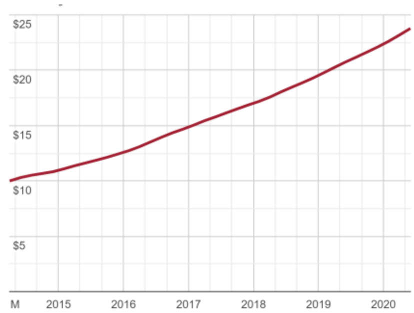


EPS: Major US Investments

EPS: Major Australian Invretments

For the Fund, we need to arrive at a single EPS figure over all companies.

This single EPS figure is a weighted average of the EPS for the individual companies. The adjacent chart shows the growth of this EPS since the Fund's inception in April 2014 assuming an initial level of $10.00. By June 2020 this had grown to $23.78, an average annual growth of 15.5%.



The stability of the growth of weighted average EPS is due to the selection criterion of stable growth of earnings. This is achieved using proprietary tools in the Conscious Investor software.

Over time this clear upward trajectory of earnings should convert into satisfactory performance of our Fund.

3. Growth of Net Asset Value

Despite the impact of the pandemic due to the COVID-19 virus, the return of the Conscious Investor Fund for the recent financial year 2019-2020 was 8.08% (after all expenses such as performance fees and transaction costs). By comparison, the market was down -7.68% over the same period—an outperformance of 15.76%. The following table shows the performance over longer periods since the inception of the Fund until 30 June 2020.

Period	12 Months	3 Years (p.a.)	5 Years (p.a.)	Since inception	Compound annual return
Conscious Investor Fund	8.08%	13.33%	12.47%	99.59%	9.88%
S&P/ASX 200 Accumulation Index	-7.68%	5.19%	5.95%	58.02%	6.44%

The adjacent chart shows the growth of the dollar value of an actual investment in our Fund since April 2014 after any success fees and assuming distributions (if any) are reinvested. Over this time, an investment of $100 grew to $199.59. This is a total growth of 99.59%, an average of 9.88% per year. In contrast, an investment in the S&P/ASX 200 accumulation index would have grown to $158.02, an average of 6.44% per year, over the same period.

Our patient investment philosophy has delivered consistent wealth creation.

Contributors to Performance

The performance of individual companies in our Fund is important. Their real importance becomes apparent when we know how much of each company is held by the Fund.

For this reason, we consider the absolute contribution as measured by the dollar amount contributed to the portfolio over the year.

It is only over time that the share price can begin to reflect the value of the underlying businesses.

Over the 2019-2020 financial year the largest contributor was Fisher & Paykel. The company boomed during the first half of 2020 because of demand for its respiratory hospital products and supplies—leading the company to work extra shifts to meet the needs. This may not continue as strongly into the future.

The next largest contributors were Mineral Resources, Apple and Alphabet (Google). Another sizeable contributor was a newish addition to the Fund, Tractor Supply Company.

The largest detractors were Ulta Beauty, Corporate Travel and NIB Holdings.

There can be large variations of performance of companies in the same sector. Consider Ulta Beauty and Tractor Supply company. Ulta Beauty operates almost 1,200 stores in all states of the US focussing on, as they say, “all things beauty”: cosmetics, skin care, fragrances, hair salons, and so on. Tractor Supply company operates almost 2,000 stores across the US with a focus on products to care for home, land, pets and animals in rural and semi-rural areas.

These two companies have similarities (retail industry, large number of stores across the US, focus on a particular segment of the population, both implemented curb-side pickup). Yet the effect of the COVID-19 pandemic on them has been quite different.

Tractor Supply was considered an essential service, keeping its stores open during this pandemic. Net sales for the second quarter 2020 increased 35.0% to $3.18 billion from $2.35 billion in the second quarter of 2019. In addition, the Company’s e-commerce sales experienced triple-digit sales growth.

Ulta Beauty had to close a large proportion of their stores and have only recently reopened them. We don’t yet have results for the second quarter, but for the first quarter, net sales decreased 32.7% to $1,173.2 million compared to $1,743.0 million in the first quarter of fiscal 2019 due to the impact of COVID-19.

Both are great companies that we are pleased to have them in the Fund. Yet the pandemic has affected them quite differently in the short-term.

Buying for the Long-Term

The following chart provides a reminder that there are always reasons to sell. Yet staying in for the long-term is almost always the best choice. Over time, great businesses continue to spin of huge amounts of wealth.

Though the chart is for the US market, similar outcomes would likely be seen in the Australian market.

"Invest at the point of maximum pessimism. That is the time to be most optimistic." That adage belongs to John Templeton, one of the greatest investors of the 20th century.

Founder Led Companies

No one knows a business better than the founder. For this reason, the Capital Allocation Team particularly loves companies that are led by their founders. These companies generally exhibit more purpose and drive, and hence become more profitable.

By a founder-led company we mean companies where the founder is still the CEO or occupies some other senior executive role (such as Technology One and Flight Centre). We also include companies where the founder is on the board (such as Super Retail Group). Finally we include companies where the founder has set up structures, usually with appropriate mission and vision statements, so that the company still follows the original principles (such as Blackmores and Ramsay Health Care).

These companies represent the life's work of the founder. Their advantages include attributes such as:

- Clear understanding of the role of the company in its industry
- Clear vision of its future
- Longer term view
- Willingness to make tough decisions for the future of the business
- Passionate about the future success of the business
- CEO and/or the board less likely to get side-tracked in making short-term decisions

- Spend money as if it is their own (much of it often is)
- Less likely to set up remuneration structures that reward short-term share price gains as opposed to long-term genuine wealth creation
- Founders are likely to be large shareholders so will make decisions that will benefit themselves and thereby the shareholders

A key example of frugality of a company founder is Sam Walton, the founder of Wal-Mart, who visited his stores in an old pick-up truck. He said: "I just don't believe a big showy lifestyle is appropriate." He made sure business expenses related were kept to a minimum.

Consider TechnologyOne. The company was founded by Adrian Di Marco in 1987, after extensive experience in the software industry.

For 30 years he was the CEO, responsible for all operational aspects of the company. Now he is the Executive Chairman and Chief Innovation Officer enabling him to spend more time on strategy, innovation and creativity to ensure the company continues to build future platforms for strong growth. He holds approximately 27 million shares, around 8.5% of the total shares outstanding.

Since May 2017 the company has been led on a day to day basis by Edward Chung. But he is not a hired gun from the outside. Before his appointment as CEO, he had more than 10 years in senior executive roles at the company. These included one and a half years as the company's Chief Operations Officer. From 2014, Edward headed up TechnologyOne's products and solutions division, including R&D where he led the team that transitioned the business into a fully SaaS-based organisation. Prior to that he led the finance and corporate services division and developed the commercial frameworks to drive the company's expansion.

From the perspective of the Fund, we can see how this plays out in business success. In 2006 earnings per share were 4.1 cents. Over the last financial year they were 18.2cents. This is a growth of 344%, an average of approximately 11.2% per year. When you add in a dividend yield that is often close to 3.0% it is easy to see why we choose to have this founder-led company as one of the top ten holdings in the Fund.

Stop Press: Apple—New Top-Ten Holding

A few days ago Apple reported an 18% increase in quarterly earnings per share. This boosted the share price by 14.7% making Apple one of the top-ten holdings in the Fund.

Most importantly, though, is how this growth was achieved.

Tim Cook, Apple's CEO, explained: "Apple's record June quarter was driven by double-digit growth in both Products and Services and growth in each of our geographic segments. In uncertain times, this performance is a testament to the important role our products play in our customers' lives and to Apple's relentless innovation."

Sales for Apple products increased by 9.8% over the corresponding quarter 12 months ago. It is more pleasing to see sales for services increased by a larger amount, 14.8%. These are the areas of the App Store, Apple Music, Apple Pay and iCloud. This is a source of revenue, and revenue growth, that is easier to maintain than continually developing innovations and new products.

The Fund first purchased 200 Apple shares in April 2016 for US$111.04 per share. We have been taking opportunities to top up ever since with the lowest price US$94.03 in the following month. Now the

Fund has 4,700 shares for a total value of approximately AU$2.8 million. We also have a sizeable position in Apple through our large holding in Berkshire Hathaway.

With its commitment "to making the best products on earth, and to leaving the world better than we found it", Apple is a great fit in the Conscious Investor fund.

Stop-Press 2: Berkshire Hathaway 2nd Quarter Report

For the 2nd quarter in 2020 Berkshire Hathaway had almost $US30 billion in year-on-year investment gains which meant its net income grew 86% to US$26.3 billion from the same quarter in 2019.

Berkshire also repurchased US$5 billion of its stock. In addition, its cash pile ballooned by about US$10 billion to US$147 billion, leaving ample opportunity for Warren Buffett to make further Wealth Winner acquisitions or purchases.

Berkshire Hathaway Holdings

Berkshire Hathaway BH is one the largest Fund holding in our Fund. In its share portfolio BH holds 52 different companies. By far the largest weighting is Apple making up 42% of the share portfolio. Banks also make up a sizeable proportion of the largest holdings.

The following is a table of the twenty largest holdings of Berkshire Hathaway with their industries, dollar values and weightings. (The amounts in this table and the subsequent comments are in US dollars.)

You could say that we indirectly hold these companies in our Fund on your behalf.

	Company	Symbol	Value (millions)	Stake
1	Apple Inc.	AAPL	$95,369	5.80%
2	Bank of America Corp	BAC	$25,222	11.50%
3	Coca-Cola Co	KO	$19,208	9.30%
4	American Express Company	AXP	$14,659	18.80%
5	Kraft Heinz Co	KHC	$11,583	26.70%
6	Wells Fargo & Co	WFC	$8,912	8.40%
7	Moody's Corporation	MCO	$7,188	13.20%
8	JPMorgan Chase & Co.	JPM	$5,753	1.90%
9	U.S. Bancorp	USB	$5,641	9.90%
10	Davita Inc	DVA	$3,478	31.30%
11	Bank of New York Mellon Corp	BK	$3,204	10.00%
12	Charter Communications Inc	CHTR	$3,074	2.60%
13	Verisign, Inc.	VRSN	$2,675	11.10%
14	Visa Inc	V	$2,097	0.50%
15	General Motors Company	GM	$1,933	5.20%
16	Amazon.com, Inc.	AMZN	$1,618	0.10%
17	Mastercard Inc	MA	$1,526	0.50%
18	Liberty Sirius XM Group	LSXMK	$1,494	21.30%
19	Costco Wholesale Corporation	COST	$1,413	1.00%
20	PNC Financial Services Group Inc	PNC	$1,002	2.20%
		Total	$225,983	

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 filter stage zeros 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 identifies those companies for which these attributes are likely to continue. Finally, the return stage calculates the maximum price to pay to be confident about getting the required rate of return over the long term. Conscious Investor uses automatic margins-of-safety calculations to stress test the investment assumptions.

Once this is done, the Teaminvest Methodology focuses on the following five areas and 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 potentially weaken 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 these to guide its direction, decisions 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? The Capital Allocation Team scores the remuneration structures for the CEO and senior management in terms of clarity, alignment and quantum.

The final steps involve calculating buy and sell prices. You can find more details in the Information Memorandum together with our processes we use to invest in Wealth Winners while 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.

We aim to be outstanding stewards of your precious capital you have entrusted with us.

Wishing you the very best health and well-being.

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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