GreensKeeper ASSET MANAGEMENT
a division of LIGHTWATER PARTNERS LTD

The Scorecard
Issue #6 – January 2013

Apples and Oranges

The Value Fund was up 7.7% in 2012 after all fees and expenses. Our biggest winners for the year were Tempur-Pedic (+38.8%), Sanofi (+29.7%) and Home Capital (+23%). Our only losing positions were GMP Capital (-17.4%) and one small position that I recently initiated but prefer not to discuss at the moment as I am still accumulating shares. So how did the Value Fund stack up against the major indices?

	30-Dec-11	31-Dec-12	Change
S&P 500 Total Return Index ($CAD)	2,195.64	2,491.67	13.5%
DJIA Total Return Index ($CAD)	23,052.21	24,987.40	8.4%
GreensKeeper Class A	$9.9433	$10.7047	7.7%
S&P/TSX Total Return Index	33,302.95	35,696.72	7.2%

	30-Dec-11	31-Dec-12	Change
S&P 500 Price Return Index ($CAD)	1,278.98	1,418.92	10.9%
GreensKeeper Class A	$9.9433	$10.7047	7.7%
DJIA Price Return Index ($CAD)	12,425.26	13,037.31	4.9%
S&P/TSX Price Return Index	11,955.10	12,433.53	4.0%

I want you to compare the two performance tables above. Did you catch the sleight of hand in the table on the right? Some mutual funds compare their results against benchmarks based on *price* return indices instead of *total* return indices. What's the difference? Price return indices only track the capital appreciation of a portfolio but ignore income generated by the assets such as dividends and interest. Total return indices, on the other hand, include this income in the return calculation. Our portfolio, like most equity portfolios, earns interest and/or dividends on many of its holdings. While using the price return benchmarks may be tempting to some (it makes a mutual fund's relative performance look better), I believe that by doing so, an equity manager is making a misleading comparison. I don't ever intend to join that club. Aim high and let the chips fall where they may is more my style. The proper benchmarks for the Value Fund are the total return indices reproduced in the first table above left.

"Well, some of our success we predicted and some of it was fortuitous. Like most human beings, we took a bow."

Charlie Munger
Vice Chairman
Berkshire Hathaway

Observant readers will have also noticed that all returns are reported in Canadian dollars. Over 60% of the Value Fund's current holdings are U.S. dollar denominated assets. That percentage will likely increase over time as most of the world's great companies are publicly listed in the U.S. When we calculate the gain or loss on any position, we measure it in Canadian dollars. Accordingly the U.S. indices should be reported in Canadian dollars as well. The Canadian dollar appreciated by 2.2% in 2012 against the greenback which had the effect of reducing the reported returns on our U.S. assets.

One last point about benchmarks is worth thinking about as you open your year-end mutual fund statements that arrive in the mail. The Value Fund, like any mutual fund, is at a disadvantage when it comes to total return benchmarks. The reason is that mutual funds incur operating fees (legal, accounting, trading commissions), foreign dividend withholding taxes and management fees, all of which reduce stated returns. That said, if a fund manager cannot beat the indices, after all fees and expenses, *over the long run*, they are not earning their keep. You always have the option of purchasing a low-cost exchange-traded fund (ETF) that will only slightly reduce the returns on the total return indices.

The Value Fund's performance in 2012 fell a little short primarily due to carrying a large average cash position during the year. The stocks that we owned performed well (better than well, actually) but I didn't hold enough of them. My conservatism cost us some performance during 2012. However, I prefer waiting for severely mispriced situations that let me sleep at night knowing that with the stocks that we own, the odds are strongly in our favour. The portfolio's cash position is now at an all-time low and I expect the Value Fund to be fully invested very shortly.

Lifelong Learning

One of the things that I love best about my job is that I get to read and think all day long. I will never get tired of learning. Investors typically get better with age as experience and knowledge are both cumulative. The daily journey is a joy and full of surprises.

At the time that I was starting GreensKeeper, I came across an advertisement in the newspaper for a liquidation auction of high-end office furniture. A major Bay Street law firm was changing buildings and decided to upgrade to the latest and greatest. I invested $5 for a copy of the auction catalogue and wandered over to the TD Bank Tower during the inspection period to have a look for myself. There were some fantastic solid mahogany office suites on offer. Not having secured GreensKeeper's office space yet, I figured I could store the furniture for a few months until I signed a lease.

On auction day I registered along with about 70 other people, many of whom were clearly professional buyers who purchase office furniture to resell. Once the bidding started I sat back and watched things unfold in order to get my bearings. The first few hundred lots were well bid and I quickly caught the hang of things and turned my attention to some reading material I had brought with me (unlike my Amex card, I don't leave home without it).

A few hours later something caught my attention and I looked up. It was the sound of silence. 'Crickets' as they say. I checked the lot number against my handwritten notes and sure enough it was one of the mahogany desks that I had inspected earlier and in excellent condition. There were probably 15 identical desks on sale that day and many of the earlier ones had gone for $600 (they retail new for about $2,600).

The auctioneer asked again if there were any bids. Silence. Just before he moved on to the next lot I put up my bid number and said '$25'. Sold! I probably could have paid less but would have been embarrassed to offer anything less. I took the desk home and stored it until I secured my office space. Wouldn't you know it, my office came fully furnished with a desk even better than the one that I purchased. Not needing two desks, I put the one I had purchased at the auction up for sale on a free online auction site. Within a few weeks I had someone interested in buying it. The buyer showed up, inspected it and didn't even negotiate my $1,100 asking price. He knew that he was getting a good deal and more than happy to pay it.

"It takes character to sit there with all that cash and do nothing. I didn't get to where I am by going after mediocre opportunities."

Charlie Munger

The hardest part about value investing is having the discipline to be extremely patient. Attractive opportunities to buy shares of excellent companies on the cheap don't come along very often. Market panics are a good source but far too infrequent. More often they come in the form of companies that are encountering a temporary problem and the market overreacts. A few stocks that I purchased for the Value Fund in 2012 were examples of this. For instance, below is the one-year stock chart for Western Union:

The use of leverage is another form of impatience. I'm not referring to a company's use of a modest amount as part of an appropriate capital structure. Nor am I referring to minimal use of leverage in an equity portfolio (although my bias is to avoid it altogether). What I am referring to is the use of significant leverage in order to attempt to enhance returns. Leverage amplifies gains but also does so with losses. And they are often called at the most inopportune time.

In both my legal and investment banking careers I have witnessed situations where people that I knew have had brokers sell their margined stock holdings due to margin calls. The consequences are severe as margin loans force a sale at the worst time to sell - when stocks are plunging. Mortgage debt is another example. Used prudently, it allows the immediate use of an asset at a reasonable cost. Too much of it provides an even larger house but at the risk of losing it altogether if something goes wrong. I have always preferred something more modest knowing that I wouldn't be out on the street when life threw me a curveball.

"Learn from the mistakes of others. You can't live long enough to make them all yourself."

Former First Lady
Eleanor Roosevelt

We all make mistakes. I do and can guarantee that I will continue to. However, time has taught me that I prefer to follow the advice of Eleanor Roosevelt and learn from mistakes the easy way - by studying the mistakes of others and avoiding the painful first-hand experience.

Patience has always guided me in the investing world. Avoiding the use of leverage and waiting for obvious stock opportunities are both dependent on maintaining the discipline of being extremely patient. It is difficult as I am driven and extremely competitive. Fortunately my fear of loss has always been stronger than my desire to compound invested capital quickly. Mathematics taught me that the magic of compounding works the same way in reverse as it does when stocks are rising. I prefer to wait for favourable situations and to avoid giving up any meaningful ground. I am fortunate in that my conservatism comes naturally. It is just how I am and have always been – in other words it is simply my temperament. That said, I have never had a problem buying a stock when it is universally hated provided that I view it to be materially mispriced and misunderstood.

My conservatism may cost the portfolio a few percentage points of performance from time-to-time, however I am convinced that it is the long-term path to success. I am currently GreensKeeper's biggest client (although I would be pleased to be displaced by any whales that you would be kind enough to send my way). Given that my investment dollars are right beside my clients (as they should be), you should know that I manage the portfolio no differently than I would were it mine alone.

Moats

A good friend of mine read my recent *Globe and Mail* article on owner earnings (**link**) but it left him with a unanswered question. Over the holidays he asked me what I meant when I referred to a company's 'moat'. He is a very well educated, intelligent and successful businessman so his question led me to a realization. Namely, investing terminology that I use daily and often take for granted may not be clear to those that don't manage investments for a living.

An "economic moat" is a *sustainable* competitive advantage that is possessed by certain very special companies. The term was coined by Warren Buffett in his 2007 Annual Letter to Berkshire Hathaway's shareholders. One of the Oracle of Omaha's many gifts is his ability to explain complicated concepts in a simple manner using metaphors that tend to stick in the mind:

"In business, I look for economic castles protected by unbreachable 'moats'."

Warren Buffett

" A truly great business must have an enduring 'moat' that protects excellent returns on invested capital. The dynamics of capitalism guarantee that competitors will repeatedly assault any business 'castle' that is earning high returns. … Our criterion of 'enduring' causes us to rule out companies in industries prone to rapid and continuous change. Though capitalism's 'creative destruction' is highly beneficial for society, it precludes investment certainty. A moat that must be continuously rebuilt will eventually be no moat at all."

Warren Buffett

Moats come in several forms and Morningstar has done a good job of categorizing them in an easily understood format. A few specific examples that I came up with should help you to understand them better:

Types of Moats	Examples
Intangible Assets *(Patents, Brands, Licenses)*	AstraZeneca, Coke, Home Capital
Switching Costs	Joy Global, Microsoft
Network Effects	American Express, Google
Scale / Cost Advantages	GEICO, Exxon, Western Union

On occasion you will discover a great business that possesses several of these economic moats (e.g. Coke – strong brand, trade secrets, economies of scale). When multiple moats are combined, the company that possess them can often keep its competitors at bay and maintain its abnormally high profits for many, many years.

Why do moats matter and why does Buffett focus so much time and effort trying to identify and understand them? The answer is: the *w i d e r* a company's economic moat, the more confident you can be about its future financial results. And when you can predict a business' future with reasonable certainty, you can value it. Knowing what a business is worth allows you to purchase its shares when the stock market does not recognize what you do.

GreensKeeper Annual Meeting – March 23, 2013

My goal in building the Value Fund's portfolio (My Painting – Scorecard #1: **link**) is to assemble 15-18 stocks in exceptional businesses that I understand and at prices that are very attractive. I am nearly finished the first draft of 'my painting' and should be fully invested in Q1 2013. My painting is unfinished and always will be as I constantly strive to make it better.

A list of selected current and former holdings of the Value Fund can be found in the margin at left. A few stocks that we currently hold are omitted as I am still building a position in them.

On completion of the annual audit of the Value Fund by KPMG, GreensKeeper clients will receive an Annual Report that will contain a more detailed discussion of the portfolio and the first full year of operations for the Value Fund. I also plan to host an Annual Meeting on Saturday, March 23 (invitation to follow) where I will make a very brief presentation and provide attendees with the opportunity to ask any and all questions about the Value Fund or investing in general. If you know of any friends that are growing tired of their current investment returns and interested in learning more about GreensKeeper and value investing, please bring them along.

If you have any questions or would just like to chat, I would be pleased to hear from you at any time.

Michael McCloskey
Founder & President

Value Fund
Selected Former and Current Holdings

Aeropostale (NYSE:ARO)

AstraZenica PLC (NYSE:AZN)

Berkshire Hathaway (NYSE:BRK.A)

Cash (US$ and CAD$)

Cisco Systems (Nasdaq: CSCO)

GMP Capital Inc. (TSX:GMP)

Home Capital Group Inc. (TSX:HCG)

Joy Global, Inc. (NYSE:JOY)

Microsoft Corporation (Nasdaq:MSFT)

Sanofi S.A. (NYSE:SNY)

Tempur-Pedic (NYSE:TPX)

Wells Fargo & Company (NYSE:WFC)

The Western Union Company (NYSE:WU)

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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.