GreensKeeper Asset Management
a division of LIGHTWATER PARTNERS LTD

The Scorecard

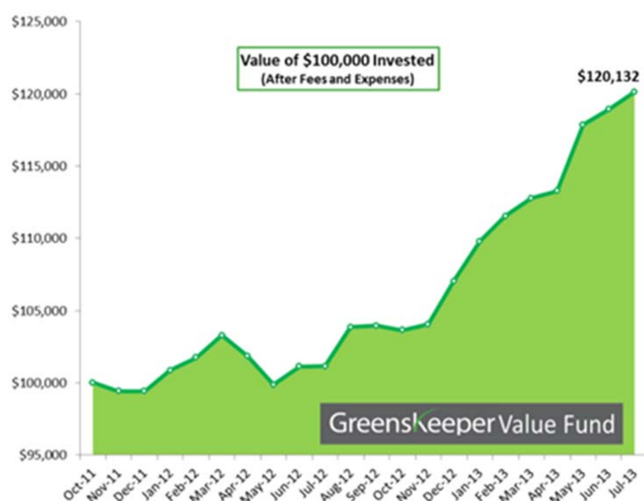
Issue #8 – August 2013

"When there's nothing particularly clever to do, the mistake lies in insisting on being clever."

Howard Marks
Oaktree Capital Management

Unconventional Wisdom

The Value Fund is up 12.2% so far in 2013 and 18.8% over the past 12 months (both figures are after all fees and expenses). Since inception we have had 17 positive months and 4 down months. As reported in our last Scorecard, it took some time to deploy our cash holdings as attractive opportunities have a tendency of presenting themselves at their own pace. The continuing influx of new investors into the Value Fund makes this a constant challenge, but one that we welcome.



2013	YTD	1-Year
Value Fund	12.2%	18.8%
S&P/TSX Total Return Index	2.3%	10.5%
S&P 500 Total Return Index ($CAD)	23.7%	28.4%

Statistical Analysis	Value Fund	S&P/TSX	S&P500 (CAD$)
Standard Deviation [1]	4.93%	8.77%	7.20%
Total Positive Months	17	12	16
Total Down Months	4	9	5
Median Market Capitalization	$34.7 Billion		
2012 Annual Turnover Rate	18.6%		

[1] Annualized and based on monthly returns since inception (Nov. 1, 2011).
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Helen and Tom

A couple that I know recently approached me for a loan but their request was declined for reasons that will soon become clear. "Helen and Tom" are fantastic people. Kind, very charitable towards others and I enjoy their company. Unfortunately they have one negative quality. Helen and Tom consistently spend more than they earn, hence their request for a loan.

Now before you think that I am completely cold hearted, I did give them the opportunity to explain why they needed the money. There were lots of great things that they planned to do with it. Despite their bad habit of overspending, I was tempted to write a cheque and asked about their thoughts on repayment.

Helen and Tom were flexible on the repayment terms (I suspect that they would take what they could get). But their clear preference was for a longer term loan so that they didn't have a maturity date hanging over their heads. Ten years would be ideal but they would take five. That made me pause to say the least.

Believe it or not, I continued to hear them out because I have known the couple for a long time and know that their credit is good. They have fairly stable incomes and I was confident that they would pay me back. Even if that meant that they would likely have to borrow from others to do so.

When I asked them my final question about an appropriate interest rate their answer surprised me. They thought that "two or three percent a year" was sufficient. They knew that the risk of their defaulting on the loan was remote and they knew that I knew that too. Given the current level of inflation and the likelihood of higher inflation in the future, Helen and Tom were really asking me for a loan that wouldn't make me a reasonable return. In fact, in inflation-adjusted dollars I would probably be going backwards.

"Neither a borrower nor a lender be."

Polonius,
Hamlet, Act I, Scene III

"Conventional wisdom is often, but not always, correct. Learn to think for yourself and when logic and reason lead you to a different conclusion, take advantage of it by reacting with equanimity."

The GreensKeeper

Put yourself in my shoes and ask yourself if you would lend them the money on this basis. Take the charitable aspect of their request out of the equation and evaluate it on purely financial terms. Be honest about it. Would you lend them the money on these terms as a prudent financial investment? Like me, I suspect that your answer is "no".

Not to worry, Helen and Tom ended up finding someone else to lend them the money. In fact they found many millions lining up to do so. For my friends' real names aren't Helen and Tom. They are Canada, the United States, Germany and several other highly rated sovereign credits.

As this allegory demonstrates, lending your money to a credit-worthy borrower for a decade at two per cent or so makes little financial sense. Buyers of sovereigns pay a steep price for the owning these "risk free" assets at current prices.

Conventional wisdom holds that as we get older, we should blindly allocate a larger and larger percentage of our investment portfolio to bonds. One hundred minus your age invested in equities comes to mind. The problem with this rule of thumb is that it doesn't factor in the relative attractiveness of bonds to other investment alternatives at different points in time. Price always matters.

Safety doesn't come from an asset class. It comes from the price that you pay for an asset. An investment can be wise at one price and foolish at another.

Before allocating our investment dollars we always determine the relative attractiveness of the options available to us. There are plenty of choices: public equities, private businesses, real estate, commodities and cash equivalents. Based on current prices, we continue to favour equities for our own investment dollars.

Now, equities aren't for everyone. Some people can't stomach the inherent volatility that comes with the markets. Others have investment horizons that are too short. Investors should take the time to speak with their own financial planner about what makes sense for them.

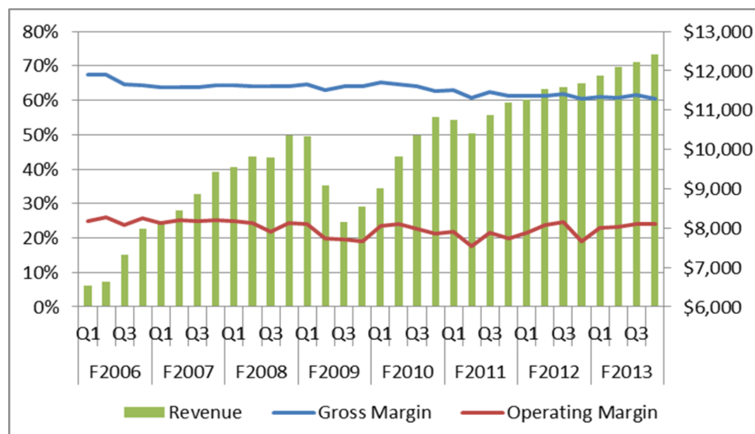
But for us, based on current prices, equities are the place to be. We will be investing our portfolio for many years to come and believe that the stock market will provide us with the best returns over the long term, despite the occasional bump in the road.

And if we can continue to find great companies to invest in at attractive prices, over time our results should not only provide us with a satisfactory result. They should turn out to be safer than investing in the broader market as well.

Cisco Systems, Inc. (Nasdaq:CSCO)

Cisco Systems is the world leader in the design, manufacture and sale of high-performance networking equipment for the Internet. Their products are ubiquitous and most often the industry standard. In an era of increasing usage of smartphones, tablets, and connected devices (the "Internet of Everything") data transfer and consumption should continue to increase exponentially. As a result, telecommunications companies, governments and other organizations will continue to require faster routers, switches, etc. to keep up with the onslaught. In other words, Cisco should benefit from a tailwind as demand for its products and services is set to continue for years to come.

Financially speaking, Cisco is an excellent business. High, stable gross and operating margins and the company generates a tremendous amount of free cash flow. Cisco has managed to maintain a dominant market share in its core routing and switching products (>50% of revenue). For example, their share of the switch market has exceeded 60% in each of the past five years. Cisco's market share in the telephone carrier router market is about 50%.



Cisco is simply dominant and brutal to compete against. These attributes should continue going forward as high switching costs, intellectual property and scale combine to provide Cisco with what we perceive to be a wide economic moat.

On August 14 after the market close, Cisco reported its fiscal Q4 results. Revenues for the fiscal year were up 5.5% from the prior year and Q4 non-GAAP EPS of $0.52 was slightly ahead of expectations. The stock dropped 8% the next day due to management's conservative short-term revenue guidance (growth of "only" 3%-5% for the next quarter). Our take of the market's reaction is that expectations for the stock were simply too high. Cisco's quarter is a great example of what value investing is all about. We thought that the quarter was decent and the guidance conservative, prudent and very short-term. In a slow-growth world, providing aggressive guidance for a large company like Cisco is unwise. It is always better to manage expectations and try to outperform. Accordingly, our investment thesis on Cisco remains intact.

Cisco currently has over $50.6 billion of cash and equivalents on its balance sheet (or $34 billion, net of debt). This represents $6.42 per share of net cash sitting idle on its balance sheet. Even if we assume that the offshore cash is repatriated and taxed, this still leaves $4.16 in net cash per share. GAAP earnings of $1.86 over the past year actually understate the company's earnings power and our calculation of *owner earnings* for the year was $2.06.[1] The current share price of $24.07 implies that the stock is trading at less than 10 times trailing *owner earnings* (net of cash) for a world-class but slow growing business.

Most often, mispriced stocks are found in oddball corners of the market. However, when Mr. Market puts the best of breed on sale, all else being equal we would rather own quality. In rising markets everybody looks great but when the tide goes out, it is usually the strong that survive.

"I would rather be certain of a good result than hopeful of a great one."

Warren Buffett
1996 Annual Report

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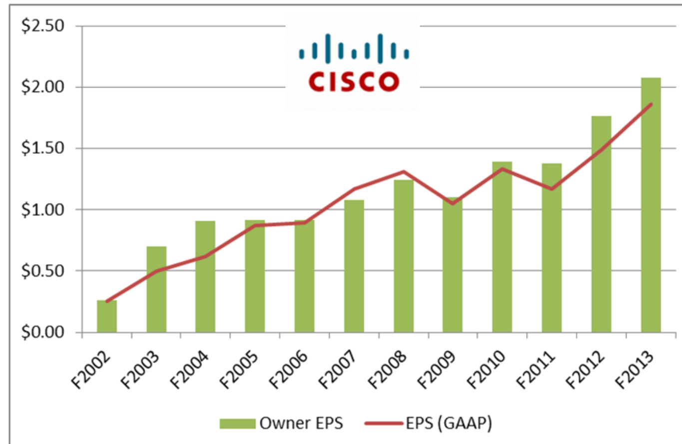
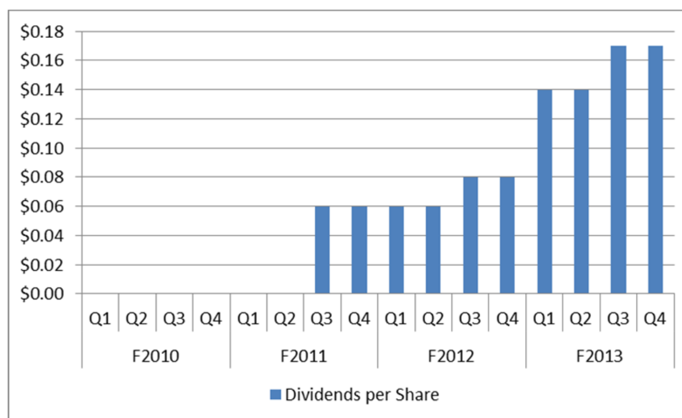
*[1] Owner Earnings are our preferred measure of a business' earnings power. A detailed description of the concept can be found in our Dec. 20, 2012 Globe & Mail article available by clicking **here**: "Add 'owner earnings' to your toolbox of financial metrics".*

Cisco's management has historically been a poor capital allocator but this has started to change over the past few years. Share repurchases, the implementation of a dividend and steady dividend increases are all positive signs. Importantly, the company has publicly stated its commitment to returning at least 50% of annual free cash flow to shareholders.



The bears on Cisco cite the risks of increasing competition and technological changes such as Software Defined Networking (SDN) that are potential threats. Cisco spent $6 billion (12% of revenue) on R&D in its past fiscal year. This figure is larger than the *revenue* for some of the competitors that are described as potential threats.



We suspect that Cisco will stay on top of industry trends and continue to work with their customers to provide best in class networking solutions. When new technologies emerge and Cisco is late to the game, they will likely continue to make tuck-in acquisitions to maintain their industry leadership position. Even after returning $6 billion to shareholders, they still have almost $6 billion available to spend on acquisitions, if necessary.

"Value stocks are about as exciting as watching grass grow. But have you noticed just how much your grass grows in a week?"

Christopher Browne
Tweedy, Browne & Co.

Our take is that Mr. Market was eager to get euphoric on the back of Cisco's Q4 results. However, management's conservative (we would say prudent) guidance did not give him permission to do so. We still believe that the stock is worth at least $30.00 and are content to continue to hold it in the Value Fund. However, we are not adding to our position at the current price as we prefer a larger margin of safety (our adjusted cost base is $17.68).

Cisco may not be a "sexy" investment but it possesses the attributes that we look for at GreensKeeper (see the quote at left which was the inspiration for our company name). Cisco's balance sheet is rock solid and we know that our money is safe and should continue to grow at a satisfactory rate over time. If Cisco happens to deliver a blowout quarter along the way, Mr. Market may get another chance to get really excited about the stock as he happens to do from time to time. If and when that happens, we plan to take full advantage of it.

Michael McCloskey
Founder & President

GreensKeeper ASSET MANAGEMENT

a division of LIGHTWATER PARTNERS LTD

Investment Objective

We aim to deliver absolute returns to our 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.

Alignment of Interests

Our founder has over 70% of his family's net worth invested alongside our clients.

Michael McCloskey
Founder & President

The GreensKeeper Value Fund

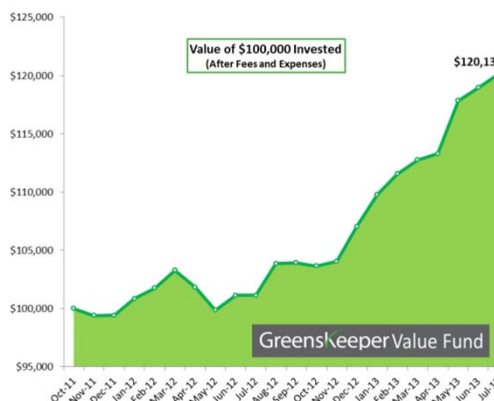
Minimum Investment	$150,000
Eligible for Registered Plans?	Yes (RRSPs, TFSAs, etc.)
Launch Date	November 1, 2011
Type of Fund	Long equity, Long-term capital appreciation
Valuations	Monthly
Redemptions	Monthly on 30 days' notice
Management Fee	1.5% annual - (A series) 1.0% annual - (F series)*
Performance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

The GreensKeeper Value Fund



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Corporate Profile

GreensKeeper Asset Management, a division of Lightwater Partners Ltd. is an independent, owner-managed asset management company. GreensKeeper was 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.

Investment Philosophy

Bottom-up fundamental analysis combined with the value investing methodology taught by our investing heroes: Benjamin Graham, Philip Fisher, Warren Buffett and Charlie Munger. We strive to purchase interests in high quality businesses for less than their *intrinsic value*. That discount provides us with our *margin of safety* to safeguard our clients' investments.

What We Look For :

> 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 is managed as a concentrated or "conviction" portfolio. We prefer to make a few large bets on 15-18 situations that we understand well and where we like the risk/reward trade-off. In other words, *our best ideas*.

Aversion to Leverage - We avoid the use of leverage. Doing so provides us with the benefit of never being forced to sell when market conditions are difficult.

GreensKeeper ASSET MANAGEMENT

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

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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 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.