BLUE STAMP
COMPANY

5th September, 2014

2014 Financial Year

Performance Measures

2014

Following on from the anaemic half year result, the performance of the Trust continued to deteriorate, falling 10.80% over the year. A brief summary of the performance measures for the 2014 year are given below. A more detailed review is provided in the Manager's Report.

	Unit Price	Return
01-Jul-13	$1.7010	
30-Jun-14 before Perf. Fee	$1.5173	-10.80%
after Perf. Fee	$1.5173	-10.80%
after Distribution	$1.5173	

High Water Mark (unit price):

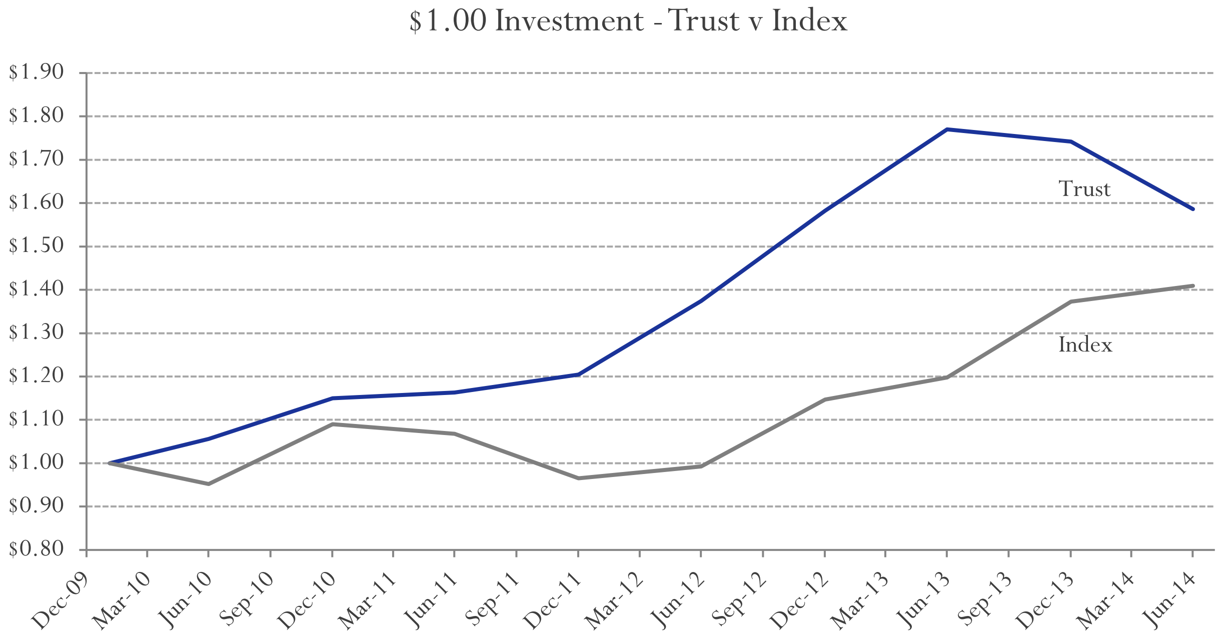
01-Jul-13	$1.7010
01-Jul-14	$1.7010

Historical

Below is a summary of the performance of the Trust (both before and after Performance Fees) against the preferred yardstick, being a 10% return. In this data, the return for the Benchmark in 2010 has been adjusted to reflect the part year of operation.

Year	Trust (pre PF)	Trust (post PF)	Benchmark	Variance
2010	7.21%	5.63%	3.18%	2.45%
2011	10.29%	10.14%	10.00%	0.14%
2012	27.01%	18.50%	10.00%	8.50%
2013	50.57%	30.36%	10.00%	20.36%
2014	-10.80%	-10.80%	10.00%	-20.80%

The following graph tracks the change in value of $1 invested in the Trust versus the All Ordinaries Accumulation Index (Index). This Index is used because it is the broadest measure of the Australian share market's performance whilst also including the effect of dividends, making it the most comparable to the Trust. The value of the investment in the Trust is after performance fees and includes any distributions which have been paid.

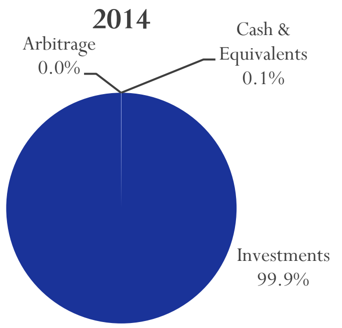


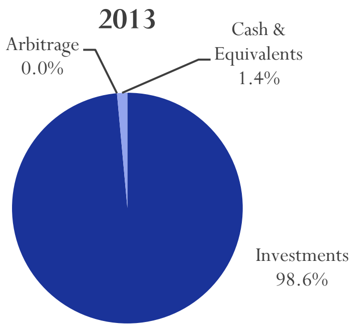
This next table shows the yearly return of the Trust (after performance fees and including physical distributions) against the yearly return of the Index.

Year	Trust	Index	Variance
2010	5.63%	-7.27%	12.90%
2011	10.14%	12.17%	-2.03%
2012	18.50%	-7.04%	25.55%
2013	30.36%	20.67%	9.68%
2014	-10.80%	17.64%	-28.44%

As mentioned in prior communication, viewing the return of the Trust against the Index should only act as a supplement in understanding the performance achieved in the prevailing climate. Instead, our main concern should be focused toward beating the 10% Benchmark by an acceptable margin. Obviously the 2014 result has come up well short on any measure. This is something I take complete responsibility over and will not seek to deflect attention by furnishing excuses. I will however discuss in more detail what drove the result, so as you may reach your own understanding as to my performance and the prospects of the Trust.

A breakdown of the Trust's assets at 30 June 2014 is shown below against the prior year. The main element comprising the Trust's assets was its holding of long term investments. Indeed, this structure was reflective of that experienced for much of the year.





Remuneration of Manager

Fee	Description	2014	2013
Performance Fee	Cash	-	-
	Units	-	$99,592.51
	Total	-	$99,592.51
Annual Fee	Eligible	$5,574.03	-
	Paid	-	-

Amounts shown include GST.

While the introduction of the 1% Annual Fee was unanimously agreed to by Unitholders during the year, in light of the performance of the Trust, the Manager did not consider it appropriate to take such payment. Accordingly, no amounts were paid for this Annual Fee during the year and no amounts forfeited will accrue and become payable in future years.

Operating Review

Income

Given the Trust doesn't rely on the sale of a product/service to generate its returns, but rather the price movement in financial assets, to appraise the results of the Trust, the components outlined below must be considered.

1. Long term investments
    a. Realised positions
    b. Unrealised positions
2. Arbitrage transactions
3. Dividend income

As can be seen from the numbers below, the component explaining the overriding majority of the Trust's performance for 2014 was unrealised movements in long term investments.

	2014	2013
Investments - Realised	$ 176	$ 11,909
Investments - Unrealised	($ 144,590)	$ 189,876
Arbitrage	($ 15,925)	$ 6,064
Dividends and interest	$ 26,282	$ 17,621
Other	($ 5,583)	$ 1,409
Gross Income	**($ 139,640)**	**$ 226,879**

Depending on your perspective, the presence of unrealised losses influencing the 2014 result may be either heartening or disheartening. On reading the commentary below, if you believe the outperformance demonstrated in prior years was simply myself putting the 'luke' in fluke, with this year's result being a sign that my investing compass does not actually point to true north then, understandably, you would find this performance disheartening and not unreasonably may wish to withdraw your investment. Alternatively, you may read the below words and consider this result as an investment in future year's profitability and find my obstinacy in pursuing and applying the same process we have done previously, through all different markets and all different popularity trends – toward either stocks in general or our stocks specifically – as heartening. As investors yourselves, this is what you must weigh up given the facts laid out before you.

Accordingly I have presented the information and commentary in a way in which I, as an investor, would hope to see, and which would allow me to evaluate the performance of management and the prospects of the business.

Long Term Investments

As has been the case in the recent history, the Trust's assets are almost exclusively those considered long term investments and as outlined in the figures above, price movements in these holdings was the chief reason as to what was driving the Trust's performance.

While the contribution from realised investments was near negligible, it is worth noting that this result wasn't produced without first generating as much movement as a Swiss watch whilst achieving the same outcome – going round in circles. A particular example to mention was McMillan Shakespeare. This is a fabulously profitable business, with a dominant market position, growing strongly. Traits that make any investor salivate. Indeed, McMillan was a business that I had been aware of for many years; however the price it historically traded at kept any amorous considerations firmly at bay. However with McMillan's service being built very much around a tax efficient way to purchase a vehicle (read government subsidising car ownership), this service was also subject to legislative risks. Enter the 2013 federal election where the candidate for Labor, Kevin Rudd, in his election campaigning, proposed to tighten up the rules around who would be eligible for this subsidy from the government. This announcement elicited two responses, the first being from the stock market sharply readjusting the price McMillan was trading at and the second being from the candidate for the Coalition, Tony Abbott, to continue to do the opposite of everything Labor put forward, and subsequently support the ongoing subsidisation of vehicle purchases. In all fairness, this policy relating to salary packaging vehicles had been in place for around 30 years and while it had been adjusted here and there, had never been so threatened. As we know, the Coalition went on to win the election and retain its pledge to keep the salary packaging industry untouched. However, now there was a wonderfully profitable business trading for a fraction of its previous price. This lured me to open our wallet and begin to build a position in the business. As weeks went by though, what became very clear was the rapidly declining shelf life of domestic automotive manufacturing operations and a federal budget that was suffering from overly generous election promises. With car manufacturers leaving Australia, there was less incentive to ensure Australian made cars had a strong market for sale into and with the Government's revenues deteriorating and cost pressures building we wound down our position and looked to deploy the capital elsewhere. While McMillan may very well go on to remain fabulously profitable, for the Trust, I considered the industry to have changed and so too the investment case. While the net result of this was to act as a headwind for the Trust's performance, a not insignificant lesson learned in this episode was the importance in waiting for a cheap price to buy, rather than one which assumes that from now until infinitum, all will go the way of the organisation. In this sense our original capital was protected far more than otherwise would be the case.

Moving along, and of far more importance in understanding the Trust's performance is the area of unrealised losses. The presence of which and subsequent performance will indicate whether the prior year's outperformance was sustainable or not.

Throughout the year, some of our core holdings were downgraded by the market and we used these opportunities to invest further. However despite my protestations that we were getting good value for money, the market performance continued to deteriorate over the full year.

In addition to these holdings which we've carried for a number of years, the Trust also identified and invested in new opportunities. These businesses are well run, profitable operations, but whose market movement nevertheless continued to follow a long slow decline over the course of the year. The combination of which meant the majority of our investments to which we began the year with and those new concerns identified and invested in, showed a consistent negative trend over the year.

Being an investor focused on receiving value for each dollar of capital committed, I acknowledge that the moments we will want to invest – and indeed, be most excited to allocate capital – will be when the mood is most grim. Accordingly, it is not uncommon to invest in enterprises that have been identified as offering value, only for them to continue to offer that same value (if not better), as the particular cause for the negative mood often lingers for some time. What I was not expecting was the number of our investments that would simultaneously fall foul of the markets affection and the degree to this negative appraisal, particularly with the prevailing investor sentiment being generally quite buoyant.

Often though, this sentiment can cause the movement in a company's share price to become detached from the underlying performance of the business. Take for example one of the Trust's core investments, which for the past nine years had shown strong and consistent growth in profitability. During the year however, this business indicated they had experienced some headwinds and expected the results for 2014 to be in line with the prior year. This communication was made in a candid, no-nonsense way (consistent with how they operate). Such frankness however, doesn't pander to the jittery nerves of many investors and the price of the shares subsequently fell. As price is a relative measure, any change in its level should be viewed in the context of something else. In our case, that 'something else' is the value of the business. By doing this we can gauge whether that change in price seems reasonable and what our subsequent action might be.

To help illustrate the situation, this business was earning in 2012, for the sake of round numbers, $1.00/share on a net profit before tax basis. Of these $1.00/share earnings, they were paying to shareholders, dividends of more than $0.50/share. Furthermore, this business had demonstrated an ability to profitably grow and if we were to plot these earnings, we would see a nice graph with a line rising from left to right at an average rate of increase from each year to the next of greater than 15%. Coupled with a strong market position, this type of picture is a work of art (having it available at an attractive price, makes it a master piece). At this time, the market was valuing each share of this business at $10.00. Among many factors, in 2012 this was an attractive investment to make. Now in 2014 this same business was earning just under $1.40 per share, and paying out to shareholders over $0.70/share in dividends. Only now, despite it earning near on 40% more profit per share, with a corresponding increase in cash dividends being paid to shareholders, the market was valuing the same shares at $10.40. Obviously, in the aftermath of lower profit guidance the market was not prepared to pay the same amount for each dollar of future profitability.

Later in the year, the results up to December 31 were handed in for this business, which confirmed the conservative approach that management had taken in under promising and over delivering – as the performance was not only beating their recent forecast but also the result of every prior year. However with the original announcement acting like an arrow, slung at the psyche of investors, the sentiment toward the company was certainly wounded and the market continued to live out the idiom of, once bitten, twice shy.

While we only began the year with a small position in this business, with the sharp reaction it received from the market in relation to the announcement, the Trust took strong and decisive action to increase our holding. At risk of sounding like a parrot, all we can do is look to allocate capital when it makes business sense to do so – accordingly, I expect the shares acquired to be assisting our results for many years to come.

When looking back on a year's performance to understand the quality of decisions being made, it is obvious and necessary to evaluate those decisions that resulted in action and weigh each one based on their subsequent performance. A natural corollary to draw from this is that successful investing relies on successful investments to be made. What is not as obvious but equally important in contributing to future performance are the decisions made which resulted in no action. While it is important to remain on the sidelines when dealing with assets that may cause future financial injury, nonetheless you still need to be on the field to score the points. Missing out on these points is as much an error and loss as are those errors and losses which resulted from action taken.

My decision regarding Challenger Financial Group was one such case of unwarranted bench-warming. Late in the 2013 financial year and early in the 2014 year, I looked long and hard at investing in this enterprise. While annuities (Challenger's mainstay) are not a glamorous, bustling business to be in, as long as we can pick up the business at a cheap price relative to expected likely future profitability then the Trust is most certainly interested. However after following a more uncharacteristic approach of work shopping my idea and attraction to the group (at the then bargain price) to industry peers and receiving a doubtful response, I ended up questioning my work. Needless to say Challenger's shares went on to turn in a performance for the year that would make tech stocks, the world over, blush.

Measuring the performance of decisions that resulted in no action – regardless of whether that protected against wealth destruction or meant abstaining from wealth creation – is just as important and critical (albeit more intangible) as measuring the performance of investments made. Pausing to recognise these results provides another form of classroom to assist in the continual development that is required to make more informed decisions in the future.

Arbitrage

For the most part of the year, there was very little mergers and acquisitions activity taking place. While this started to change toward the end of the year, by this time, the opportunities available to invest capital into attractive long term propositions far outweighed the one-off boosts we could receive from these short term transactions. Regardless, of the small number of transactions we did pursue, some failed to consummate with the overall effect weighing on the performance of the Trust.

There were no arbitrage transactions invested in at year end and I do not expect this to change given the alternative options available.

Dividends

For 2014, the contribution from dividends was markedly up on the 2013 result, driven by income received from McMillan Shakespeare and increased contributions from our other long term investments.
As the Trust increased its holding throughout the year in companies that maintain a healthy dividend payout ratio, I expect our dividend income for 2015 to again be higher on the 2014 result.

Other Income

Other income comprises income from movements in foreign currency. During the year, the Trust sold Australian dollars and bought US dollars in a bid to capitalise on the slow emergence of the US economy from the stupor it has been experiencing; however, despite yielding a small loss, this position was exited as more attractive investments emerged.

At year end, less than 1% of the Trust's assets were in US dollars. Other than US dollars, the Trust does not own any other foreign currency and does not have any intention to do so.

Expenses

	2014	2013
Brokerage - Investments	($ 5,365)	($ 2,185)
Brokerage - Arbitrage	($ 1,980)	($ 901)
Interest expense	($ 11,098)	($ 3,037)
Total Operating Expenses	($ 18,443)	($ 6,123)
Performance fees (incl. GST rebate)	$ -	($ 92,802)
Annual fee	$ -	$ -
Total Management Expenses	$ -	($ 92,802)
Total Expenses	**($ 18,443)**	**($ 98,925)**

Consistent with the growth in the overall size of the Trust, the expenses incurred to carry out the operations likewise increased from 2013. Simply by investing more capital, the Trust incurred greater levels of transaction charges, being led as expected by brokerage related to long term investments. In making sure these costs have the lightest effect possible on the operations of the Trust, the average brokerage rate incurred for the year was 0.280% (2013: 0.348%).

Also contributing to the higher operating expenses was an increase in interest payments made in 2014. This was the result of a higher balance of borrowings held throughout the year. The borrowings were incurred in order to take advantage of investment opportunities and were made by the Trust on an unsecured, non-current basis with an average interest rate of 5.35% (2013: 5.99%). Borrowings were kept at a prudent level and at year end represented 13.2% of total assets.

There are a number of mechanisms to which the Trust can draw on to repay these borrowings, however it is expected the primary means of repayment will be through the receipt of dividend income over the ensuing years.

In light of the fall in unit price and with regards to any future performance fees, the presence of the high water mark will prevent any fee being levied on the increase in value of the unit price, up to this existing high water mark. After which, the same threshold of an annual 10% return will continue to apply. To be clear, I do not have any interest in earning performance fees from volatility in the price of units. This is a key factor behind the presence of a high water mark.

Operating Profit

	2014	2013
Gross income	($ 139,640)	$ 226,879
Total expenses	($ 18,443)	($ 98,925)
Net Operating Profit	**($ 158,083)**	**$ 127,954**

In line with earlier discussion, the net operating loss led to a fall in the unit price for 2014 of 10.80%.

General Discussion

Looking to the year ahead, I will not hazard a guess as to what may be on the horizon because evidently my short-run projections make those of astrologers look reputable. What I can say though, is that we do own some fabulous businesses, all of which have reported their results for the 2014 financial year. Given these results didn't reflect the dark mood surrounding them, the market has somewhat adjusted its attitude toward these businesses. This reappraisal is being reflected in the amount the market is prepared to pay for each dollar of future profits, which has in turn lifted the unit price to $1.7647 as at 31 August 2014.

Following on from this concept of market price being set by how much someone will pay for each dollar of future profit, we can see the basic components that flow into this calculation of market price and value are:

1. The quantum of likely future returns;
2. The time taken to realise these returns; and
3. How to discount these future returns back to the present day.

The successful projection of the first two points is the kernel of sound long term investing (as a quick sidebar to this notion and moderating those of us who want to see a defined definite value of a business before we make any investment decisions, it is worth remembering that investing is part art and part science where the saying, 'it's better to be roughly right than precisely wrong' certainly applies – or to put it another way, for sound long term investing we're not trying to pin the tail on the donkey; in many cases the most important element is simply being able to tell a donkey from a stallion).

The third point regarding discount rates, I believe to be a redundant one. The reason being, that humans have been investing capital for thousands of years and on an absolute basis we have a very good idea as to what level of return we collectively want to see before we allocate that capital. This understanding of a required return is built from very slow moving demographics such as our general level of wealth, our expected lifespan, average inflation rates over many years, just to name a few. So accordingly, while economies will expand and contract – at times with more volatility than others – our required return should still remain very stable.

For a stock market to increase, in general one would expect either the first point to increase or the second point to decrease (or any combination of these) – with the most desirable effect coming primarily from an increase in the first point. However, since June 2012 until June 2014, the price of the market (All Ordinaries) has increased 30.1%, while the earnings of the market have actually decreased by 0.4%[1]. With the overall value of the market now sitting around its historical average, it is clear the price improvement that it has enjoyed has come not from an increase in the first point, but more generally from a reduction in the discount rate referred to in the third point. Furthermore, imbued in this pallid earnings result is a tailwind of significant cost-outs many corporations have been pursuing recently, to help offset stalling growth in revenues. However cost reductions are only useful for one-off improvements and cannot by themselves underpin future growth – why these measures aren't taken every day is another question to be considered, for a later date. With an earnings trajectory like this, it is abundantly clear the easy gains for the market have been achieved and the picture for continued gains is certainly questionable – without the market becoming overvalued.

You may ask, 'why did he spend so long talking in arcane language to make such a limp point?' The reason being that the improvement experienced in the market's value is in no small measure due to the concerted actions of the world's central banks. Whilst the action was most certainly necessary and indeed admirable, the continual implementation of these extreme monetary policies – more than five years on from the financial turmoil to which they were formed in – has led many investors to reappraise the third point above and lower their discount rates, in light of the ultra-low interest rates that have been prevailing. The net result being higher asset prices in a low growth environment – a double boost to the general level of risk.

Whether we end up in an overvalued market will be to a significant degree a result of these extreme monetary policy measures in place. Measures which were designed to heal the destruction of a previous financial crisis, but which may be sowing the seeds of a new dislocation. However the final buck must rest with those responsible for allocating capital and it's these people who are now acting as though the current low interest rates will continue ad nauseam. Regardless of how long interest rates are expected to remain low, having an investment justified simply by a compression in rates is like building your house on sand, and this Manager certainly doesn't look to rely on the continuation of current monetary policy settings as the foundation for investment decisions; while interest rates may be low now, fixed they are not.

Luke Trickett

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Date	All Ordinaries	Price Earnings Ratio	Earnings	Change in Price	Change in Earnings
30-Jun-12	4,135.5	11.18	$369.90		
30-Jun-14	5,382.0	14.61	$368.38	30.1%	-0.4%