Greenskeeper
ASSET MANAGEMENT INC.

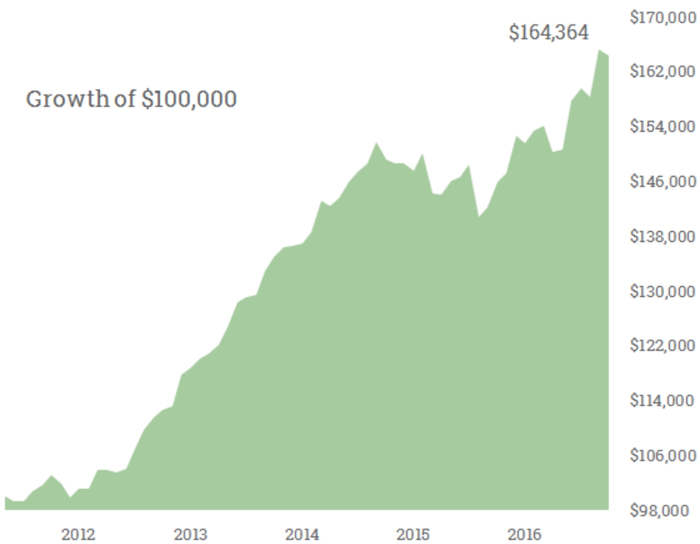
The Scorecard
Issue #18 - April 2017

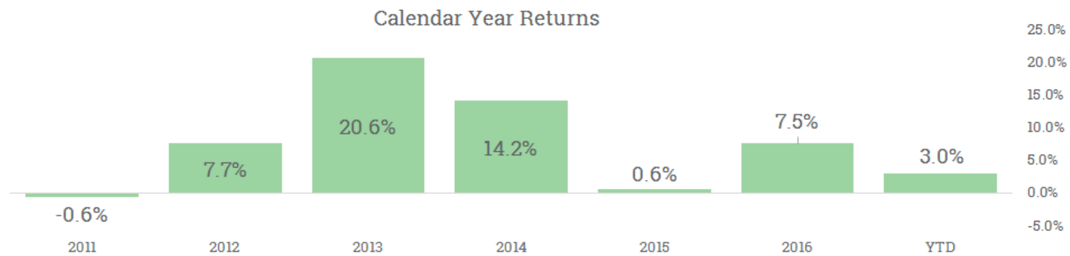
Cruel, Cruel Irony

The Value Fund returned +2.96% in the first quarter (net of fees and expenses) despite currency headwinds of approximately 0.8%.

Our best performers for Q1 by portfolio contribution were S&P Global +21.6%, Visa +13.9% and Cisco Systems +11.8%. Our laggards were our energy names, namely Exxon (9.1%) and Chevron (8.8%).

We established one new position during the quarter, added to several others and trimmed some of our year-end holdings. While the markets remain expensive, we have been able to find a few attractive pockets of value.





Notes: All returns and Value Fund details are as of March 31, 2017, based on Class A units and are net of all fees. The Value Fund was launched on November 1, 2011. Prior to January 17, 2014 the Value Fund was managed by Lightwater Partners Ltd. while Mr. McCloskey was employed by that firm.

> *""How did you go bankrupt?" Bill asked.*
>
> *"Two ways," Mike said. "Gradually and then suddenly."*
>
> Ernest Hemingway
> **The Sun Also Rises**

Home Capital Group Inc. (TSX:HCG)

Over the past year, Home Capital's stock is down (84%) and the company has lost over $2 billion of market value. Over a billion dollars of that decline happened *in the past 7 days.* The reason? A classic run on the bank. From my prior investment banking experience, I know the sector and the company very well. However, it has been so long since a bank failed in Canada that I actually had to look it up (1996 it seems).

Before delving into what is causing the current meltdown, let me first repeat what I wrote in our 2016 Annual Report about the company:

> During 2016 we also fully exited our position in Home Capital Group (TSX:HCG). This is a stock that we have purchased and sold on several occasions over the past five years. At one price we viewed it is attractive, and at another less so. More recently there have been two main issues that have factored into our decision to exit the stock. First, as the media reminds us daily, the Canadian housing market is not cheap.

That doesn't mean that a selloff is inevitable. However, it does mean that the risk for mortgage lenders like Home Capital is heightened. Second, there have been a number of company-specific issues that gave us pause. Third-party mortgage broker fraud, the retirement of the founding CEO and slowing mortgage origination. We concluded that we were better off taking profits and investing elsewhere.

For the Value Fund and all of our clients, we are watching Home Capital safely from the sidelines. But we are still watching it closely as there are many lessons worth learning and we may yet be provided with a direct (or indirect) opportunity as a result of the current panic.

Banking 101

At its heart, banking should be a fairly simple business. Banks accept depositors' savings and recycle them into loans for credit-worthy borrowers. In this way, banks serve a useful capital allocation function like the equity markets. Banks borrow from depositors at a rate below their lending rate and pocket the difference (referred to as a bank's net interest margin). Banks repeat this process many times and by growing their assets and adding leverage to their equity base they can earn attractive returns for shareholders.

One prominent feature of this arrangement is that depositors can withdraw their money on demand (hence the term demand deposits) yet banks make loan commitments for much longer periods of time. Banks borrow short (and cheap) and lend long. In order to avoid bank runs and to maintain stability, governments around the world invented deposit insurance to assure retail depositors that their money was safe.

Given this arrangement, bank runs and panics are things that governments prefer to avoid as they end up holding the bag. Hence they regulate banking activity through several means including limits on a bank's ability to use leverage.

"Liquidity is like oxygen: when it's abundant you don't notice, when it's not, it's all you notice."

Warren Buffett

Cruel, Cruel Irony

Due to this funding model, *banks are creatures of the public's confidence*. Once that confidence is lost, a bank's ability to continue to do business is put in jeopardy as it needs to constantly attract deposits in order to fund its business. Several years ago, Home Capital encountered a major mortgage fraud issue in its business which the market had previously learned about and digested. However, one week ago the Ontario Securities Commission (OSC) released allegations[1] of misleading disclosure relating to that incident against the company and some of its current and former officers. One of the OSC's mandates is to maintain public and investor confidence in the integrity of the capital markets which is presumably why they brought the allegations forward. Ironically, their actions have had the effect of spooking Home Capital's investors and exacerbating the stock's selloff.

Similarly, Home Capital's board fired its former CEO Martin Reid one month ago given the company's financial underperformance and the board's view that the company should be doing better. In a more recent statement, the board pre-released decent Q1 financial results and stated that they "recognize that we have had our share of challenges recently and the confidence of our stakeholders has been understandably shaken." Both board actions were meant to bolster confidence, but ironically seem to have heightened investor concerns about the company. Ratings agencies also took notice of the management changes and the OSC investigation and downgraded the company.

Canada's banking regulator is the Office of the Superintendent of Financial Institutions or "OSFI" as it is more commonly known. Part of OSFI's mandate is to control and manage risk and ensure that Canadian banks are sound. Unlike the US, Canada's banking sector sailed through the Great Recession with flying colours.

[1] None of the allegations have been tested or proven at a hearing or in court and the company has responded that they are without merit and will be vigorously defended. We make no comment regarding the veracity of the allegations.

With OSFI's reputation intact, Home Capital is certainly front and center with Canada's banking regulator at the moment. A little-known fact is that several years ago OSFI encouraged Home Capital to broaden its funding sources by growing demand deposits. Historically, almost all of Home Capital's funding came from fixed-term deposits (GICs) which were locked in and closely matched to the term of the company's assets (mortgage loans). Demand deposits represented $2.5 billion of Home Capital's funding at the end of 2016 (vs. only $0.1 billion in 2012). In the past month, $591 million of those demand deposits have in fact been demanded by customers and are now gone. Even though they are fully guaranteed by the Canadian government (via the CDIC), depositors are fearful and withdrew their money creating a funding issue for Home Capital.

As a result, yesterday morning Home Capital announced a one-year funding deal with a major institutional investor. Under the facility, $2 billion will be available to the company but at an interest rate of 10%. In addition, the loan comes with a $100 million non-refundable commitment fee. For perspective, Home Capital earned $247 million in all of 2016. This secured loan has an effective interest rate of at least 15% and would represent only a fraction of the company's $16 billion of deposits and GICs. Compare that rate with the 2% that Home Capital was paying on its deposits and the fact that the company earned an average of 4.24% on its assets in 2016. In other words, they can't earn a spread borrowing at 15% and lending at lower rates. You can now understand the equity market's reaction. The irony here is that OSFI's goal of reducing risk by having Home Capital diversify its funding sources may have perversely have contributed to the current run on the company's funding. Term deposits may not be renewed, but generally aren't payable on demand.

Over the past few years, a number of short sellers have been betting on Home Capital's demise. Some have been suggesting that the company is an outright fraud while others have made inflammatory statements in an effort to make mountains out of financially-immaterial molehills. The reality is that the shorts have a perverse economic incentive to try and incite panic as deposit-taking lenders are vulnerable to runs. Another reality is that most of these investors have been shorting Home Capital because of Canada's expensive housing market, the fact that Home Capital is a "pure play" on the Canadian housing market and their prediction of a Canadian housing price crash.

We concur that housing is overvalued in Canada. However, to date housing prices have continued to appreciate without any meaningful blip allowing Home Capital to make enormous profits along the way. In fact, Home Capital just pre-released that it earned $58 million in Q1. They were and remain a good lender. Over the past week, these short bets turned out to be very profitable, but ironically for different reasons than most short sellers anticipated. Their investment thesis was focused on perceived problems with the company's assets (loans), whereas the stock's recent collapse has been caused by the company's liabilities (deposits). The shorts got it right, but for the wrong reasons, and their actions likely contributed to the current bank run.

The Next (Final?) Chapter

So how does the Home Capital saga, which is still very much in progress, ultimately play out? We can foresee several possibilities. But unfortunately we do not believe that we can properly assign probabilities to each scenario or determine with enough certainty the valuation of the company's shares in each case. As a result, we plan to continue to watch Home Capital from the sidelines (but as always, reserve the right to change our minds as the facts change).

Scenario 1 – Home Capital manages its way through the crisis, albeit badly scarred. This will take plenty of time as deposits aren't the only current challenge. The company requires a new CEO and needs to regain the confidence of third-party mortgage and deposit brokers that refer business to them. The company's earnings will be severely diminished (or worse) in 2017 and a short-term dividend suspension likely. But in time, they may recover and hopefully preserve the company's >$20 per share of book value and live to fight another day.

"History doesn't repeat itself, but it does rhyme."

Mark Twain

Scenario 2 – OSFI arranges for a major Canadian bank to buy Home Capital, possibly with a regulatory backstop protecting the buyer against losses for a period of time until the business is stabilized. This makes the situation "go away" as long as the buyer is large enough that its solvency isn't brought into question as a result. This scenario reminds me of the acquisition of Bear Stearns by JP Morgan in 2008. Jamie Dimon of JP Morgan was allegedly willing to pay $4-5 per share but the deal was ultimately done at $2. The reason? Former Treasury Secretary Hank Paulson was reported to have insisted on a lower price to avoid the moral hazard of using public funds to bail out private shareholders. Remember Mark Twain's advice (at left).

Scenario 3 – OSFI puts Home Capital into resolution mode – in other words, they provide enough short-term liquidity to Home Capital and oversee an orderly liquidation of the bank's assets and the full and orderly repayment of depositors. But this doesn't fully deal with a key problem. The company's $11 billion of non-prime mortgages will come up for renewal in the next few years. If Home Capital isn't around to renew them, who is? The company built its business lending to borrowers that the major banks wouldn't or couldn't lend to.

There are likely other scenarios that I haven't even considered. But I am certain that the significance of properly managing this situation is not lost on anyone involved. Home Capital's main competitor Equitable Group Inc. (TSX:EQB) has seen a 40% decline in its shares over the past few weeks. Other smaller financial services companies shares are selling off and even the larger banks started to wobble yesterday. Contagion is very dangerous in banking and it can happen very quickly.

The latest chapter in the Home Capital saga is a sad one. In 1986, a talented real estate lawyer named Gerry Soloway decided to become an entrepreneur by founding a Canadian mortgage company called Home Capital. In the company's first year, Home Capital had revenue of less than half a million dollars and the company lost a nominal amount of money. Last year, Home Capital earned profits of almost $250 million on its $29 billion of assets under administration. Over the decades, Home Capital had been one of the best performing stocks on the TSX. How this ultimately plays out is too tough for us to handicap. But we do hope that it ends well for everyone involved. That visionary founder and the company's many honest and hard-working employees deserve a better ending to what had been a wonderful Canadian success story.

Annual Meeting

GreensKeeper's 6th Annual Meeting will be held on Thursday, June 1 at 7:00 pm at the Mississaugua Golf & Country Club. Additional details will follow shortly via separate invitation.

For those less familiar with our firm, you should know that we invest our own money alongside our clients (in my case, over 70% of my family's net worth and 100% of our investible assets). We are employee-owned and our clients get to deal directly with the people who actually make the investment decisions. We are believers in capital preservation and disciplined practitioners of a time-tested valuing investing methodology that should be a component of every investor's portfolio.

In short, we are different. If you are interested in learning more over coffee at our Oakville office or downtown Toronto, feel free to give me a call.

Michael McCloskey
President & Founder

April 27, 2017

GreensKeeper Value Fund

As at March 31, 2017

Fund Details

	Class A	Class F*	Class G**
Fund Codes	Pending	Pending	Pending
NAV	$14.20	$14.31	$10.73
MER (%)	1.8%	1.3%	< 1.8%

Load Structure	No Load
Performance Fee	20% over 6.0% annual hurdle
Min. Initial Investment	$25,000
Min. Investment Term	1 Year
Registered Plan Status	100% Eligible (RRSPs, TFSAs, RESPs, RDSPs, LIRAs, RIFs, etc.)
Inception Date	November 1, 2011
Type of Fund	Long equity, Long-term capital appreciation
Fund Category	Global Equity
Currency	CAD
Valuations	Monthly
Redemptions	Monthly on 30 days' notice
Distribution Frequency	Annually (December)

Fund Distributions (Class A)

Dec. 31	($/unit)
2012	$0.2318
2013	$0.2147
2014	$0.6542
2015	$0.2939
2016	$0.5416

Service Providers

Investment Manager	GreensKeeper Asset Management Inc.
Custodian	National Bank Correspondent Network
Auditor	KPMG LLP
Administrator and Registrar	SGGG Fund Services Inc.

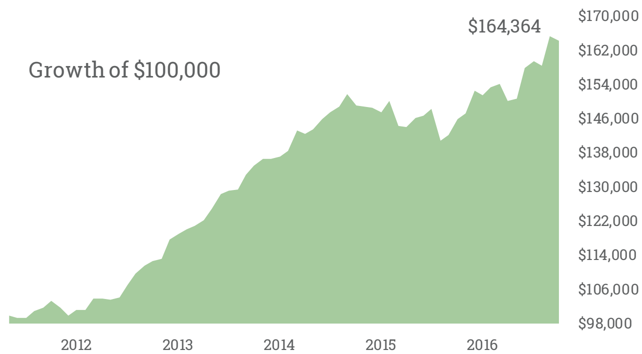
Investment Objective

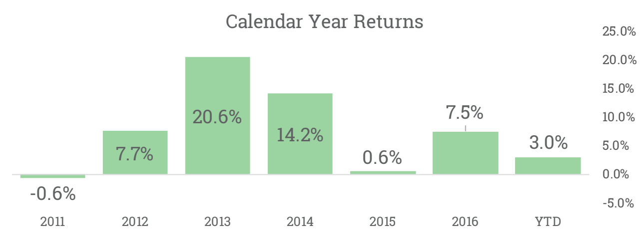
To deliver absolute returns to unitholders (net of all fees) in excess of both the S&P/TSX Index and the S&P500 Index (measured in Canadian dollars) over the long term. The Fund seeks to accomplish its set objective through investments in a concentrated portfolio, primarily in equities from any sector and market capitalization.

Investment Eligibility

Accredited Investors including Investment Advisors (IAs) with long-term time horizons seeking to better protect and diversify their clients' equity portfolios.

Portfolio Performance (Class A)





			Annualized			
Compound Returns(1)(2)	1 MO	YTD	1 YR	3 YR	5 YR	Inception
Value Fund	-0.6%	3.0%	12.6%	6.8%	9.7%	9.6%

Portfolio Allocations

Asset Mix *	
U.S. Equity	73.3%
European Equity	9.2%
Canadian Equity	8.8%
Cash and Equivalents	8.7%

Sector	
Financial Services	25.2%
Healthcare	14.6%
Insurance	13.3%
Technology	10.2%
Consumer	9.7%
Communication & Media	9.6%
Cash & Equivalents	9.4%
Energy	8.0%

* Based on corporate domicile.

GreensKeeper Value Fund

As at March 31, 2017

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Statistical Analysis (3)

	Value Fund	S&P/TSX	S&P500 ($CAD)
Fund Beta vs. Selected Index	n/a	0.35	0.43
Standard Deviation	6.0%	8.1%	9.6%
Sharpe Ratio	1.44	0.86	1.98
Best Month	4.7%	5.3%	6.9%
Worst Month	-5.1%	-6.1%	-5.5%
Percentage Positive Months	75.4%	66.2%	73.8%
Maximum Drawdown	-7.1%	-14.3%	-8.3%
CAGR Since Inception	9.6%	7.7%	21.2%

Investment Philosophy

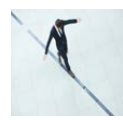
We follow a time-tested value investing process and conduct bottom-up fundamental research to identify attractive and underpriced equity investments for the portfolio. GreensKeeper believes in buying an interest in a quality business for less than its true worth or *intrinsic value*. That discount provides us with our *margin of safety* to safeguard our clients' investments.

Aversion to Leverage

Aversion To Leverage : We avoid the use of leverage. As a result, we are never forced to sell when market conditions are difficult (and stocks are undervalued).

Our Best Ideas

Only our best ~20 ideas find their way into the Value Fund. We prefer to assume shorter term volatility in exchange for what we expect will be longer-term outperformance.



How We View Risk

We reject the premise that volatility is the proper way to define and measure risk. Instead we believe that risk is best defined as the risk of a permanent loss of our clients' capital.

Disclosures

(1) All returns are as at March 31, 2017. (2) GreensKeeper Asset Management Inc. (GKAM) assumed the investment management responsibilities of the Value Fund on January 17, 2014. Prior to that date, the Value Fund was managed by Lightwater Partners Ltd. while Mr. McCloskey was employed by that firm. (3) Where applicable, all figures are annualized and based on monthly returns since inception. Risk-free rate calculated using 90-day CDN T-bill rate. * Class F Units are for purchasers who participate in fee-based programs through eligible registered dealers. ** Class G Units are for purchasers and dealers who have greater than $1 million managed by GreensKeeper and who enter into a Class G Agreement with us. Class G Units are not charged a management fee or performance fee by the Fund as Fees are paid directly to the Manager pursuant to the Class G Agreement.

This document is intended for informational purposes and should not be construed as an offering or the solicitation of an offer to purchase an interest in the GreensKeeper Value Fund or any other GreensKeeper Funds (collectively, the "Funds"). Any such offer or solicitation will be made to qualified investors only by means of an offering memorandum and only in those jurisdictions where permitted by law. GKAM is registered in Ontario, Canada under the categories of Portfolio Manager, Investment Fund Manager, and Exempt Market Dealer. An investment in the GreensKeeper Value Fund is speculative and involves a high degree of risk. Opportunities for withdrawal, redemption and transferability of interests are restricted, so investors may not have access to capital when it is needed. There is no secondary market for the interests and none is expected to develop. Investments should be evaluated relative to an individual's investment objectives. The information contained in this document is not, and should not be construed as, legal, accounting, investment or tax advice. You should not act or rely on the information contained in this document without seeking the advice of an appropriate professional advisor. Please read the Fund offering memorandum before investing.

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