Greenskeeper Asset Management
a division of Lightwater Partners Ltd

The Scorecard

Issue #5 – October 2012

> *"If I'm pretty sure I won't lose money, all the other possibilities are good ones."*
>
> **Joel Greenblatt**
> **Gotham Capital**

Birdy Num Nums

The Value Fund was up 2.8% in Q3 and 4.5% year-to-date (after all fees and expenses). Since inception the Value Fund is ahead of the S&P/TSX total return index but lags the S&P500($CAD) – our two primary benchmarks. The biggest movers in the quarter were Tempur-Pedic (+39%), Sanofi (+14%) and Home Capital (+14%). Our poorest performer was a recent addition – Joy Global (-7.9%). The 3.5% appreciation of the Canadian dollar during Q3 was also a headwind given our large holdings of US dollar denominated assets. I do not hedge our US dollar exposure as I do not believe the cost is worth it, and I am comfortable being long US dollar assets at current exchange rates.

I had planned to write about the latest addition to the portfolio (Joy Global - NYSE:JOY) but several recent events changed my mind. First, the actor Herbert Lom, best known as Chief Inspector Dreyfus to Peter Sellers' Inspector Clouseau in the brilliant *Pink Panther* movies, passed away. Next, Tempur-Pedic (a former Value Fund holding) traded strangely and subsequently announced a significant acquisition. Finally, a lot of ink was spilled critiquing Facebook's "successful" IPO which turned out to be anything but. The first event may seem difficult to reconcile with an investing newsletter but bear with me for a few moments and all will become clear.

Peter Sellers is one of my favourite character actors of all times and I must have watched each of his Pink Panther movies dozens of times. The recent passing of Herbert Lom made me reminisce about their collective comedic genius. It also made me think of one of Sellers' lesser-known films - a 1968 oddity called *The Party*. The movie consists of a series of skits involving Sellers buffoonish lead character Hrundi Bakshi being mistakenly invited to an exclusive Hollywood party. In one scene Hrundi picks up a bowl of bird seed labelled Birdy Num Nums and "feeds" them to a parrot in a large cage by hurling the entire bowl's contents at the bird. Good stuff! (YouTube: http://bit.ly/5GYarP). The investing lesson in all this… please bear with me a little longer.

Tempur-Pedic (NYSE:TPX)

My investment thesis for Tempur-Pedic (TPX) was very straightforward. In brief, I believed that: (i) people would continue to purchase mattresses, premium mattresses in particular, (ii) TPX would retain its premium brand and pricing power while tweaking its business model to respond to increased competition, and (iii) the company would continue to grow its sales and earnings over the long-term along with the growth in the premium segment. A longer version of my investment thesis on TPX is available from a recent BNN appearance (BNN video: http://bit.ly/PMvUe1).

Source: S&P CapitalIQ.

Since the date of purchase, TPX's stock price action was as follows:

The stock generally increased in price since purchase until it peaked at about $35 in mid-September and then made a sharp reversal until an acquisition was announced on Sept. 27. So what happened to the company and/or the industry during this period to justify the price action? Was the stock worth $22 or $35? The reality is that there was no material announcement that would justify the market valuing the business as much as 60% higher over that short period of time. The S&P500 was up about 11% during that time, so that only explains a small portion of the major move. The reality is that Mr. Market started to view the business more favourably and the stock as underpriced.

In my mind, the critical question that an investor must always ask is: "what is the stock worth"? If my investment thesis was correct, I believed the stock to be worth well in excess of $40. If TPX delivered the results that I expected going forward, in the long-run I trusted that Mr. Market would value the stock accordingly. By buying at less than half of what I believed it to be worth, I de-risked the purchase for my clients. Modern portfolio theory suggests that TPX is a very risky stock given that the volatility of its stock price relative to the market (Beta of 2.0) is quite high. Without putting too fine a point on it, this measure of risk is idiotic. The risk of owning a stock isn't its price volatility, it is the price that you pay relative to its intrinsic value. An intrinsic value is difficult to calculate with pinpoint accuracy, so it is important to buy cheap enough that you leave yourself plenty of cushion or *margin of safety*.

Whenever a stock that I own makes a large move (in either direction) without any noticeable change in the underlying business or its industry it usually elicits a strong involuntary emotional reaction. I can't control it - it's simply part of the human condition. My response is to try and picture the imaginary Mr. Market as one of Peter Sellers' zany characters. Should I be asking Inspector Clouseau or Hrundi Bakshi for investment advice? Of course not! This little mental trick may seem silly to you. But it is my own way of internalizing Benjamin Graham's Mr. Market allegory and a golden rule of investing: You can't value a stock by just looking at the movement in its share price.

Yes portfolio managers can be a little eccentric. But it is mental tricks like this that keep me from making rash judgments and giving in to my fight or flight responses when markets move sharply. The most important thing about investing is temperament, not intelligence.

After peaking at $35 in mid-September, TPX's share price retreated rather aggressively. Again there didn't appear to be any rationale for the change in sentiment. However, this time I suspect that there was something behind the move. On September 27, TPX announced a $1.3 billion acquisition of Sealy (NYSE:ZZ). Mr. Market was quite excited by the deal and TPX's stock was up 14.4% on the day. I didn't like the transaction and sold our entire position at $30.52. I will take our 39% three-month return and find somewhere else to deploy the capital. For those that are inclined, I published a more detailed article on the reasons that I disliked the transaction on *Seeking Alpha* which can be found here: http://ow.ly/e4lsv.

"Basically, price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal."

Benjamin Graham
The Intelligent Investor

"Success in investing doesn't correlate with I.Q. once you're above the level of 125. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing"

Warren Buffett,
Berkshire Hathaway

“If you want to find the true culprit behind the Facebook IPO ‘debacle’, take a look in the mirror."

GreensKeeper

“We have met the enemy and he is us."

Pogo

Facebook Fail

Andrew Ross Sorkin wrote an interesting article in the *New York Times* on subject of the Facebook IPO “debacle” and came to the conclusion that it was the company’s CFO – David Ebersman – who was to blame. It didn’t take long for the online comments to pile up with opinions all over the map. Having participated in many IPOs as an investment banker and in my former life as a securities lawyer, several people have asked me for my views on the matter. No surprise, I have strong opinions on the topic.

The reality of the Facebook IPO is that this was a bubble in search of a sharp object. Facebook may be an amazing social utility but it is too early to tell if it will evolve into a cash generating machine like Google. Facebook is approaching 1 billion users, a truly astonishing feat. However, its business model is still evolving as the company struggles to find ways to monetize this traffic.

So how do you value a business like Facebook? I would argue that it can’t be done. In my opinion, you cannot predict with any degree of certainty how much money the company will make in the coming years or whether or not they will be displaced by a newer technology. In other words, prudent investors should stay away. Unfortunately this approach isn’t as exciting as jumping on board of a stock that seems to go higher and higher every time that it is traded in the private market prior to the IPO. In my mind, looking around at the major parties involved, there was plenty of blame to go around.

The Company: Mark Zuckerberg is probably a genius and has created something that has changed the world and will probably continue to do so. I applaud his vision. However, he is young and inexperienced when it comes to the financial markets. Everyone has a blind spot and it is important to surround yourself with people you trust and respect that can make up for your shortcomings. If the goal of the Facebook IPO was to sell as little stock as possible for the maximum valuation achievable, then the Facebook IPO was a huge success for the company. But I don’t believe that was the goal. Mr. Zuckerberg is a billionaire many times over and his other actions don’t lead me to believe that he had any intention of overpricing the IPO. He was just out of his league. The entire executive team (including the CFO) would have been involved in the final pricing decision and the board would have been involved at one stage as well. They all had their opportunity to take a more cautious approach by pricing less aggressively, accepting a little more dilution and leaving more on the table for new investors. In my view, that is the primary mistake that the company made. The IPO “debacle” has been an unnecessary distraction to the company, its employees and their morale. People that congratulate the company for getting the best price possible fail to recognize that the IPO created lasting damage to the company’s reputation and their momentum.

The Underwriters: In an IPO, the key role of the underwriters, and the lead bookrunner (Morgan Stanley) in particular, is to assess demand and recommend an initial pricing range and a final IPO price and size. They do this based on the valuations of other similar companies that are publicly traded and indications received during the IPO roadshow. The underwriters are often faced with conflicting demands – sellers that want the highest possible price and buyers that want to buy cheap. A large “pop” in the stock means that the issue was priced too low. If the stock trades down, it was priced too dear. The right balance is to have the stock trade up slightly to balance these competing interests. When in doubt, my instinct was always to err on the side of leaving more upside for new investors. To be fair, I wasn’t in the room and don’t know the discussions that took place. Nevertheless, the fact remains that the demand that was perceived to be there dried up very quickly. The Nasdaq’s technology snafu didn’t help matters. However, Morgan Stanley could have recommended pricing lower and sizing less aggressively. Recall that the IPO pricing range and size of the offering were both increased shortly prior to the launch. The reality is that they misread the market.

"If making money right away is important to you, please take your money out."

Seth Klarman
Baupost Group

Value Fund Former and Current Holdings

AÉROPOSTALE
BERKSHIRE HATHAWAY
Cash (US$)
Cash (CAD$)
CISCO
GMP Capital Inc.
HOME CAPITAL GROUP INC.
JOYGLOBAL
Microsoft
SANOFI
TEMPUR-PEDIC
WELLS FARGO

The Investors: You may not be surprised to learn that this is where I believe most of the blame ultimately rests. At the end of the day, people were lining up to buy Facebook's stock at any price. Most buyers were likely looking for a quick flip and panicked when that didn't happen. There were even certain so-called "value" funds that bought stock in the IPO. If I ever buy a stock for the Value Fund at a valuation of 100x trailing earnings (65x forward earnings), feel free to physically knock some sense back into me. As a joke I told one of my investors (with a straight face no less) that we had bought into the Facebook IPO. His astonished reaction was priceless but he quickly figured out that I was joking. Priceless.

Valuation Matters

Markets will forever continue to oscillate between the extremes of panic and greed. The common thread is that at both extremes, most people ignore valuations to their peril and become transfixed with stock price movements. It has happened for centuries and will continue to as it is simply in our nature.(1)

I would encourage you to honestly ask yourself the following question (be honest):

> *How many times have I invested in a company after only looking at its stock chart or reading a news article without ever looking at the company's financial statements?*

Whenever you find yourself doing this, try and imagine that you are taking investment advice from Inspector Clouseau or Hrundi Bakshi. Remind yourself that he is a temperamental imbecile. Take advantage of his temporary bouts of stupidity. If, on the other hand, you can't avoid internalizing the "wisdom" that his stock quotations are imparting on you, just accept the fact that you are speculating, not investing.

My goal in building the Value Fund's portfolio (My Painting – Scorecard #1) is to assemble 15-18 stocks in exceptional businesses that I understand and at prices that I feel are very attractive. The valuation requirement means that they are often unloved by the market at present for varying reasons. On occasion things work quickly like they did in the case of Tempur-Pedic. More often, the market takes longer to agree with my view of the stocks that I have selected.

It is important that you understand my investment philosophy as I want to attract the right kind of investors to the Value Fund. My value investing philosophy and methodology will inevitably lead to some volatility in our monthly performance. My own focus is to measure the Value Fund's returns over years, through both good and bad markets. If my grasp of the facts and my reasoning are right, I am confident that we will have protected our downside and be rewarded handsomely over the long-run.

Michael McCloskey
Founder & President

(1) For an excellent book on the history of stock bubbles and human folly throughout the ages, I recommend *Extraordinary Popular Delusions and the Madness of Crowds* by Charles Mackay, first published in 1841.

GreensKeeper ASSET MANAGEMENT

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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.

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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.

This 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 Lightwater Funds (collectively, the "Funds"). Any such offer or solicitation will be made to qualified investors only by means of a final offering memorandum and only in those jurisdictions where permitted by law. Lightwater Partners Ltd 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.

The fees and expenses charged in connection with this investment may be higher than the fees and expenses of other investment alternatives and may offset profits. There is no guarantee that the investment objective will be achieved. Moreover, the past performance of the investment team should not be construed as an indicator of future performance. In addition, the performance of the GreensKeeper Value Fund should not be mistaken for, and should not be construed as an indicator of future performance. The performance figures for the GreensKeeper Value Fund are unaudited, include actual or estimated performance or management fees and are presented for information purposes only.

Certain statements contained in this presentation are based on, *inter alia*, forward looking information that are subject to risks and uncertainties. All statements herein, other than statements of historical fact, are to be considered forward looking. Such forward-looking information and statements are based on current expectations, estimates and projections about global and regional economic conditions as well as industries that are major markets for Lightwater Partners Ltd. There can be no assurance that such statements will prove accurate and, therefore, readers are advised to rely on their own evaluation of such uncertainties. Further, to the best of management's knowledge the information throughout the presentation is current as of the date of the presentation, but management and the agents specifically disclaim any duty to update any forward looking information. The GreensKeeper Value Fund strategy in no way attempts to mirror the S&P/TSX or the S&P500. The S&P/TSX Composite Index and the S&P500 Index are provided for information purposes only as widely followed indices and have different compositions and risk profiles than the GreensKeeper Value Fund.