SELECTIVE WEALTH MANAGEMENT

2014

Annual Report

Authored By:

Christopher J. Devlin – *Portfolio Manager*

Each account experienced different returns due to differences in account size and the inception date. We have taken some time to explain these differences in great detail on pages 27 and 28.

We encourage all of you to read them.

For additional information email: info@selectivewm.com

Executive Summary

Year	Selective	S&P 500[2]	Relative
2009	+86.0%	+60.1%	+25.9%
2010	+23.3%	(4.5%)	+27.8%
2013[1]	+39.2%	+24.2%	+15.0%
2014	(4.4%)	+13.7%	(18.1%)
Cumulative	+205.5%	+115.9%	+89.6%

Accomplished at previous investment partnership.

Table 1: Businesses Sold During 2014

Business	Symbol	Purchase Price	Sale Price	Dividends	Gain (Loss)
SolarWinds Inc.	SWI	$32.78	$45.62	-	39.17%
Qlik Technologies Inc	QLIK	$21.22	$27.45	-	29.36%
Heartland Payment Systems	HPY	$37.83	$45.86	$0.09	21.46%
China Mobile Ltd	CHL	$45.07	$52.41	$0.41	17.20%
National Interstate Corp	NATL	$24.62	$28.71	-	16.61%
Cisco Systems Inc.	CSCO	$21.08	$23.08	$0.36	11.20%
Coach Inc	COH	$37.84	$35.57	$0.675	(4.22%)
Higher One Holdings Inc.	ONE	$7.59	$7.11	-	(6.32%)
Liquidity Services Inc. (p)	LQDT	$18.29	$15.53	-	(15.09%)

1) Returns are from inception (March 1st) to year-end. Returns for partial years are not annualized.
2) S&P 500 returns are total returns - which include price changes and dividends. The S&P 500 is not a suitable benchmark and is used for general comparison. We do not believe there is a suitable benchmark given the concentrated nature of our investment style.

Table 2: Businesses Presently Owned

Business	Symbol	Purchase Price	Current Price[1]	Dividends	Gain (Loss)[2]
Solarwinds Inc	SWI	$40.13	$49.83	-	24.17%
Cognizant Technologies Solutions	CTSH	$42.47	$52.66	-	23.99%
Penns Woods Bancorp	PWOD	$43.14	$49.26	$0.94	16.37%
Biglari Holdings Inc	BH	$373.18	$399.51	-	7.06%
Quality Systems Inc.	QSII	$15.33	$15.59	$0.54	5.22%
BofI Holdings Inc.	BOFI	$74.81	$77.81	-	4.01%
Google Inc	GOOG	$507.31	$526.40	-	3.76%
Lancashire Holdings Inc.	LCSHF	$10.72	$8.85	$2.00	1.21%
Jiayuan.com International Ltd.	DATE	$5.45	$4.75	$0.65	(0.92%)
International Business Machines	IBM	$177.91	$160.44	$5.20	(6.90%)
Pulse Seismic Inc.	PLSDF	$2.97	$2.52	$0.06	(13.13%)
Liquidity Services Inc.	LQDT	$18.29	$8.17	-	(55.33%)

Results

Our results for 2014 can be summed up in a single word: Disappointing. The bull market continued with the S&P 500 climbing 13.7% while our performance was lackluster at -4.4%. Outside of one position, Liquidity Services, our performance was a respectable +17% on the year. However, mistakes cannot be ignored.

Year	Selective	S&P 500	Relative
2014	-4.43%	+13.69%	-18.12%

Lessons Learned

The poor performance in 2014 was attributed to two factors working in tandem – a very large position size in Liquidity Services (LQDT) and steep decline in the price of that position. In February our position in LQDT was up more than 30% and accounted for roughly 30% of our assets. The company then received adverse news regarding the pricing of their largest contract with the Department of Defense. The pricing change would impact profits in 2015 and beyond. As a result, the stock declined 70% over the course of the year. This single position cost our firm roughly 21 percentage points of performance in 2014. Obviously we've taken action to ensure this type of relative performance is never repeated. The steps taken and valuable lessons learned are explained on the following pages.

1) Current Prices are from market close on December 31, 2014.
2) Gain (Loss) calculation includes payment of dividends.
Additional information is available upon request – info@1311capital.com

Lesson #1: Position Size

As we construct our investment portfolios we look to diversify our clients across several industries into businesses that are debt free with dominant competitive positions. Prior to our purchase of LQDT our average position size ranged from 7% to 10% of assets. This level of concentration allowed us to excel when our businesses performed well and provided sufficient diversification in the event that our analysis of a single business proved incorrect. In 2014 we accumulated a 30% position in LQDT – roughly 3x the largest position we had previously taken. This large position can be attributed to over confidence and provided a lesson in humility. Moving forward we've established rules to ensure no position exceeds 15% of assets at cost and intend to make purchases following these general rules:

Timing of Purchase	Position Size (% of Total Portfolio)	Rational
Initial Purchase	5% (could range from 3-7%)	Large enough for exceptional performance, small enough for sufficient diversification.
Second Purchase	Additional 5%, Total =10%	Allows to increase our position as the price declines.
Third Purchase	Additional 5%, Total = 15%	On rare occasion an outstanding business falls dramatically and a third purchase is warranted to greatly increase our stake.

These rules are consistent with how we constructed our portfolio during 2013 and allow us to concentrate sufficiently to excel, but not concentrate so heavily that a single investment might threaten the performance of the overall portfolio. Had these rules been in place during 2014 the portfolio performance would have landed solidly in the positive territory including the ownership of Liquidity.

Lesson #2: Business Analysis

While the portfolio management rules are helpful in reducing the impact of mistakes, the primary objective is to avoid mistakes altogether. Over the last 10 years LQDT had demonstrated characteristics consistent with our investment philosophy. The company had grown its core business at a rate in excess of 20% per year, possessed a pristine balance sheet with no debt, and offered a compelling value proposition to clients in liquidating surplus assets. The company had one unfortunate flaw…

In general we attempt to avoid businesses that have a concentration of profits from a single source. The research report we wrote on LQDT noted that 22% of all merchandise sold through the company's market places were from the Department of Defense. We assumed that the merchandise sold under this contract contributed roughly 22% of profits. Under these conditions if the contract was lost profits would decline 22% and the remaining customer base was highly fractured. Without the DoD contract our investment would still be sound and there was evidence supporting this conclusion…but it ultimately proved incorrect. In reality the DoD contract accounted for approximately 80% of the profits of LQDT; a fact that was unknowable *a priori*. In the future we intend to focus our purchases on businesses with customer bases that are extremely fractured to avoid a similar mistake in the future.

Lesson #3: Humility

This likely needs no explanation. So…other than that, how'd you like the play, Mrs. Lincoln?

Deals Completed In 2014

In 2014, excluding LQDT, we purchased or sold 18 companies. As a whole these businesses performed very well and contributed roughly 17% to our performance. Below is a summary of the businesses sold during 2014. Each business deal is described in greater detail on the following pages.

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(p) Represents a partial sale of the position.

SolarWinds Inc.

Ticker: SWI
Purchase Price: $32.78, Sale Price: $45.62
Change: +39.17%

Purchase Decision – SolarWinds Inc. (SWI) sells network monitoring software to small businesses around the world. The value proposition for SWI products is extremely compelling due to the vital nature of a fully functional network. Businesses of any size rely on their network to achieve maximum productivity out of their employees. When a network goes down serious opportunity costs are incurred. To illustrate the strength of this value proposition imagine a small dental office that generated $3 million annually in revenue. The practice uses their network for appointments, billing, X-rays, electronic health records, etc. This small dental practice generates roughly $1,600 per hour in revenue – if the network is down for a single day the opportunity cost may be as high as $13,000.

In steps SWI…this small dental practice can pay an upfront fee of roughly $8,500 to license SWI software and then $1,500 per year moving forward. This small purchase helps to ensure the company network stays up and running. The value proposition is high.

At $8,500 SWI is a low cost provider in the network monitoring space and has been rapidly gaining market share against both incumbent firms and greenfield opportunities. SWI has an extremely fractured customer base and currently services only 150,000 of the potential 11 million small businesses globally – meaning they have a lot of room to run. In addition to being the lowest cost provider customers are very satisfied with the product. Renewal rates on software contracts are more than 90% annually making SWI's income extremely predictable.

Early in the year SWI reported that growth was decelerating rate from a rate of +30% per year down to +15% per year. The deceleration in growth was received poorly by Wall Street and the price dropped well below fair value. We paid approximately 15x earnings to buy our stake in SWI. An excellent price for such a dominant company.

Sell Decision – Shortly after our purchase SWI reported growth that was more in line with historical averages, namely, +30%. The stock price increased sharply over the ensuing months and we elected to sell when the price appreciated by roughly 40%. It was our opinion that the company had reached a more appropriate value and our sell decision was at a fair price. This proved to be a great investment for us and one we intended to revisit in the future.

Qlik Technologies Inc

Ticker: QLIK
Purchase Price: $21.22, Sale Price: $27.45
Change: +29.36%

Purchase Decision – Qlik Technologies creates and sells software that allows business decision makers to analyze vast amounts of data quickly. The software is a tool, like Microsoft Excel, that enables customers to build very powerful solutions to solve unique problems in order to reduce costs and capture additional revenue. Purchasing Qlikview software can help an enterprise save thousands (or even millions) of dollars annually.

The tremendous value offered to customers is evident by the high retention rate of existing customers (+90%) and the success of QLIK's 'land and expand' sales strategy. The sales strategy works as follows: QLIK sells a small number of software licenses to a large enterprise company (land) and this small user base pilot tests the software. These users create customized solutions to help solve business problems they encounter daily. As these individuals utilize the software the time saved and value of the software is affirmed and the enterprise purchases additional licenses for more employees (expand). This model has been tremendously successful and enabled QLIK to grow revenue at a rate in excess of 30% for more than a decade.

The growth in the top line has yet to translate to the bottom line as QLIK reports almost zero income annually. However, a careful analysis of the income statement reveals why. As revenue increases the company continues to hire additional sales staff increasing the sales and marketing expense. The potential income is instead reinvested into additional growth. This is fully expected for a company growing as rapidly as QLIK. The gross margins on recurring software licenses is in excess of 85%, meaning every customer QLIK signs up eventually will add a tremendous amount to the bottom line. The transition from a zero income high growth company to a cash cow will be a very simple transition for QLIK – they simply need to stop hiring sales representatives. However, we fully agree with the business decision to keep hiring as quickly as possible to capture maximum market share.

Our opportunity to purchase QLIK came after the second quarter when the company released earnings grow that failed to meet Wall Street's expectations (+10%). The deceleration of growth was very logical to us in light of the fact that a new version of Qlikview was going to be released in a few months. We believed that many clients that were interested in purchasing Qlikview or adding additional licenses were waiting for the next version of the software. The decline in price allowed us to purchase QLIK at a price of roughly 15x potential earnings (if hiring was frozen). This was a fantastic price considering the high value proposition and sensational growth of the business.

Sell Decision – Shortly after our purchase the growth rate in new license sales accelerated back to historical levels and the price of the stock responded accordingly. After appreciating nearly 30% in value we decided to sell the business and realize our profits. This was a very successful investment for us and we will be watching QLIK carefully in the future for the opportunity to repurchase the business.

Heartland Payment Systems

Ticker: HPY
Purchase Price: $37.83, Sale Price: $45.86
Dividends Received: $0.09
Change: +21.46%

Purchase Decision – Heartland Payment Systems (HPY) provides electronic payment processing for merchants. They install point-of-sale terminals for Small and Midsize Enterprise clients (SME). In exchange for the installation and processing of electronic payments HPY receives approximately 0.50% of each transaction processed. In plain English, HPY installs point-of-sale terminals that let you pay with a debit or credit card.

The company has demonstrated exceptionally stable revenue growth posting year-over-year increases for 10 straight years. The consistent performance of the business can be attributed to the nature of the payment processing industry. In this industry client's sign multi-year contracts, typically between 3 and 5 years, and pay a percentage of total sales to the payment processor. The multi-year contracts lock-in revenue for the payment processor. Once the contracts expire the majority of clients renew their contracts and sign new multi-year deals. Contractual obligations, high renewal rates, and a fracture customer base make it easy for HPY to increase revenues annually – they simply need to add a few more customers each year. At our time of purchase HPY serviced more than 150,000 clients and was continuing to add a few thousand annually. No single client represented more than 1% of total revenue. If we had to describe HPY in a single word it would be 'stable'.

Typically our purchases are driven by an event that drives down the price, but in the case of HPY we simply bought an outstanding business at a fair price. We purchased our stake in HPY at a per share price of $37.83. The total value of the business at this price was $1.35 Billion. We anticipated earnings over the next twelve months of approximately $90 million which equated to a purchase price of 15.2x earnings. A fair price for an impressive business with stable earnings and strong growth.

Sell Decision – In the last two years HPY allocated roughly 100% of the company's earnings to share repurchases. For this reason, the business was highly attractive as an investment when the price of the stock was fairly valued. The lower stock price allowed HPY to retire shares relatively quickly and increase EPS at a rapid clip. During our holding period the price of HPY increased more than 20% which reduced the effectiveness of future share repurchases. Due to the reduce effectiveness of future share repurchases at the elevated price level we elected to sell for a 21% profit. We'll be on the look out to repurchase this business should the price fall to an appropriate level again.

China Mobile

Ticker: CHL
Purchase Price: $45.07, Sale Price: $51.41
Dividends Received: $0.41
Change: +17.20%

Purchase Decision – China Mobile LTD (CHL) is the world's largest cell phone and data plan provider with more than 700 million customers in Mainland China. The company's extensive network spans all 31 provinces in Mainland China providing the best coverage in the nation. In the last 10 years the company has benefited greatly as a quasi-government entity with the PRC holding a 70% stake. The key metrics; Revenue, Average Revenue Per User (ARPU), Total Users, and Owner Earnings have all benefited during this time period to establish CHL as the most dominate Wireless carrier in China. In the last five years the government has encouraged increased competition and the prices on cell phone plans are slowly coming down as a result. Despite these headwinds we viewed CHL as a safe investment due to the strength of the company's balance sheet with more than $72 billion USD in cash and only $5 billion in debt.

We purchased CHL at $45.07 per share translating into a total market capitalization of $188 billion for the business. With more than $67 billion in net cash the enterprise value at purchase was roughly $120 billion or less than 7x TTM earnings. To clearly demonstrate the attractiveness of this purchase a contrast to two wireless behemoths in America is in order – namely AT&T and Verizon. CHL boasts more than $67 billion in net cash while AT&T and Verizon carried $70 billion and $40 billion in net debt, respectively. CHL also scored better on market share, return on assets, return on equity, and net income margin. Despite the obvious dominance you would have to pay roughly 50% more to purchase a stake in either AT&T or Verizon. The sensational performance of CHL can be attributed to the largest user base in the world and the phenomenal operating leverage that comes with it.

This purchase was one of the cheapest purchases we made throughout 2014. The opportunity to make our purchase came following the announcement that the PRC would be implementing a VAT tax of approximately 11% on wireless carriers. While this surely would decrease 2014 net income the market reaction was not justified. With a strong dividend of more than 4% we elected to make this purchase as a safe and superior alternative to cash.

Sell Decision – After holding China Mobile for only 6 months we had the opportunity to sell the business for a gain, including dividends, of roughly 17%. Due to the mature nature of the business and some risks associated with the investment we thought it was wise to take the profits. While China Mobile was a safe investment we still had concerns about the potential for ARPU dropping over the next few years due to increased competition, unpredictable rule changes in the telecommunications industry by the PRC, or currency fluctuations between the USD and the RMB. As the price increased our willingness to assume these risks decreased and we sold at a healthy profit.

National Interstate Corp

Ticker: NATL
Purchase Price: $24.62, Sale Price: $28.71
Change: +16.61%

Purchase Decision – National Interstate Corp sells insurance policies for commercial vehicles, such as semi-trucks or buses. The company is one of the premier insurance companies in the business - posting profits in all 24 years of existence with 22 years of underwriting profits. In the twelve months leading up to 2014 underwriting performance soured and the combined ratio exceeded 100%, marking the 3rd time in history that the business did not earn underwriting profit.

In the insurance business there is only one way to correct underwriting losses – increase prices. The problem with this approach is that insurance is a price competitive business and when prices increase customers move elsewhere. In the first six months of 2013 National Interstate drastically increased prices and lost $35 million in premium volume, or 12% of the annual total. This was precisely what needed to occur in order to return to historic levels of profitability. Many insurance companies give lip service to underwriting discipline, but very few actually take the actions required to post profits. This price increase and loss of customers is the exact type of behavior that has made National Interstate one of the most impressive insurance companies of the last 25 years.

A price increase like the one recently initiated takes time to play out. The policies that were written for the last two years were underpriced and raising prices today would not improve profits of old policies – it will however raise the profits on policies moving forward. It takes time for underwriting profits to be restored – in this case likely between 12 and 24 months, but we strongly believed that larger profits were on the horizon.

National Interstate earned roughly $17 million in the twelve months leading up to our purchase despite poor underwriting performance. Income was derived from the company's large investment portfolio – slightly offset by losses on underwriting. When underwriting returns to a normal level we expected profits in the range of $40 to $55 million – even after accounting for the loss of business through increased prices. This level of profitability is well within the historical levels of National Interstate and would equate to a forward looking P/E ratio of roughly 11 on our purchase.

Sale Decision – The decision to sell NATL was a relatively simple one. American Financial Group (AFG), who owned 51% of the company, made a tender offer to purchase the remaining 49% of the business that they did not own. The price they offered was $28 per share. We ended up selling our position to AFG at $28.71 per share. While this price wasn't quite as high as we originally hoped the return was satisfactory given the short holding period of roughly 2 months.

Cisco Systems Inc.

Ticker: CSCO
Purchase Year: 2013, Sale Year: 2014
Purchase Price: $21.08, Sale Price: $23.08
Dividends Received: $0.36
Gain: +11.20%

Purchase Decision – Our original purchase of Cisco occurred early in 2013. The business was subsequently sold for a profit and then repurchased later in the year. The purchase logic here will serve as a brief reminder for existing clients and an introduction to those clients that are new.

Cisco Systems Inc. sells networking products and services. The company's equipment directs the flow of information across companies and around the world. The network for any institution is extremely important and decision makers have consistently demonstrated that they are willing to pay a premium to ensure their network is running smoothly.

We've observed a substantial amount of dialogue among investment professionals about the risks associated with selling network products, but the data seems to suggest otherwise. Several technologies have been released since the advent of the internet, but the company the world buys from has not changed – it continues to be Cisco. No brand name in the world is more trusted for establishing a reliable network. Cisco is in a league of its own when it comes to sales and the company currently has enough cash to purchase their five nearest competitors *combined*. If one becomes a serious threat I suspect that a large check could acquire the new technology and fix the impending danger. Cisco is afforded the same luxury as the New York Yankees – anyone they can't beat they can buy.

Cisco makes for an interesting case study when it comes to buying a great business at the right price. In the year 2000 Cisco had a market capitalization of $467 billion (not a typo), $5 billion in cash, and earnings of $2.6 billion per year. The market cap was a whopping 175 times earnings. The share price was roughly $60 dollars.

Since that time the company has succeeded mightily. Earnings had increased from $2.6 billion to more than $9 billion in 2013 and the cash pile swelled to more than $50 billion. However, the market capitalization over the same 13 year time period fell by $356 billion, or 75%, down to $111 billion. A $1 investment in Cisco in 2000 is now worth roughly 25 cents despite the overwhelming success of the company. The price in 2000 was insanely high and the price in 2013 was surprisingly low.

After backing out the cash we paid roughly 10 times earnings for Cisco. This multiple was much lower than many of our other purchases giving us an increased margin of safety. We like to have an ample margin of safety when buying a technology company - even one as dominate as Cisco.

Sell Decision – We sold Cisco after an earnings release that resulted in the stock surging upward netting us an 11.20% gain with dividends. The sale decision mirrored that of our previous sale in 2013. I suspect we may have another opportunity in the future to profit from Cisco.

Coach Inc

Ticker: COH
Purchase Price: $37.84, Sale Price: $35.57
Dividends Received: $0.675
Change: -4.22%

Purchase Decision – As many of you will recall we owned Coach during 2013 and sold at a +24.40% gain at $59.15 per share. A full explanation of the business in available in our 2013 annual report.

In 2014 we made the decision to repurchase the business due to a considerably lower stock price - $37.84 per share. The decline in price was attributed to market share losses in North America to competitors such as Michael Kors. Coach was trading at a valuation of less than 50% of the competition and we believed the price was very attractive. It was logical to us that when competitors open up a location near an existing store that market share would be lost, but an equilibrium value would eventually reached. The economics might be similar to when a CVS opens next to a Walgreens. We anticipate market share to stabilize and Coach to continue to excel internationally. Despite the high probability of recovery it appeared that Coach was priced for extinction – a scenario we viewed as highly unlikely.

The company continue to post outstanding profits and was growing more than 20% internationally – nearly sufficient to offset the declines in North America. However, fear was prevalent on Wall Street and the stock was sold in droves. We made our purchase in Coach at a price that was 36% lower than our previous sale price less than a year prior.

Sell Decision – Our decision to sell Coach was a difficult one. During the third quarter the majority of our clients were fully invested and we saw new opportunities arise that had a superior risk / reward profile when compared to Coach. While we maintained the conviction that Coach would be a positive investment in the long term it was apparent that we had opportunities available that would likely yield higher returns and sold to free up cash. This marked the first time we had to sell a business to make room for a new one, but likely will not be the last time. The slight loss on the position had very little impact on overall results (less than 0.5% for the entire portfolio).

Higher One Holdings Inc.

Ticker: ONE
Purchase Price: $7.59, Sale Price: $7.11
Change: -6.32%

Purchase Decision – Our purchase decision for Higher One (ONE) can be found in our 2013 annual report.

Sale Decision – Higher One was one of the few businesses that we had to sell due to fundamental changes in the business model. Last year we described the disconnect between those who select ONE's services, namely higher educational facilities, and those that pay for the service, namely students and merchants. This disconnect allowed ONE to grow rapidly and monopolize the loan disbursement business with little competition. Higher education facilities were able to save money by selecting ONE at almost no cost and lower tuition for students. However, we were not the only ones the noticed this disconnect as the Department of Education stepped in to evaluate if students were being treated fairly. Last year we mentioned that students would be charged less than $4 per month to utilize a ONE debit card – highly comparable to a bank – and suspected that fees would not be eliminated. In the worst case scenario, where fees could no longer be charged to students, ONE would still earn ample income based on the interchange fees on cards that are paid by merchants. These fees are an industry standard and typically profits go to the bank that issued the debit or credit card. ONE's profits were earned at the expense of the banking sector, not the student. It never occurred to us that the DOE would step in and render the entire business model obsolete. This assumption was incorrect.

In early 2014 the DOE ruled that ONE would no longer be eligible to send students Higher One debit cards prior to the student making an election on how they wished to receive their student loan refund. This decision made it impossible for ONE to continue to disburse student loans competitively and collect interchange fees from merchants. In effect, ONE was providing disbursement services to higher education facilities at no cost to the university and being compensated by gaining market share from the banking sector (those that normally collect interchange fees). By stealing market share from banks it actually lowered the overall cost of education for students. The decision by the DOE will effectively increase the overall cost of education and return interchange market share to the banking industry. In order to 'protect' students the DOE indirectly increased the price of an education and returned roughly $35 million in profits back to the banking industry. The decision came as surprise to us and we exited the position immediately following the irrational decision.

Higher One is an excellent example as to why 'annual returns' can in some instances be slightly arbitrary and misleading. In 2013 ONE rallied 37% and increased our reported performance during 2013 by approximately 5%. This gain, however, was not realized and the price of the stock fell slightly below our purchase price during 2014. This effectively reduced our 2014 by 5%. Had this investment not straddled the arbitrary calendar date, December 31, it would have had almost no impact on either years performance since no profits were made on the transaction. However, because it straddled December 31 2013 was artificially inflated by 5% and 2014 penalized by the same amount. Combining this price change with the effect from LQDT we had an uphill battle on the performance front during 2014. This is one reason we like to evaluate the outcome of an investment from the purchase date to the sale date and ignore price movements in between. In this respect the Higher One as a completed deal had very little impact on client accounts as we closed it at a slight loss.

Liquidity Services

Ticker: LQDT
Purchase Price: $18.60, Sale Price: $15.63
Change: -27.30%

Purchase Decision – Below outlines our original purchase logic which – as you know by now – was incorrect. We've elected to restate the original purchase logic here and provide an update on the business under the section of this report titled "Businesses Presently Owned".

Liquidity Services Inc ("LQDT") provides online auction marketplaces for surplus and salvaged assets. The assets could be returned retail items, old fork-lifts, military beds, or scrap metal from a battle ship. They sell it all. LQDT gets paid for connecting buyers and sellers through consignment or profit-sharing arrangements. As a business they have a very strong competitive position due to their network effect. The more buyers that participate in each auction the higher the sale prices and the faster the assets are liquidated. They have the largest buyer base in the world with more than 2.4 million registered buyers – many of those being entrepreneurs and businesses that buy in bulk. This large buyer base has attracted the world's largest sellers with more than 600 corporate and 8,000 government sellers. Their seller clients include behemoths such as Walmart, Target, Amazon, Best Buy, Home Depot, and the Department of Defense.

The business model is very simple to understand, but their accounting is rather complex. There are three primary ways they offer to auction goods on behalf of their seller clients: consignment, profit-sharing, and purchase. Each transaction type creates very different reported revenues and profit margins, but almost identical income as a percentage of the merchandise sales price. For this reason we ignore the reported revenue and profit margins and instead focus heavily on the total sales value of all the merchandise sold through their marketplaces, or gross merchandise volume (GMV), and the income they generate off those sales. Historically net income has been extremely consistent between 4% and 6% of the GMV.

In 2013 LQDT reported net income of $42 million dollars. This included a one-time charge of $5 million associated with an acquisition they made in a prior year. We added this back to forecast 2014 net income. They also have a $7 million amortization expense associated with a customer relationship that they acquired in 2012, which is a phantom expense. This was added back. After these additions, factoring in a 40% tax rate, and forecasting 10% growth for 2014 we estimate they will earn $54 million in the next twelve months.

We paid roughly 13x earnings for the business.

Sale Decision – At the time of sale roughly 25% of our assets were invested in LQDT. We elected to sell a large portion of this to reduce the position size down to 10% of assets. Moving forward we will adhere to the portfolio management rules outlined in the section "Lessons Learned". By limiting the position size no single business will dictate results like LQDT did during 2014. For further information about how the business is performing please read the Liquidity Services located under the section titled "Business Presently Owned".

Businesses Presently Owned

The businesses included in this section are those that we presently own. We've included in this section progress made during 2014 for those businesses we purchased in previous years, the logic behind purchases made in 2014, and future expectations for each business moving forward. With the notable exception of LQDT each business made outstanding progress in 2014 and is performing up to expectations. We're excited about the future prospects of every company listed below, including LQDT, and intend to close each position for a sizeable gain. The price changes are calculated from the time of purchase until market close as of December 31, 2014.

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Quality Systems Inc.	QSII	$15.33	$15.59	$0.54	5.22%
BofI Holdings Inc.	BOFI	$74.81	$77.81	-	4.01%
Google Inc	GOOG	$507.31	$526.40	-	3.76%
Lancashire Holdings Inc.	LCSHF	$10.72	$8.85	$2.00	1.21%
Jiayuan.com International Ltd.	DATE	$5.45	$4.75	$0.65	-0.92%
International Business Machines	IBM	$177.91	$160.44	$5.20	-6.90%
Pulse Seismic Inc.	PLSDF	$2.97	$2.52	$0.06	-13.13%
Liquidity Services Inc.	LQDT	$18.29	$8.17	-	-55.33%

Solarwinds Inc

Ticker: SWI
Purchase Price: $40.13, Price At Year End: $49.83
Change: +24.17%

Purchase Decision – This was our second purchase of SWI in less than a year. The original purchase logic can be found in the previous section of this annual report. We sold SWI early in 2014 at a price of $45.62. After the time of sale two things occurred that enticed us to repurchase the business: 1) The price declined and 2) The business grew more than 30%. The outstanding growth of the business and the decline in the stock price made a repurchase of the business attractive.

Business Update - SWI had a sensational year in 2014. The company had robust growth year-over-year posting overall revenue increases of 28% with recurring revenue increasing 31% and new license revenue growing 24%. The new license revenue growth rate is a leading indicator for the future of the business and demonstrates how well SWI is competing in the market place. It was evident that customers are very pleased with the product as the company won several industry awards in 2014 and maintained customer retention rates above 90%. The business also continued to show outstanding operating leverage as margins continued to expand and profits climbed at a faster rate than revenue. The business operates with no debt and the cash pile now stands at $215 million. We could not have been more pleased with Kevin Thompson, the CEO, and the team at SWI. It would appear that 2015 has a high probability of continuing very strong growth.

Expectations – The long term expectations for SWI remain unchanged. We anticipate revenues and income to climb at an annual rate in excess of 15% for the foreseeable future. The company now has more than 90,000 customers in over 170 countries worldwide. The total addressable market is large with more than 11 million small businesses. We fully expect great things from SWI in the years to come.

Cognizant Technologies Solutions

Ticker: CTSH
Purchase Price: $42.47, Price At Year End: $52.66
Change: +23.99%

Purchase Decision – Cognizant Technology Solutions Corp (CTSH) is a leading provider of IT consulting and business process outsourcing services. The company specializes in helping clients build more efficient businesses. CTSH employs 170,000 software developers located in countries around the globe that are organized into teams based on geography and work seamlessly around the clock to write software programs and develop business processes to save money for their clients. In the last 10 years CTSH has managed to compound earnings at a rate in excess of 30%.

The rapid growth and extreme profitability of CTSH is protected by a wide economic moat consisting of three factors: high switching costs, a strong brand name, and a position as the low cost provider. The high switching costs are an industry specific phenomenon making the BPO industry one of the most predictable and profitable in the world. Companies in this industry work closely with their clients to develop solutions that save their clients' money. This tight client relationships forms a long-term partnership that is extremely difficult to replace. Once an enterprise selects their BPO partner it is likely that the two companies will collaborate on projects for years (often decades). For this reason CTSH benefits from revenue retentions rates with existing clients that is in excess of 100%.

In addition to high switching costs CTSH has cultivated an outstanding brand name among enterprise companies around the world. The strong brand name allows CTSH to competitively bid and win a large number of enterprise and government contracts. CTSH's client base consists of enterprises with annual budgets for BPO projects ranging from 5 million to 50 million or more. Names include companies such as Bank of America, AstraZenca, Philips, Coors, Merck, the Security Exchange Commissions, Pfizer, and MetLife. Finally, CTSH has elected to pursue a business model that is slightly different than its peers – the company charges less and anticipates making up the difference through market share gains.

We acquired our stake in CTSH at approximately 14x earnings with an average purchase price of $42.24 per share. This purchase price compared favorably to the current price multiple of 16x earnings for the average S&P 500 constituent. The rationale behind our purchase was simple - we believe we paid a fair price for an outstanding business. CTSH has compounded earnings at a rate of 28.4% for the last five years and has only experienced one year of growth below 20% since its public debut in 1998. In 2014 the business is on pace for 15% growth, the lowest in the company's history, and the momentary deceleration has created a buying opportunity.

Expectations – Due to the high quality of CTSH business model we intend to hold the position for the foreseeable future. It is our expectation that the business would continue to grow at a rate in excess of 12% per year for the next 5 years. The only way we would considering selling such an outstanding company is if the price multiple expands to unreasonably high levels – in which case we would make considerable gains on our investment. This is a long-term position for us.

Penns Woods Bancorp

Ticker: PWOD
Purchase Price: $43.14, Price At Year End: $49.26
Dividends Received: $0.94
Change: +16.37%

Purchase Decision – Penns Woods Bancorp (PWOD) is the holding company of Jersey Shore State Bank and Luzerne Bank. These two banks operate in small towns in the northern part of Pennsylvania and have a dominant market share in the regions which they operate. In terms of deposit market share the banks hold the #1 position by a very wide margin in Lockhaven, Clinton, Lycoming, and Jersey Shore, PA. The towns in which they operate are not of sufficient size to attract additional competition allowing PWOD to earn unusually high profits as the market leader. In the last 10 years PWOD has earned an average return on assets that is roughly 2.5x more than an average bank. In addition to earning uniquely high profits the business is exceptionally well capitalized with an equity to assets ratio of more than 12%. This high level of capitalization allows the bank to operate very safely during difficult credit cycles.

In the twelve months leading up to our purchase the company earned $13.8 million in income after taxes. During this timeframe the company acquired Luzerne bank and incurred one-time charges of $1.5 million associated with closing the deal. Excluding these one-time expenses the bank should be able to generate income of more than $15 million in the next twelve months barring any unusual loan charge offs. This compares very favorably to our purchase price of $206 million or roughly 13x earnings. We view this investment as a stable and safe alternative to cash. The company allocates the majority of its earnings to dividend payments and had a dividend yield of more than 4.5% based on our purchase price. This is significantly better than alternative fixed income investments and provides the potential for capital appreciation.

Expectations – We anticipate modest growth between 3% - 5% over the next 10 years. The company would benefit greatly from rising interest rates and has the potential to earn more than $20 million per year under such conditions. Due to the low projections for growth we would be content selling the position for a modest gain if the price should appreciate over a short-time frame. This position would also be one of the first we'd consider selling if cash were required for a superior investment. Through the collection of the dividend and potential capital appreciation we expect this to perform better cash.

Biglari Holdings Inc.

Ticker: BH
Purchase Price: $373.18, Price At Year End: $399.51
Change: +7.06%

Purchase Decision – Biglari Holdings (BH) is a diversified holding company run by Sardar Biglari. The corporation operates as a parent company with operating subsidiaries and as such there are two divisions: Operating Businesses and Investments. The operating businesses generate profits and remit those earnings to the parent company for Sardar to invest. Sardar allocates this capital by purchasing additional operating companies or purchasing shares in publically traded stocks through the investment portfolio. The vision for the company is to build a business empire similar to Berkshire Hathaway.

Our purchase logic for BH was based on three factors: Impressive leadership performance, substantial discount to value, and limited downside risk. In the last 5 years, since Sardar Biglari assumed control, the company has allocated capital brilliantly to build wealth for shareholders. The investment portfolio has grown from $54 million to more than $766 million today. The investment portfolio was built by the profits of the operating businesses, a special dividend from Steak N Shake through non-recourse debt, two rights offerings, and investment gains. Over the last half decade these decisions demonstrate that Sardar is skillful at allocating capital. We valued the operating businesses and investments separately to arrive a combined value for the enterprise. The operating businesses, namely Steak N Shake, earn roughly $32 million per year before franchising activities and would be valued at more than $400 million in a private transaction. The investment portfolio currently stands at more than $766 million for a combined value of $1.166 billion. Our purchase price of $650 million was exceptionally attractive relative to our valuation.

There were several factors that contributed to the depressed price level of BH stock. The company has a complex corporate structure whereby the investment portfolio is held in an affiliated hedge fund run by Sardar known as The Lion Fund. This fund holds more than 10% of the outstanding BH stock and those shares have not been retired – which is an unusual accounting convention. For this reason the number of outstanding shares is artificially high when viewed through most published sources (such as Google or Reuters). We believe this has caused confusion for many investors and will be remedied overtime as the business is understood more thoroughly. A second reason for the depressed price level is the controversial pay package for Sardar – he is awarded 25% of all annual gains in book beyond the first 6%. Many Wall Street analysts believe this pay package is excessive and refuse to purchase the stock. We disagree and believe that this type of compensation is more than fair for an individual of Sardar's talents. This was an outstanding buying opportunity for us.

Expectations – Bigalri Holdings is known as a jockey stock – meaning the value of the business is derived from the man in charge – Sardar Biglari. We anticipate one of two scenarios to pan out for our investment: 1) The business is revalued closer to the $1.166 billion intrinsic value in which case we could sell for a large short-term gain, or 2) the value remains low and we hold onto the company as Sardar continues to build the investment portfolio in the upcoming years. We view both outcomes as favorable.

Quality Systems Inc

Ticker: QSII
Purchase Price: \$15.33, Price At Year End: \$15.59
Dividends Received: \$0.54
Change: +5.22%

Purchase Decision – Quality Systems Inc. (QSII) is a software firm that specializes in creating and implementing solutions specific to hospitals and dental practices. In the last 10 years QSII has grown income from \$7 million to more than \$70 million. The firm was able to rapidly compound income as the majority of health practices switched from archaic paper systems to more modern electronic based systems. As QSII captured a large portion of this new market the company locked in profits for years to come due to the 'sticky' nature of electronic health record solutions. Typically when a health practice implements a solution they stick with that solution for many years (sometimes decades). This creates highly predictable and strong recurring revenue for QSII as the solutions provider.

The market conditions in which QSII operates today are drastically different than those of the preceding 10 years. The majority of the largest health providers have implemented electronic solutions and the number of 'greenfield' opportunities has diminished. In order for QSII to grow they will need to gain market share from incumbents – a much more difficult task. However, the Affordable Health Care act has forced changes on the industry that may provide an opportunity for QSII to continue growing at a healthy pace. The AHC act mandates all electronic health care providers (like QSII) to be compliant with ICD-10 by October 2015 and the majority of the providers are non-compliant (and likely too small to afford compliance). There is a very high probability that the EHR industry will continue to consolidate and firms such as QSII will gain additional market share.

While the implementation of ICD-10 creates a potential opportunity for QSII to gain market share it has also placed substantial short-term pressure on earnings. The company has increased the research and development budget from roughly 9% of revenue to more than 15% of revenue to make the changes required for ICD-10. This increased R&D spend will reduced reported income for the next few years. Wall Street sold QSII to 4 year lows in light of the increased R&D spending. We viewed this as an opportunity to purchase. We believe that when ICD-10 is implemented QSII will capture additional market share and return to historic levels of profitability (and beyond).

Expectations – Our expectations for QSII are very similar to that of PWOD. The company pays out the majority of earnings as a dividend and based on our purchase price the dividend yield is almost 5%. This is an outstanding dividend yield in the present low interest rate environment, especially when considering the stability of QSII's business model. The company has retention rates of nearly 100% (they only lose a client when that client is acquired by another hospital with competing software). We view QSII as a safe and stable investment with a healthy dividend and the potential for price appreciation. We would be content to sell our position in QSII at a modest gain due to the low prospects for growth in this relatively mature industry. This also would be a candidate for sale in the event we needed cash for a more opportunistic purchase.

BofI Holdings Inc

Ticker: BOFI
Purchase Price: $74.81, Price At Year End: $77.81
Change: +4.01%

Purchase Decision – BofI Holdings is the holding company of BofI Federal Bank - an online bank that focuses on providing banking services through multiple low-cost digital channels. The bank has customers nationwide and provides financing for single family and multifamily residential properties, small-to-mid size businesses, and select specialty finance receivables. In the last decade BofI has been one of the most successful banks in the nation with industry leading of cost controls, profitability, underwriting, and growth. We purchased and sold BOFI previously in 2013.

The purchase logic was relatively straight forward: The company is one of the most efficient banks in the United States and continues to steal market share from the brick-and-mortar competition. In the last 5 years the business has compounded assets and core earnings at a rate in excess of 30% and continues to gain efficiencies as the business scales. These efficiencies are being passed along to customers in the form of cost savings and higher interest payments on checking accounts. The table below shows that BOFI operates with less than 50% of the expenses of a traditional bank:

Expenses As % of Assets

As % of average assets	**BofI %**	**Banks $1-$10bn in Size**
Salaries and Benefits	0.71%	1.52%
Premises and Equipment	0.13%	0.36%
Other non-interest expense	0.54%	1.29%
Total non-interest expense	**1.38%**	**3.17%**

When we sold BOFI in 2013 we did not anticipate such robust growth moving forward. The bank exceed our earnings estimates by more than 50% and grew assets by a staggering 40%. The dramatic increase in size and continued success of the business was compelling enough to repurchase. We effectively paid 15x earnings for a rapidly growing business with a strong competitive position. This compared very favorably to the average P/E multiple of 16x earnings for an S&P 500 constituent.

Expectations – Our expectations are slightly different than last time we made our purchase. The management team at BOFI has continued to exceed expectations and realize efficiencies as the business scales. It is our intention to hold onto the bank for the foreseeable future. We anticipate growth in both assets and earnings to exceed 15% per year as BOFI gains market share from the brick-and-mortar competition. This has the potential to be a very large business.

Google Inc

Ticker: GOOG
Purchase Price: $507.31, Price At Year End: $526.40
Change: +3.76%

Purchase Decision – If you're unsure about what Google does…Google it.

All jokes aside, Google is a global technology leader focused on improving the way people connect with information. The company innovates in web search and adverting to make *www.google.com* a top internet property and one of the most recognized brands in the world. Businesses use the AdWords program and AdSense program to promote their products and services through advertising both on Google-owned properties and publishers' sites across the web. Through their internet properties Google collected roughly 12% of all advertisement spending on the planet in 2013. The company's search platform provides a critical service that is extremely difficult to duplicate or replace.

In the last 5 years Google has compounded revenue at a rate of more than 28% per year and owner earnings at a pace of 14%. The company fits our investment philosophy as a debt free business with more than $57 billion in net cash and a dominant market position with more than 50% of the global market share for search. The company benefits from a strong network effect and a disconnect between the users who select the service (individuals that search the web) and the companies that pay for the service (advertisers). This allows Google to offer most of the company's products and services for free – meaning competitors cannot undercut them on price. After backing out the excess cash we effectively paid 19x future earnings for the business. This was a slight premium to the forward looking P/E ratio of 17x earnings for the average S&P 500 constituent at the time of purchase, but Google is no average business.

Expectations – The number of individuals moving online continues to increase globally. We anticipate strong future growth as the world becomes more connected and more digital advertising dollars continue to shift from traditional print media – such as newspapers or direct mailers – to online paid search. We believe this trend will continue and Google will be at the epicenter. It is our expectation that the company will grow revenue and earnings at a rate in excess of 15% for the next 5 years. The search business alone will increase through more paid clicks and a higher average cost per click as more businesses bid for online ad slots.

In addition to the dominant search business Google is uniquely position to revolutionize several industries. There is a chance, although not required for investment success, that Google could launch an automated car in the next 10 years. The software for this vehicle would be an incredibly lucrative profit center for Google as they make a move into the $2 trillion dollar global transportation industry. This project represents one of many that has the potential to change the world. We view Google as an outstanding investment with free 'options' imbedded in these potential technologies. It is our intention to hold onto Google as long as the price multiple remains at reasonable levels moving forward. This could arguably be the most dominant business of our generation.

Lancashire Holdings Inc.

Ticker: LCSHF
Purchase Price: $10.72, Price At Year End: $8.85
Dividends Received: $2.00
Change: +1.21%

Purchase Decision – Lancashire is of the world's premier insurance companies. The company specializes in large and bizarre policies that are difficult to price. The majority of insurance operations tend to underwrite insurance policies at approximately breakeven and generate investment income based on the 'float' that these policies generate. This business model has been very successful for many decades, but in the current investment environment with interest rates near zero many insurance firms are having trouble earning adequate returns on equity. Not Lancashire.

Lancashire differs from the traditional insurance company in that the company's operating income is derived from sensational underwriting. The company typically collects far more in premiums than it pays out in claims allowing the business to earn sensational returns on capital. For the last 8 years the combined ratio has averaged 61% - one of the very best in the business. This sensational track record can be attributed to the people at Lancashire; they truly are the best in the business. Lancashire is able to continue earning large profits in a zero interest rate environment due to the unique business model. However, in the most recent years the insurance market has been in a 'soft' cycle, meaning there is too much capital allocated to writing insurance policies and competition is fierce. This drives prices down reducing premium revenue and compressing the combined ratio. Due to the difficulties of this soft cycle Lancashire has been forced to walk away from business that is priced incorrectly and reduce the premiums collected. When the industry as a whole experiences catastrophic events that require huge payouts by insurance firms the weakest players will be eliminated and the market will harden. When this occurs Lancashire will be perfectly position to return to historical levels of profitability.

Over the last seven years the company has averaged approximately $260 million in income per year. Due to the nature of the industry the income has been lumpy, but this is expected in insurance. Last year Lancashire acquired an insurance firm, Cathedral, and opened a new business division, Kinesis. As these two divisions are integrated into the parent company we believe they will increase average earnings over the next 10 years to levels in excess of $260 million. Due to the current 'soft' cycle we were able to purchase our stake in Lancashire for roughly $2 billion or 8x average earnings.

Expectations – We make no forecast as to when the soft cycle for the insurance market will end and pricing firms. As we wait for the market to harden and profits to rise we will be content collecting and annual dividend from Lancashire in the form of a special dividend. As the company earns profits they typically remit these excess earnings to shareholders once per year through a special dividend. In 2014 we received $2.00 in dividends and based on our purchase price of $10.72 equated to an 18% payout. We do not expect this level of payout to continue due to the fact that Lancashire reduced their capital base to make the payment, but we anticipate annual dividends in the range of 8-10% while we wait for the market to firm. This dividend level is sensational relative to the alternatives in the present investment environment.

Jianyuan.com International

Ticker: DATE
Purchase Price: $5.45, Price At Year End: $4.75
Dividends Received: $0.65
Change: -0.92%

Purchase Decision – Jiayuan International (DATE) operates the largest online dating website in mainland China with more than 100 million registered users. The website is geared toward addressing the dating and marriage needs of China's rapidly growing urban singles population by providing trusted, effective platforms and superior user experiences. Jiayuan.com targets single adults that have the intention of forming long-term relationships with an end goal of marriage. The website ranks first in terms of the number of unique visitors and time spent among all online dating websites globally.

Online dating sites tend to perform very well once established as a leader in a particular market. This has to do with the network effect that occurs among the user base – register users are interested in finding someone to date in their area and the more people they have to choose from the more they value the service. For this reason typically only two or three dating sites dominant one particular country and it is difficult for new participants to gain traction against the incumbents – and DATE is the largest dating site in the world.

In 2013 DATE posted profits of roughly $10 million dollars and we were able to acquire our stake at a price of $165 million, but there is a catch. When we acquired our stake in DATE the company had zero debt and roughly $80 million in excess cash. After subtracting this massive cash pile our effective purchase price was 8.5x 2013 earnings. This purchase price was a substantial discount to the average 16x forward looking earnings of the S&P 500 constituent. We believe that this discount was available due to two short-term headwinds: 1) The Average Revenue Per User (ARPU) is temporarily declining due to user migration from the PC to mobile platforms and 2) the company spent an unusually high amount on marketing during 2014 for television advertising. We expect ARPU to increase in 2015 and 2016 when the mobile platform is fully developed and the company shifts its focus to monetizing active users. We have seen many companies successfully perform this shift in the last two years and believe Jiayuan will also be successful. The unusually high marketing budget was a discretionary expense that the CEO felt was necessary to continue to position the company as the nation's leader in online dating. This was the first time the company engaged in such an extensive advertising campaign and we believe the marketing budget will return to more normal levels moving forward.

During 2014 DATE announced that $20 million dollars would be paid to the owners of the business through a special dividend. This equated to a dividend payout of 14% when compared to our purchase price and was a very pleasant surprise.

Expectations – Our future expectations for DATE is that the ARPU will increase as the mobile platform is completed and the company focuses its efforts on the monetization of the user base. A slight uptick in the ARPU would create a substantial increase in profits during 2015. We view DATE as a relatively mature company and intend to own the business while collecting a special dividend in excess of 10% per year. In the event that the price increases dramatically in the short term we would be content to sell for a gain of roughly 40%.

International Business Machines

Ticker: IBM
Purchase Price: $177.91, Price At Year End: $160.44
Dividends Received: $5.20
Change: -6.90%

Purchase Decision – Our purchase logic for IBM can be found in our 2013 annual report.

Expectation – Below is an excerpt from our original IBM expectations verbatim:

"We anticipate growth in the range of 0%-2% per year for the next 10 years on average. IBM could actually be earning the same exact amount annually 10 years from now and our investment be extremely successful for one reason - share buybacks. IBM has been allocating the vast majority of their earnings to repurchasing shares for several years and many would argue that this has been a foolish way to deploy capital, but we couldn't disagree more. Repurchasing stock at 11 times earnings has the same impact on the business for remaining shareholders as acquiring new business relationships through acquisitions at 11 times earnings (which is nearly impossible, acquisition prices would be much higher). We would much prefer stagnant revenue and income growth at the business level with strong repurchases at 11 times earnings than acquisitions at 15 to 20 times earnings.

We are content to hold onto IBM as long as the price remains low so that their share buyback program can continue with great efficacy, but would be willing to sell if the market capitalization exceeds $240 billion or a 20% rise."

Business Update – IBM made tremendous progress in 2014 and continued to build value for shareholders. As part of our original investment thesis we mentioned that IBM has been in the process of exiting price competitive hardware products and moving into the more lucrative and stable software and consulting services. This transformation continued in 2014 as Big Blue sold off a hardware division to Lenovo that was losing roughly $500 million per year. While this reduces revenue in the short-term it is an exceptionally wise decision and is consistent with the road map the executive team laid out many years ago.

Overall the company met our expectations of 0% growth for 2014 generating $21 billion in pre-tax income and $12.5 billion in free cash flow. While the company overall experienced no growth the 'strategic imperatives', those being cloud, analytics, mobile, social and security, were up 16% and now generate $25 billion in revenue. These divisions are not only growing rapidly, but are exceptionally profitable (more so than hardware). If this grow rate continues our investment thesis of 0% to 2% growth for 10 years could prove conservative. This would be a pleasant surprise.

Either way, the cash generated in 2014 was deployed as expected – toward dividends and share repurchases. The company retired roughly 8% of the outstanding shares meaning our stake increased 8% in the business with no further investment. To conclude I'll repeat what we stated last year: We are content to hold onto IBM as long as the price remains low so that the share buyback program can continue with great efficacy, but would be willing to sell if the market capitalization exceeds $240 billion or a 60% increase.

Pulse Seismic

Ticker: PLSDF
Purchase Price: \$2.97, Price At Year End: \$2.52
Dividends Received: \$0.06
Change: -13.13%

Purchase Decision – Pulse Seismic ("PLSDF") owns the second largest seismic data library in Canada. They license this library to oil and gas exploration companies that are interested in drilling for hydrocarbons. These licenses are sold on a non-exclusive basis and the same region can be sold multiple times to several different companies. The seismic data maps have extremely long useful lives - maps as old as the 1970s continue to generate revenue today.

We purchase PLSDF at a price of \$2.97 (USD) per share for a market capitalization of \$176 million. In the last five years the earnings of the business fluctuated between \$41 million and \$16 million depending on the data license activity in Western Canada. In the last 10 years the average earnings for the business was \$25 million. During that same time period the size of the data library quadrupled. We believe the increased size of the library should contribute to PLSDF averaging at least \$25 million on average for the next 10 years. This equated to an effective purchase price of 7x earnings for the business. We believe that this attractive purchase price was available because the company is under followed by professional analysts and has complex accounting that masks the true earning power of the business. The company's large amortization expense of the data library shields there income from taxes annually and protects profits, but creates 'phantom' losses on the income statement when reading the company's financials.

Since our time of purchase the price of oil has fallen from more than \$110 per barrel to less than \$50 per barrel. Fortunately, PLSDF was able to post outstanding profits during 2014 with license sales in excess of \$30 million and free cash flow to shareholders of \$28 million. The company allocated these earnings brilliantly paying off debt, repurchasing shares lows, and paying dividends.

Expectations – Our future expectations remained unchanged despite the dramatic decline in oil. We fully understood that the company has volatile earnings fluctuating between \$16 million and \$41 million, but would very likely average \$25 million per year for the next 10 years. Due to depressed oil prices it is likely that 2015 will be a poor year for PLSDF on the earnings front, but over a long period of time this investment has a huge potential for appreciation.

The potential for future gains is largely due to the fact that Neil Coleman, the CEO, and Pamela Wicks, the CFO, do a sensational job allocating the earnings of the business to activities that greatly increase the wealth of shareholders. We anticipate that approximately \$8 million (25% of earnings) will be paid as dividends and the remaining 75% will be invested opportunistically into share repurchases. If the stock price remains at these depressed levels for an extended period of time, say 3 years or more, the share repurchase program will be extremely effective and create tremendous value for the owners of the business. Much like IBM we hope that the price of PLSDF remains low as Neil and Pamela gobble up additional shares at bargain prices.

We intend to hold this investment as long as the market capitalization of the business remains below \$200 million. In the event the market capitalization exceeds \$200 million by a meaningful amount we will sell the investment due to the reduced effectiveness of share repurchases, but earn a considerable profit (55% gain from the current level).

Liquidity Services

Ticker: LQDT
Purchase Price: $18.29, Price At Year End: $8.17
Change: -55.33%

Purchase Decision – The original purchase logic can be found in the preceding section "Business Sold During 2014". A portion of the position was sold to reduce the position size down to 10% of assets.

Business Update – The past year was a perfect storm of difficulties for Liquidity Services and revealed several short-comings in our original assessment of the business. In April the company announced that it had renewed its contract with the Department of Defense (DoD) but that it would have to pay more than double the historical price to purchase goods from the DoD and auction them through the company's marketplaces. This dramatic increase in price revealed that the large majority – perhaps 80% - of all profits at LQDT were generated through this single contract. Prior to the renegotiation this information was unavailable and the highly concentrated nature of profits was masked. The new contract will reduce profits from our estimate of more than $50 million to somewhere between $10 million and $20 million.

The company has taken strides to reduce expenses and increase profitability. The executive team has made it clear, both in word and in deed, that they believe the company will be significantly larger and more profitable in the coming years. This statement was personally backed by cash – the CEO, CFO, CAO (Chief Accounting Officer) and several directors personally purchased several million dollars of LQDT stock after the DoD announcement. Additionally, the company utilized the $100 million cash pile on hand to repurchase $41 million in stock which effectively increased our stake in the business by 10% with no additional investment. While 2014 will go in the record books as an extremely difficult year for LQDT we believe that the business be very successful in the long term.

Expectations – Moving forward we anticipate LQDT to recover from the difficult 2014 fiscal year. As the largest reverse supply chain management company we continue to believe that LQDT is uniquely positioned to provide value to this segment of the market. We anticipate the business to resume growth in 2016 and compound GMV and earnings at a rate in excess of 15% per year. We anticipate selling LQDT at a profit, but the income lost from the DoD contract will take several years to recover. In light of the developments with the DoD it is apparent we overpaid for the business, but in due time, we should be able to turn a profit.

A Bit on Politics

In 2014 we learned a great deal about political risk. The two businesses we owned that had a major impact on performance, namely LQDT and ONE, were both adversely effected by actions taken by the United States government. Our primary focus in evaluating risk prior to these two businesses was estimating earning power and evaluating competitive position. In both of these respects the analysis of LQDT and ONE was accurate. Both companies were very difficult to compete against, but we over looked one major risk – political risk. This lesson learned will ultimately prove extremely valuable moving forward when selecting prospective businesses for ownership. We will be significantly more cautious when considering businesses heavily regulated or intertwined with any type of government body. While avoiding all political risk is an impossibility 2014 demonstrated that we clearly underestimated the impact a few politicians can have on an otherwise exceptional company.

Looking Ahead – 2015

There is no doubt that 2014 was a difficult year, but looking ahead there is a lot to be excited about. Our current portfolio is loaded with undervalued companies that are performing well. The majority of portfolio's are fully invested – a statement that could not have been made 12 months prior. There is still a lot of uncertainty when evaluating the prospects of the market in general – the S&P 500 is at all-time highs, oil at all-time lows, and interest rate increases may be in the future. Regardless of how these macro-factors pan out we are confident that the businesses we presently own will be larger and more profitable in the years ahead. We are very confident that a year as dismal as 2014 on a relative basis will not be duplicated and the lessons learned are paving the way for outstanding results in the years to come.

Clarifications

For those of you that have questions about the returns in your account we would appreciate it greatly if you would read the following carefully because they answer some frequently asked questions and should put your mind at ease with respect to how we are managing your investment account.

Clarification #1 – Your results are different than what is reported on the preceding pages.

We manage all of our client accounts separately, which means that the businesses you purchased and how much you paid is dependent on when you opened your account or contributed funds throughout the year. For this reason all accounts have different results. The results reported are a collected average of all accounts. We wish that all accounts experienced identical results, but they do not, cannot, and should not.

We work extremely hard to make the best decision for each account based on the size of the account and when it was opened. If you are new to the firm your results are likely materially different than those reported – that is expected because you weren't with us for each decision we made this year.

You can, however, rest assured that as your account grows your results will converge to the firm average going forward. Smaller accounts and new comers take the most time to meld with the rest.

Clarification #2 – You may not have owned all the businesses found in this report.

When a business is available at what we believe to be an attractive price we review how much cash is available in each account and then purchase a position that we believe to be an appropriate size. If you did not own a business found in this report it is for one of two reasons:

1) You did not have an account when we made the original purchase. If you opened an account after we made an original purchase it is unlikely that you owned that business this year. We purchased the business on your behalf *only if* the business was selling for the same price we originally paid or less. If the business rose in price we did not make the purchase in your new account. This is to your advantage as it protects your investment principle. Don't be bothered that you missed some investments – there will be many ideas going forward.
2) You did not have enough cash in your account at the time of purchase. There is the potential that when we purchase a business for new accounts that your account was already fully invested.

Clarification #3 – Returns for each individual business are from the time of purchase to the time of sale.

The sections of this report entitled "Businesses Sold In 2014" & "Business Presently Owned" describe each business that we purchased, held, or sold during this year. The returns presented in these sections are total returns – meaning the return of the investment from start to finish – regardless of duration. The calendar year of purchase and sale is also provided to show an approximate holding period. We find this presentation style simple, clear, and believe it is a fair way to evaluate the success of each individual investment.

Clarification #4 – The purchase price and sale price for each business may differ from your account.

The purchase price and sale price for each business is typically the same for all clients. Differences exist for individuals that opened an account after we made an initial purchase if the price of the business had declined from our original purchase price. Those new accounts will have a different and *lower* purchase price – meaning superior results.

Clarification #5 – Different accounts held different percentages of the same investment.

Accounts may have purchased a different percentage of a particular investment based on account size. This is to minimize the impact of trading commissions charged by our custodian to your account. For example, a $100,000 account may purchase 5% of a particular stock ($5,000), but a $10,000 account may purchase 7% of the same stock ($700).

Disclaimers & Disclosures

Past performance does not guarantee future results, and a loss of original capital may occur. The information herein should not be construed as a recommendation to purchase or sell any particular security or an assurance that any particular security held in a portfolio will remain in the portfolio or that a previously held security will not be repurchased. Securities discussed herein may not represent a portfolio's entire holdings. It should not be assumed that any of the security transactions or holdings discussed herein have been or will equal or exceed the investment performance of the securities discussed.

This report is provided for the general information of the clients of Selective Wealth Management LLC. It is not intended for distribution to prospective investors unless preceded or accompanied by an effective prospectus, which contains more information on fees, charges, and other expenses and should be read carefully before investing or sending money.

Returns for 2014 have been independently verified.

Definition of the Firm

Selective Wealth Management LLC (the "Firm") is a registered investment adviser that was established in 2012 and has a single, all-cap, value-oriented, concentrated investment style approach. The Firm is based out of Lynchburg, Virginia and services institutional and retail clients in the United States. A list of the Firm's composite descriptions, as well as information regarding the Firm's policies for valuing investments, calculating performance and preparing compliant presentations, are available upon request.

Fees

Returns are presented net of management fees, custodial fees, withholding taxes and trading expenses.

Fee Schedule

The standard fixed management for all accounts is 1.25% and accounts are billed in arrears.