Conscious Investor® Fund
Annual Letter to Members: 2021 - 2022

Noble Purpose:	Focussing on growth of wealth with peace of mind for Members and their families.
Mission:	The Capital Allocation Team does this with consciousness and stewardship, making use of unique and proprietary software and processes to identify the most likely Wealth Winners® while avoiding potential Capital Killers.
Vision:	That our Members view the Fund as a fundamental part of the growth and preservation of wealth, for themselves and their families, to live the lifestyle they choose while investing in companies that add value to society.
Cultural Values	1. We stay true to the philosophies and methodology of Teaminvest and Conscious Investor®—centred around long-term growth of earnings per share—to maximise long-term capital growth for our Members. 2. We recognise Members and their families have faith in us, by investing their money in the Fund. 3. We support our Members by being responsive to their questions and by providing regular reports explaining the principles of how and where we invest their money. 4. We emphasise that we only make money as managers when our Members make money, and not simply by having funds under management irrespective of performance.

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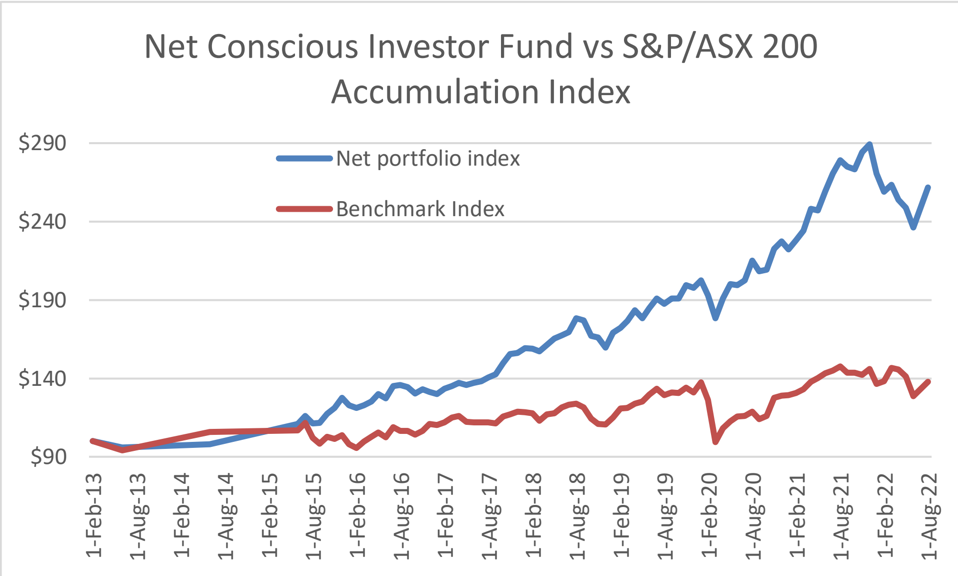
Dear Fellow Members of our Conscious Investor Fund:

Welcome to our annual 2021-2022 letter. We hope you enjoy it and find it useful. Before getting started, we hope you and your family are well and keeping safe in these challenging times.

In the process of setting up the Fund we spent two years of regular meetings working out what we wanted in the Fund and what we wanted to achieve with it. We did not want it to be just another fund chasing more funds under management to generate fees. We wanted it to satisfy a higher purpose.

Recently we spent time revisiting these early discussions giving rise to the Noble Purpose, Mission, Vision and Cultural Values above. Let us know if you have any comments.

The next chart tracks the net performance of the Fund since inception assuming an initial investment of $100 compared to the S&P/ASX 200 accumulation index.



Our Two Loves: Wealth Winners® and Bargains

As custodians of your investments in the Conscious Investor® Fund, we have two loves: finding Wealth Winners® and identifying bargains. Even though they both support each other, they are really two sides of the same coin. Let's see why.

The fundamental link between Wealth Winners® and bargains is supplied by the formula:

Price = EPS X P/E Ratio

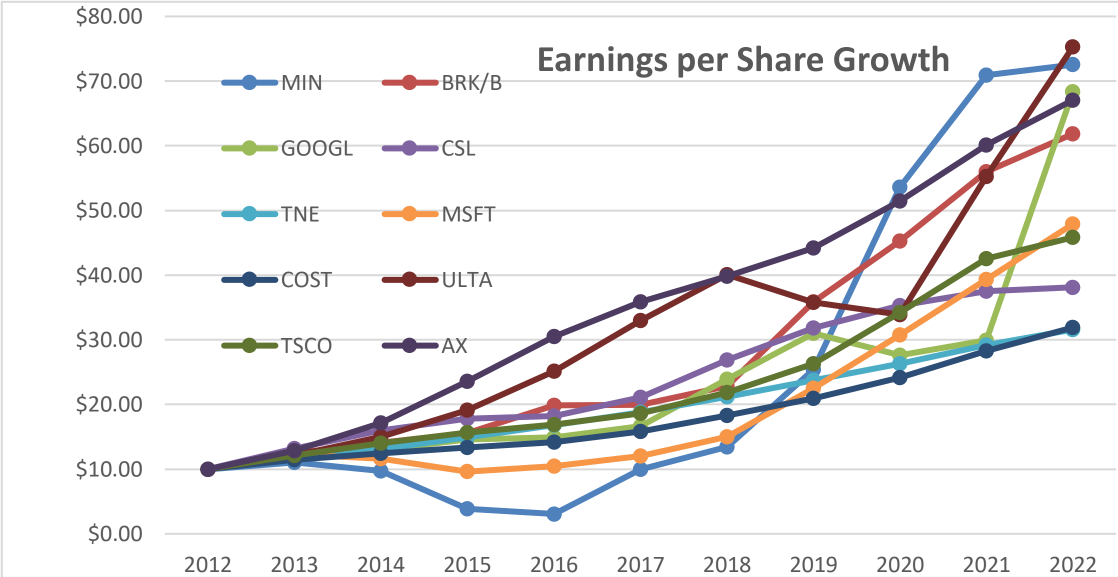
where EPS is earnings per share and P/E Ratio is the ratio of price divided by EPS. (Call this the Conscious Investor® Price Formula or the CIP Formula.) So, for the price to rise, we must have a rise in EPS or the P/E ratio (or both).

This gives us two areas of focus: our primary focus is finding companies in which we can be confident that EPS will be materially higher five and ten years from now. (By materially higher we mean after allowing for inflation.) We call these companies Wealth Winners®. And our secondary focus is on Wealth Winners® with P/Es that have room to grow. These are our bargains.

Wealth Winners®

To identify these Wealth Winners®, we look at features such as high and stable growth in EPS, strong and durable economic moats, consistent and high return on equity (ROE), remuneration incentives that align with investor goals, not too much debt and limited risks.

These are the main requirements for making Fund purchases. This is why we are confident in the continuing growth of EPS. The following chart, which we emailed in June, shows this clearly for the largest ten companies in the Fund.



Wealth Winners®, occupying the EPS growth component of the CIP formula, form the basis of the activity of the Capital Allocation Team: finding them and carefully monitoring them is the foundation of the Fund's performance and the way it outperforms the market over the long-term. But it doesn't preclude share prices bouncing around in the short term.

Wealth Winners® at Bargain Prices

The CIP formula splits the share price into two components. Over time EPS is reported and changed at most every six months in Australia and every three months in the US. Moreover, since the holdings of the Fund are all Wealth Winners, this fluctuation is often not more than an upward trend. Hence the EPS part of the price is usually quite steady with an upward trend. The bargain part of purchases comes from the P/E ratio.

Fluctuations in Prices Come from P/E Ratios

In contrast to EPS, the P/E Ratio jumps around minute by minute. Traders and investors with a short-term mentality invent all sorts of reasons to explain these movements. This is futile. Studies show that short-term price movements are mostly random.

What is not futile, though, is to use Conscious Investor® to calculate prices for the Fund investments at particularly attractive prices. In this way volatility and randomness become our friend.

"Whether we're talking about socks or stocks," Buffett wrote in the 2008 Annual Report, "I like buying quality merchandise when it is marked down." So do we.

Let's see some examples.

Topping up our Wealth Winners®

Overall, there have been large drops across markets around the world during the first half of 2022, a splendid buying opportunity for the Capital Allocation Team to top up our Wealth Winners®.

The following table shows some of this buying activity. Each row shows a specific purchase. After the symbol and company name, the next column shows the highest price for the company over the past 12 months. The next column shows the price we paid in the last purchase, provided it was made in the most recent 6 months. Finally, the last column shows the current price.

For example, the table shows that CSL was purchased for $264.86, a discount of 17.17% below the highest price of $319.78 for the last 12 months. Taking the average over the eight companies, the average discount paid was 26.85%. (For simplicity these purchases were stated in dollar terms. But the actual purchase decisions were based on margins-of-safety calculation within Conscious Investor® involving P/E Ratios.)

Since the purchase of CSL, the price has increased by 12.04% to $296.75. The average increase in price was 10.69%.

Symbol	Company	Highest Price Last 12 Months	Last Purchase by Fund	Current Price
CSL	CSL	$319.78	$264.86	$296.75
FPH	Fisher & Paykel	$33.01	$18.45	$19.43
TNE	Technology One	$13.60	$9.98	$12.30
AMZN	Amazon	$188.65	$120.65	$139.52
BRK.B	Berkshire Hathaway	$362.10	$299.95	$294.96
COST	Costco	$612.27	$426.00	$547.01
GOOGL	Alphabet	$151.55	$116.62	$118.08
MSFT	Microsoft	$349.67	$278.90	$282.47
Average discount of top-up purchase price			26.85%	
Average price increase since purchase				10.69%

The Fund Contribution to the Wealth of its Members

Putting together Wealth Winners® and attractive purchase prices, preferably bargain prices, we get the overall performance. How much a purchase contributes to the Fund's performance depends on the performance of the individual shares in the company held by the Fund and the size of the holding.

Below we list in alphabetic order the contribution of the ten largest holdings in the Fund, plus the contribution of the remaining holdings, including cash, since inception. Overall, the Fund has bought a net amount of $87,479,222 of shares. These shares are now worth $119,555,790 including dividends and foreign exchange gains. This means the Fund has added over $30 million in value for you, its Members.

Shares	Market	Name	Cost (AUD)[1]	Market (AUD)	Capital Gain
2600	NASDAQ	Alphabet Inc	$5,171,436	$8,555,241	$3,383,805
19865	NYSE	Berkshire Hathaway[2]	$5,715,398	$8,142,488	$2,427,090
8850	NASDAQ	Costco Wholesale	$3,142,152	$6,812,052	$3,669,900
25468	ASX	CSL Limited	$5,202,170	$7,621,299	$2,419,129
17400	NASDAQ	Microsoft Corporation	$7,135,936	$6,574,814	-$561,122
190000	ASX	Mineral Resources.	$2,238,752	$8,242,200	$6,003,448
687884	ASX	NIB Holdings Limited	$3,646,274	$5,221,040	$1,574,766
641000	ASX	Technology One	$3,923,732	$7,384,320	$3,460,588
18500	NASDAQ	Tractor Supply Co.	$2,984,011	$5,533,118	$2,549,107
10100	NASDAQ	Ulta Beauty Inc	$3,682,528	$5,905,394	$2,222,866
	Remaining Holdings		$44,636,833	$49,563,823	$7,447,667
	Total		$87,479,222	$119,555,790	$34,597,245

Notes:

1. These are the actual total purchase prices
2. Each Class A Berkshire Hathaway share is converted to 1,500 Class B shares.

Berkshire Hathaway and Energy

One of the major components of Berkshire Hathaway is energy. In the recent Annual Report, Warren Buffett stated:

"Berkshire Hathaway Energy (BHE), our final Giant, earned a record $4 billion in 2021. That's up more than 30-fold from the *$122 million e*arned in 2000, the year that Berkshire first purchased a BHE stake. Now, Berkshire owns 91.1% of the company.

BHE's record of societal accomplishment is as remarkable as its financial performance. The company had n*o* wind or solar generation in 2000. It was then regarded simply as a relatively new and minor participant in the huge electric utility industry. Subsequently, … BHE has become a utility powerhouse (no groaning, please) and a leading force in wind, solar and transmission throughout much of the United States."

One of the components of BHE is MidAmerican Energy which is planning a $3.9 billion renewables project in Iowa.

Berkshire Hathaway has recently invested in renewable energy in Australia with the purchase of two operating solar farms in New South Wales, and in a deal to co-develop a multi-gigawatt pipeline of solar and battery storage projects.

The two projects are the 150MW (ac) Suntop solar farm (near Wellington in NSW) and the 105MW (ac) Gunnedah solar farm, which have been bought from Canadian Solar by CalEnergy Resources Australia, a subsidiary of Northern Powergrid, which is in turn is owned by BHE.

Cloud Computing

The press is full of references to cloud computing. You will be pleased to know that your companies are well represented in this area in terms of users and IT infrastructure.

For an Australian user of cloud computing, it is hard to go past Technology One (TNE), one of our largest holdings. TNE provides a completely scalable cloud solution for a massive range of applications making life simple for their customers.

The Fund is also well represented in the service side of cloud computing through Alphabet, Amazon and Microsoft representing 7.1%, 3.3% and 5.6% respectively of the Fund.

Google Cloud revenue grew by almost 45% to US$5.5 billion for the 4th quarter 2021 from the same period the year prior.

Amazon's Web Services' (AWS) revenue rose by over 36% year on year in its first quarter.

To top it off, Microsoft's Azure delivered a 46% year on year increase in revenue.

Buffett, Inflation and the Red Queen

Inflation is not new. It comes around periodically as we experience now. As usual, Buffett had worked out long ago, and described, the best way to deal with it.

Back in the 1981 Annual Report he wrote that businesses that can best fight inflation possess two characteristics:

(1) An ability to increase prices rather easily (even when product demand is flat and capacity is not fully utilized) without fear of significant loss of either market share or unit volume, and
(2) An ability to accommodate large dollar volume increases in business (often produced more by inflation than by real growth) with only minor additional investment of capital.

These principles also guide the activity of the Capital Allocation Team, whether we are in an inflationary period or not. Every one of our investments is tested against these criteria.

The ability to increase prices is crucial for a company to be a long-term Wealth Winner® and is based on the strength and durability of its economic moats, something we evaluate carefully. Secondly, we are wary of companies with a tendency to take on too much debt, particularly if they are in an industry where operations are dependent on large dollops of capital to maintain profitability. This is much like Lewis Carroll's Red Queen who had to run faster and harder just to stay in the same place.

Analysis of Costco

Costco Wholesale is one of our stellar investments. The first purchases were made in 2016 with prices in the range $142-$151. (All amounts are in US dollars.) The price is now approximately $550. Importantly, EPS has grown from $5.33 to $12.70 over this time. You can't get much better than that.

Charlie Munger has served as a director of the company since 1997. Recently he said: "I think Costco is going to be a big, powerful company as far ahead as you can see. And I think it deserves its success. I think it has a good culture and a good moral ethos. And so I wish everything else in America was working as well as Costco does. Think what a blessing that would be for us all." He also said it "is going to be an absolute titan on the internet, because it's got curated products that everybody trusts and huge purchasing power on a limited number of stocking units."

Whenever we get the opportunity, we add to our holdings.

What follows is why we are confident to invest some of your, and our, money in Costco.

Strategy: Costco provides low price quality household products sold through 815 mega-stores (which they refer to as warehouses) around the world: At August 29, 2021, Costco operated 815 warehouses worldwide: 564 in the United States (U.S.) located in 46 states, Washington, D.C., and Puerto Rico, 105 in Canada, 39 in Mexico, 30 in Japan, 29 in the United Kingdom (U.K.), 16 in Korea, 14 in Taiwan, 12 in

Australia, three in Spain, and one each in Iceland, France and China. They typically open 20-30 new stores per year.

The key distinguishing feature of Costco is that they charge a membership fee of approximately $60 per year. Moreover, basically all their profit each year comes from these fees. For example, in FY21 fees totalled US$3.35b while net income was $3.66b.

This remarkable fact means that they have almost no mark-up on what they sell apart from minimal overheads so Members feel confident that whatever they buy at Costco will not be available elsewhere for less.

The other key distinguishing feature of Costco is the length they go to make sure their overheads are as low as possible. For instance, whenever possible items on the floor are only handled once: they arrive at the warehouse on a pallet and this pallet is placed straight onto the floor using a forklift.

Another cost-saving feature is that they have only approx. 4,000 SKUs per warehouse, a fraction of what is carried at Wal-Mart. Instead of 20 or 30 brands and sizes of, say tissues, Costco will only have a single brand in a single (generally large) size.

Success Drivers: Costco have a formula for starting and running warehouses. Starting with the US and Canada, this formula has been shown to work in numerous other countries. There does not seem to be any impediment to rolling out more stores in their current countries and also adding more countries.

Costco generates more than US$1,100 in sales per square foot. In comparison, Wal-Mart generates roughly US$420 per square foot. Their philosophy is: Keep costs down and pass the savings on to members.

Adam Baines, the Costco Warehouse Manager for North Lakes in Queensland, explained that Costco was a “top-line” company. This meant doing everything possible to make sure they have top products at best prices so that they would continue driving sales. He also explained the philosophy of choosing staff that espouse the Costco approach: choose good people, give them good jobs, and pay them good money—then good things will happen.

Economic Moats: Costco's membership creates a unique “obligation" for people to keep coming back to justify their upfront costs. A second moat is that it is almost impossible for others to compete on price.

Key Future Risks: A key risk is that they fail to stock products that their members want and sales start to drop. A related risk is that they fail to sell inventory and have to discount it. Because of their tight margins, this can have a serious effect on net profit. Another risk is they fail to maintain membership growth and loyalty.

Dividend Yield 0.7% ROE 27.9% 5 Year Growth SPS 9.7% EPS 15.6%

• Market Cap: $232b • 5-yr Total Return: 27.3% pa

Conclusion: Costco is run exceptionally well with strong moats. It has significant opportunities for steady growth around the world for years to come.

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 weaken their operations. The identified risks 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. It also describes our processes to identify Wealth Winners® while making it extremely unlikely we would place any of your capital in potential Capital Killers.

We hope this letter will give help you better understand our philosophy and what motivates us in choosing investments for your money. Please let us know of any other topics you would like us to cover.

We aim to continue being 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 rest of the Capital Allocation Team: Howard Coleman, Stephen Harrison and Michael Stewart)

P.S. Doing nothing is often the best

I thought you might enjoy this study showing consequences of the inability of humans to “stand still”. In the paper *Action bias among elite soccer goalkeepers: The case of penalty kicks* published in the Journal of Economic Psychology (2007), the authors, Michael Bar-Eli, Ofer H. Azar and Galit Schein, analysed hundreds of penalty kicks in top football leagues and championships worldwide. They showed that goals were scored 80% of the time. While the ball went down the middle about a third of the time, goalies only stayed there 6% of the time.

The authors proposed the explanation that goalies don't want to risk looking silly by standing in the centre. They want to look like they were trying, so they will almost always dive to the left or the right. But if they stayed put more often, they would likely save far more goals.

The Capital Allocation Team understands this principle well. Unless we are very confident that a particular purchase or sale will add value to the Fund portfolio, we won't do anything. But over time, we will continue seeking out opportunities to build a portfolio of long-term Wealth Winners® for you.

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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