GreensKeeper ASSET MANAGEMENT
a division of LIGHTWATER PARTNERS LTD

The Scorecard
Issue #1 - October 2011

My Painting

One of the things that attracted me to mathematics in my university days and now investments in my middle years is the rationality and objectivity of both pursuits. You are either right or wrong in both disciplines. The difference is that with investments, the proper course of action is only proven out over longer periods of time. As Benjamin Graham - the father of value investing - wrote in his seminal work *The Intelligent Investor:* in the short run the stock market is a voting machine, in the long run it is a weighing machine.

The Scorecard will be my platform to communicate the GreensKeeper Value Fund's performance to investors and to keep score against my preselected benchmarks. I aim to deliver absolute returns to my clients (net of all fees) in excess of both the S&P/TSX Index and the S&P500 Index (measured in Canadian dollars) over the long term.

I encourage readers to start with my previous newsletters (McValue Portfolio Newsletters) which are available on the website. I started writing them for a few friends and they introduce some key concepts like *Owner Earnings, Circle of Competence* and *Intrinsic Value* that I will not repeat here.

The Inner Scorecard

My investment idol Warren Buffett has often talked about the concept of an Inner Scorecard. An Inner Scorecard is the set of criteria and standards by which a person judges himself/herself. In contrast stands the Outer Scorecard, which is a picture of self-worth predicated upon the judgments of others.

As applied to investing, my interpretation of this concept is being able to think for yourself. I often listen to the opinions of others and have occasionally changed my views on certain stocks when another person's arguments were valid and improved on my thinking. However, I have never had a hard time ignoring the short term irrationality of the stock market or the views of people that I like and respect if I disagreed with their conclusions (including many management teams). The Inner Scorecard is really about being yourself – something that I am quite good at. Fortunately for me my quirks magically become "eccentricities" as I grow older.

" The big question about how people behave is whether they've got an Inner Scorecard or an Outer Scorecard. It helps if you can be satisfied with an Inner Scorecard. "

Warren Buffett

Starbucks (Nasdaq:SBUX)

I can remember the last conversation that I had about Starbucks before buying the stock. It was at a dinner on Friday, October 24, 2008 celebrating my brother's birthday and I had just completed my analysis of the stock. I asked a few people seated around the table what they thought about the company. Recall that in October 2008 the world economy was grinding to a halt, the commercial paper market was frozen and global stock markets had just crashed 30% in the past month and as much as 10% earlier that day.

The general consensus around the table was that the company was unlikely to do well in the current environment and that I should avoid the stock. People were cutting back on spending and were unlikely to pay $4+ for a cup of coffee. As a discretionary item many people were likely to give it up or find a cheaper alternative, etc. I bought the stock on Monday morning.

What was I thinking? Despite the state of panic that existed in the world at the time I figured that people would continue to drink coffee. It is warm, makes you feel good and caffeine is mildly

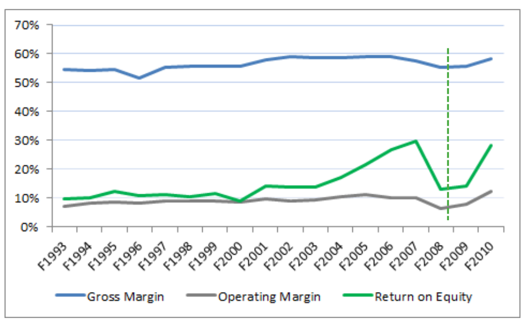
" Companies such as Coca-Cola and Gillette might well be labeled "The Inevitables." Forecasters may differ a bit in their predictions of exactly how much soft drink or shaving-equipment business these companies will be doing in ten or twenty years… In the end, however, no sensible observer - not even these companies' most vigorous competitors, assuming they are assessing the matter honestly - questions that Coke and Gillette will dominate their fields worldwide for an investment lifetime. "

Warren Buffett

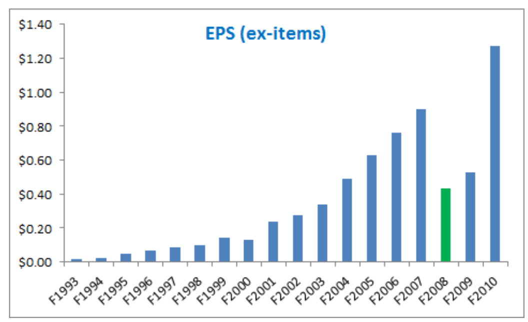
addictive. In tough times people still need small rewards to boost their spirits. Also, humans are creatures of habit and a daily trip to a Starbucks is a ritual for many people. Starbucks is the largest coffeehouse company in the world. I concluded that their ubiquity and their premium brand would mitigate migration to other lower priced alternatives. Starbucks had expanded too rapidly in recent years but the founding superstar CEO Howard Schultz was now back at the helm. Most importantly it was the numbers that spoke to me – they literally jumped off the page.

At the time of my investment the company was clearly going through a tough patch given the economic environment and their overexpansion. Stores were being closed and earnings were taking a hit. However the fact remained that Starbucks was and is an incredible cash flow machine. They sell cups of coffee for $4 – a pretty good business model. During the prior 12 months the company had generated $1.4 billion of cash from operations and spent about $1.1 billion on capital expenditures leaving $300 million in free cash flow. I estimated that $600 million of the capex was required to maintain the existing infrastructure and the rest was for expansion (new stores).

The balance sheet at the time was fine with only $740 million of net debt which existed primarily due to $3 billion of questionable share buybacks by the former CEO over the prior three years. There was $300 million of additional availability under their existing credit facilities. Even considering their off-balance sheet liabilities (leases) they were clearly going to be just fine. In a pinch they could simply slow their store growth. The numbers spoke volumes:



Source: Capital IQ



Source: Capital IQ

To me, despite the negatives and the potential risks the numbers spoke for themselves and the stock was practically being given away at what I calculated were 11 times normal owner earnings for a growing business with the market leading position. The business wasn't broken, it was just operating in a tough environment and working through some poor capital allocation decisions that had been made. I figured that Schultz would be able to fix that given his prior track record at the company. The result may not have been *Inevitable* but it was highly probable:

" Obviously many companies in high-tech businesses or embryonic industries will grow much faster in percentage terms than will The Inevitables. But I would rather be certain of a good result than hopeful of a great one. "

Warren Buffett

As any good Canadian must ask, what about Tim Hortons (TSX:THI)? There is no question that Tim Hortons is another great company with very attractive economic characteristics. Unfortunately its stock has never traded at a price at which I would consider buying it. At least not yet. Remember that even a fantastic company can be a poor investment if you overpay for its stock.

I calculated that I have made enough on my investment in Starbucks to buy a cup of coffee a day there until I am 115 years old. Let's hope that I live long enough to enjoy them all.

The Value Fund

Despite my mother's protestations to the contrary, I was never any good at art. It just wasn't my thing. But I did find my passion and talent when it came to investing.

Warren Buffett gave a speech in his native Omaha in 2003 and spoke about why he continued to work despite his enormous wealth. His answer was simple – he loved managing money and running Berkshire Hathaway:

> *"I mean, I feel like I'm on my back, and there's the Sistine Chapel, and I'm painting away; it's my painting, and somebody says, 'Why don't you use more red instead of blue?' Goodbye. It's my painting. And I don't care what they sell it for. That's not part of it. The painting itself will never be finished. That's one of the great things about it."*

Warren Buffett
Speech at the Oquirrh Club, "An Evening with Warren Buffett", October 2003.

The GreensKeeper Value Fund is my painting. I will have the bulk of my family's capital invested alongside my clients. I am truly blessed to be able to wake up in the morning and do what I love to do for a living. I will do my very best to deliver the returns that you deserve on your hard earned savings. Thank you for your trust and support.

Michael

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The GreensKeeper Value Fund

Minimum Initial Investment	$150,000
Eligible for Registered Plans?	Yes (RRSPs, TFSAs, etc.)
Launch Date	November 1, 2011
Type of Fund	Long equity, Long-term capital appreciation
Valuations	Monthly
Redemptions	Monthly on 30 days' notice
Management Fee	1.5% annual - (A series) 1.0% annual - (F series)*
Performance Fee	20% over 3.0% annual hurdle
Loss Carry-forward?	Yes – One year

Service Providers

Investment Manager	GreensKeeper Asset Management (a division of Lightwater Partners Ltd.)
Prime Broker and Custodian	CIBC World Markets
Auditor	KPMG LLP
Fund Administrator	SGGG Fund Services Inc.
Account Administrator	TD Waterhouse Institutional Services

* F series issued generally to purchasers who participate in fee-based programs through eligible registered dealers.

Michael McCloskey – Founder & President
(905) 287-5596 (direct)
(647) 990-5480 (cell)
michael@gkam.ca

2020 Winston Park Drive | Suite 100
Oakville, ON L6H 6X7

To learn more, please visit our website www.gkam.ca or contact us.

Corporate Profile

GreensKeeper Asset Management, a division of Lightwater Partners Ltd. is an independent, owner-managed asset management company. We bring a unique offering to the Canadian marketplace based on a value-investing methodology. Our investment approach and our safeguards focus on the safety of our client's capital. We aim to deliver attractive absolute after-tax returns to our investors and invest our own money alongside our clients

GreensKeeper has been over 15 years in the making. After successful careers as a lawyer at a major Toronto law firm (M&A, Corporate Finance) and an investment banker with Cormark Securities, a leading independent investment bank, Michael McCloskey established GreensKeeper in 2010.

Our Investment Philosophy

At GreensKeeper we practice bottom-up fundamental analysis combined with the value investing methodology taught by our investing heroes: Benjamin Graham, Philip Fisher, Warren Buffett and Charlie Munger. Value investing is all about buying an interest in a quality business for less than its *intrinsic value*. That discount provides us with our *margin of safety* to safeguard our clients' investments.

What We Look For - When selecting investments we scour our universe of stocks that possess the following characteristics:

> Great Businesses*:* We prefer to stick to investments in businesses that we understand, with attractive underlying economics and that possess durable competitive advantages.
>
> Solid Management: We seek investments in companies that are being run by competent and shareholder-friendly management teams.
>
> Margin of Safety: We patiently wait for the stock market to offer us a price that allows us to buy a stock for a sufficient discount to our estimate of its intrinsic value.

Our Best Ideas - The Value Fund will be managed as a concentrated or "conviction" portfolio. The benefits of broad diversification make sense for some but we prefer to make a few large bets on 15-25 situations that we understand well and where we like the risk/reward trade-off. In other words, *our best ideas*.

Aversion to Leverage - We prefer to avoid the use of leverage. We believe that doing so provides us with the benefit of never needing to sell when market conditions are difficult.

Eating our Own Cooking - Our founder has a significant percentage of his family's net worth invested alongside our clients.