GreensKeeper

ASSET MANAGEMENT INC.

2018 Annual Report

GreensKeeper
ASSET MANAGEMENT INC.

Dear Fellow Investor,

The Value Fund returned +5.3% in 2018 net of fees and expenses (or approximately +7.1% gross). We managed to outperform both of our benchmarks in 2018. The S&P/TSX Total Return Index finished down -8.9% for the year. The S&P500 Total Return Index was down -4.4% for the year. Measured in Canadian dollars (the Value Fund's reporting currency) the S&P500 Total Return was up +3.9% for the year.

This was our seventh consecutive year of positive returns. An aging bull market finally turned ugly in Q4 with steep declines in both October and December. The major North American stock indices sold off about 20% during the quarter. It was in this panicked environment that our portfolio shone. High quality companies that are undervalued tend to hold up under stress much better than former market darlings that trade at crazy valuations. Patience and hard work eventually pay off. Preserving capital by thoughtfully managing risk remains a cornerstone of our investment framework at GreensKeeper.

Given our significant U.S. stock holdings, the 8.6% appreciation of the US dollar in 2018 helped us. It basically retraced most of the 9.4% decline of the prior two years which lowered our returns in both 2016 and 2017. Exchange rate impacts on returns tend to be a wash over the long term. A more detailed explanation of our view on currency hedging (and our bias for not doing so) can be found here.

Reflections on the Market

The business media constantly tries to dissect, in painstaking detail, the root causes of market volatility and to predict the market's future direction. Especially when markets are selling off. We are often asked for our own opinion on the subject. As longtime students of the market and investor psychology, we have come to the following conclusions.

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Humans are genetically hard-wired to look for patterns and to come up with tidy narratives to explain complex events. Unfortunately, this predisposition often leads us to see patterns where none actually exist. It is our way of dealing with uncertainty. Uncertainty makes us uncomfortable. So we come up with explanations for each market move because attaching a plausible story to them makes us feel better. But that doesn't make these stories true.

The way that we process memory also causes us to think short-term.[1] We take current events and extrapolate them far into the future. As social creatures, we are also heavily influenced by the actions of others (crowd behavior). As a result, both fear and euphoria tend to be contagious. At its extremes, markets are driven purely by investor sentiment (fear and greed).

When fearful, investors focus on all the world's problems (trade wars, rising interest rates, etc.) which supports their gloomy narrative. As a result, they become risk averse and willing to part with stocks at almost any price. When euphoric, investors see the world through rose-coloured glasses. This confidence leads them to become risk-seeking and willing to purchase stocks at irrationally-high prices. During bullish periods, investors forget about risk.

When we find our emotions at either of these opposite extremes, we need to recognize it and to be cognizant of our blind spots. We need to keep calm and rely on analysis and logic, not emotion. The right temperament is essential to being a successful investor. One of our investing heroes put it this way:

> *If you're not willing to react with equanimity to a market price decline of 50% two or three times a century, you're not fit to be a common shareholder and you deserve the mediocre result you're going to get… compared to the people who do have the temperament and who can… be more philosophical about these market fluctuations.*
>
> *Charlie Munger*

Longer term, valuations drive market prices. Rising stock prices may make us feel good in the moment, but they also increase the risk of owning equities. Plunging prices make us fearful so we try to avoid pain by selling (fleeing) despite the fact that lower prices actually make owning equities less risky. Learning to fight these innate human emotions are critical to investment success. It is hard. Without possessing the proper temperament, it is nearly impossible.

The market selloff of Q4 2018 created opportunity for us. Certain stocks that we follow sold off more severely than the market indices. As a result, we started several new positions late in the year, added to a few existing positions and exited others as better opportunities arose. We are not usually this active with the portfolio but try our best to react with equanimity when opportunity knocks.

Portfolio Review

Our biggest contributor to the portfolio in 2018 was our investment in **Express Scripts** (NASDAQ:ESRX). This was a "special situation" investment related to Cigna's pending (now completed) acquisition of the company which we wrote about in detail previously. When stocks are expensive, finding value often leads us to unconventional corners of the market. Given our familiarity with Express Scripts based on a prior investment, our conviction on the M&A situation and our assessment of limited downside risk, we made a large bet (6.8% weighting). We ended up with a +23% return on our Express Scripts investment in just over five months and the investment added about 1.2% to the portfolio returns for the year.

[1] See, for example, Chapter 13 "Availability, Emotion and Risk" of *Thinking Fast and Slow*, by Daniel Kahneman – Nobel Prize winner in economics. For other recommended reading, please visit our bookshelf.

Our second-largest contributor for the year was furniture and home-goods retailer **Williams Sonoma** (NYSE:WSM). As reported in Scorecard #23, we bought the stock after a steep selloff in late 2016. After reporting strong results in September 2018, the market rerated the stock and it started trading above our estimate of fair value. As a result, we swiftly and fully exited our position. We rarely time stock purchases or sales perfectly, but in the case of WSM we nailed it. Our exit price of $71.21 was close to the stock's high for the year. Including dividends, our investment in WSM added about 1.1% to our returns for the year.

Technology stalwart **Cisco Systems** (Nasdaq:CSCO) was our third-largest contributor, adding about 1.1% to portfolio returns for 2018. We have continuously owned Cisco since inception of the Value Fund in 2011. While popular during the dot-com era of the late '90s, the stock was unloved and trading at less than 10x earnings ex-cash when we started buying it (below $18.00). Cisco may be slow growing, but it is a cash machine and uses that cash to acquire emerging technologies and rewards shareholders through a combination of growing dividends and share repurchases. Eight years on from our initial purchase, we are sitting on a sizable capital gain in an investment that we contend has been low risk given the quality of the business and our attractive entry price.

Rounding out the top five contributors for the year were **Visa** (NYSE:V) and **Berkshire Hathaway** (NYSE:BRK.A/B). These high-quality companies continue to grow earnings and should thrive for many, many years to come.

On the negative side of the ledger, **Wells Fargo** (NYSE:WFC) continued to disappoint and was our worst performer in 2018. We were initially attracted to the company due to its historical track record. At its core, Wells Fargo is a well-diversified bank with a prudent lending culture and low-cost deposit base. As a result, the company has historically delivered high returns on assets (ROA) and returns on equity (ROE) leading to attractive returns for shareholders. Unfortunately management lost the plot. In an effort to accelerate growth, senior management put undue pressure on employees which led to multiple scandals that hurt customers, damaged the company's reputation and provoked a regulatory backlash. We believe that Wells Fargo will get through this period intact but remain disappointed as this was an entirely self-inflicted wound. Our investment in Wells Fargo detracted (0.8%) from portfolio returns in 2018.

Another disappointment during 2018 was our remaining stake in **Corus Entertainment** (TSX:CJR.B). We set out our investment thesis for Corus in Scorecard #14. At the time of purchase, our analysis led us to conclude that it was one of the cheapest media stocks in North America. Despite a few twists and turns, the company delivered reasonable results and we sold half of our position at a sizable gain in 2017. Unfortunately we should have sold it all. In January 2018 Corus delivered very disappointing results and we sold the balance of our position at a loss. The gains that we made on Corus in 2017 plus the significant dividends received along the way were five times greater than the losses incurred in 2018. So overall Corus was a very profitable investment for us (buying cheap usually leads to decent results). However, when we sold the first-half of our position, Corus was only modestly undervalued. In other words, our margin of safety had largely disappeared. We try and learn from our mistakes and in hindsight, should have sold it all in 2017 and invested the proceeds elsewhere. (Hard) lesson learned.

Lest we finish this portfolio commentary on a sour note, 2018 was a good year for the Value Fund. We outperformed both of our benchmarks and almost every major asset class in an environment that was downright ugly at times. More importantly, many of our investee companies increased their *intrinsic value* at an attractive rate. We don't mind the recent market chaos as it gives us an opportunity to find bargains. In addition, many of our companies generate excess cash which they use to repurchase their own shares. Lower stock prices allow them to get more value for each dollar spent and should lead to superior long-term results provided that these companies continue to execute well on their core businesses.

We finished the year with a net cash position of about 9.9% and unrealized gains on our equity investments of approximately $4.6 million on a $25.8 million portfolio. Additional portfolio disclosures including performance statistics can be found on the pages immediately following this letter. Once KPMG completes its audit of the Value Fund's Financial Statements in March, we will provide clients with a more detailed snapshot of the entire portfolio at year end.

Facebook

One of the stocks that sold off significantly more than the market in 2018 was **Facebook** (Nasdaq:FB). With stock off as much as 40% from its peak, we took note and established a position.

We previously wrote about Facebook at the time of its initial public offering (IPO) back in 2012. Here's what we had to say about the company at that time:

> *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.*

At the time, Facebook was trading at $30 a share versus $150 today. Were we wrong in not purchasing? Perhaps. But as prudent value investors, we stand by our earlier assessment that it was too early at the time to know how Facebook would unfold (at least in our minds). But six years on, many of our questions have now been answered. In any event, the company's current challenges combined with the market selloff gave us an attractive entry price in Q4 2018.

Since its IPO, Facebook has made massive strides. Monthly active users of the platform went from 0.9 billion to 2.3 billion today. The company's IPO revenue run rate of $4 billion now exceeds $50 billion and what was a modestly profitable company will earn over $21 billion this year. Facebook has become a cash machine. The company has successfully migrated from the PC era to mobile. Emerging competitors were either eliminated via acquisition (Instagram, WhatsApp) or their popular features copied and integrated into Facebook's offerings (e.g. Snapchat). Facebook and its sister platforms are now *the* dominant social media networks and given the quality of its wide moat via network effects, that will likely be the case for many years to come.

Facebook also benefits from the increasing percentage of advertising spending that is allocated to digital platforms. Despite Facebook's significant size, these tailwinds helped the company to grow its revenues by an impressive 35% in 2018. This growth rate will inevitably slow, but at our average purchase price of $141.29 per share, we paid about 16.5x current year earnings ex-cash. For context, this is lower than the overall market multiple for a high-quality company that is growing much faster than the market.

The Facebook selloff from its July 2018 peak was due to several well-reported scandals. The company's platform was used by bad actors to influence the 2016 US presidential election. The company also has a history of paying less attention to user privacy than they should and the Cambridge Analytica scandal is but the latest incident.

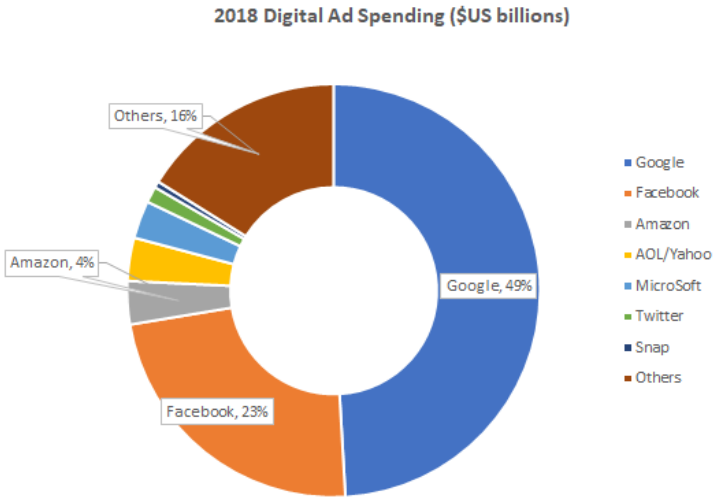
Users are mad (as they should be). Mark Zuckerberg and Sheryl Sandberg have made mistakes. But they are smart, determined to fix the issues plaguing the company and we believe that they will get through this difficult period.

Angry users of the platform will vent. But given the utility of the free service and the amount of time, effort and content that users have invested into the platform, our bet is that they will stay. Habits are hard to break. The latest user trends do not suggest that people are abandoning the platform. In fact, the number of users of Facebook-owned platforms is still growing. Given the number of users and the highly-personalized data that the company has on its users, advertising dollars will continue to flow to Facebook.

Another oft-voiced concern raised is the emergence of Amazon as a competitor for digital ad dollars. Yes, Amazon is attracting ad dollars but the actual numbers speak volumes. As the table and chart below illustrate, Facebook and Google are completely dominant. In fact, over the past two years these two companies have captured practically *all* of the incremental digital advertising spending in the world. The reason is quite simple. Given the quality and vastness of the data that these two companies have amassed on their billions of users, advertising on the platform can be highly targeted and is thus very effective. In fact, a recent survey of US digital ad buyers reported that Google and Facebook platforms delivered the highest returns on advertising investments for 86% of respondents.[2]

Digital Ad Spending - $US Billions

	2015	2016	2017	2018E
Digital Adverising				
Google	$67	$79	$95	$116
Facebook	$17	$27	$40	$55
Amazon	$2	$3	$5	$8
AOL/Yahoo	$5	$5	$5	$8
MicroSoft	$5	$6	$7	$7
Twitter	$2	$2	$2	$3
Snap	$0	$0	$1	$1
Others	$53	$56	$54	$38
TAM - Digital	$151	$178	$209	$237
Digital as % Total Ad Spend	32%	36%	41%	44%
TV	$175	$182	$178	$183
Other Media	$141	$133	$122	$119
Total Ad Spend	$466.4	$493.0	$509.3	$538.6
Capture of Incremental Digital Spend				
Google		43%	53%	74%
FB		35%	43%	54%
		79%	96%	129%



Sources: GreensKeeper estimates, Statistica, MAGNA; Recode; eMarketer

Facebook is doing the right thing by hiring thousands of additional employees to address its challenges. The additional costs associated with these initiatives will cause margins to compress over the short term. But with gross margins of 85% and operating margins of 48%, the company has margin to give and growing revenues will mitigate the impact of margin compression. Eventually, artificial intelligence (AI) will automate many of the less-efficient procedures currently being used. Unlike other media companies, content is provided by users - for free! Instagram and WhatsApp are only beginning to be monetized. Facebook has rapidly matured into a great business.

[2] Cowen and Company - December 2017 survey.

The risk of regulatory intervention is real and one that we will be monitoring closely. We think that it will be more difficult to regulate social media companies than people think. Especially by politicians that fail to comprehend basic facts such as how these platforms actually work. As with all of our investments, we reserve the right to change our mind as the facts and the future present themselves.

We like the fact that the company has over $41 billion of cash and no debt. We also like the fact that management has started to aggressively repurchase its shares ($14 billion worth over the past year) and the stock's selloff allows them to reduce their share count even faster. We agree with management's focus on increasing user engagement and make investments in the long-term health of their platforms at the expense of short-term profitability.

Our bet is that Facebook will successfully navigate their current challenges and those that will inevitably arise in the future. We also believe that the company will be making materially higher profits five and ten years from today. If they do, the combination of revenue growth, rising profits and a lower share count should turn Facebook into a highly profitable long-term investment for the Value Fund.

2019 and Beyond

My capacity to devote an even greater percentage of my time to analysis and stock selection has dramatically improved with the addition of Michelle Tait to the GreensKeeper team two years ago. Michelle does a fantastic job handling client enquiries, regulatory compliance and other administrative functions which frees up my time to do what I love most. Thank you Michelle!

I also want to thank all of our clients for the trust that you have placed in us. Investing your money (alongside our own) is something that we take very seriously. We are also appreciative of the referrals that you send us. We grew our assets under management (AUM) once again in 2018, as we have every year since inception, thanks to you.

Eight years in, My Painting (also known as the Value Fund) is not yet finished, nor will it ever be. My passion for reading and lifelong learning drive me to hone my craft in order to deliver attractive returns to the firm's clients. We will remain consistent and disciplined in our approach for many years to come.

Michael P. McCloskey

President, Founder &
Chief Investment Officer

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GreensKeeper Value Fund

As at December 31, 2018

Fund Details

	Class A	Class F*	Class G**
Fund Codes	Pending	Pending	Pending
NAV	$15.07	$15.28	$11.66
MER (%)	1.8%	1.3%	< 1.8%

Load Structure	No Load
Performance Fee	20% over 6.0% annual hurdle
Min. Initial Investment	$50,000
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
2017	$0.0000
2018	$0.5752

Service Providers

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

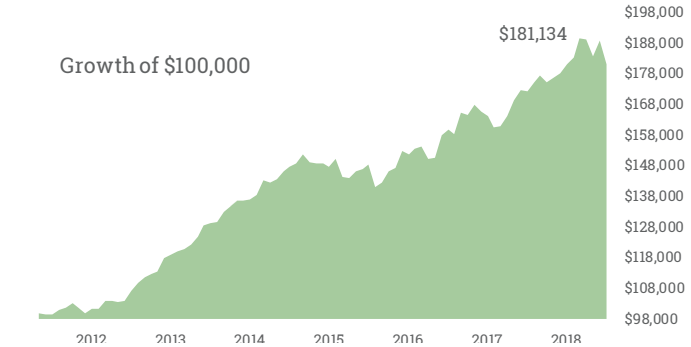
Investment Objective

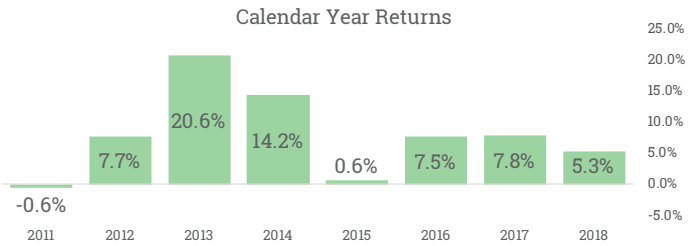
To deliver absolute returns to unitholders (net of all fees) in excess of both the S&P/TSX Index and the S&P500 Index (measured in Canadian dollars) over the long term. The Fund seeks to accomplish its set objective through investments in a concentrated portfolio, primarily in equities from any sector 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	-4.0%	5.3%	5.3%	6.9%	7.0%	8.6%

Portfolio Allocations

Asset Mix *	
U.S. Equity	80.7%
Cash and Equivalents	9.9%
European Equity	8.0%
Canadian Equity	0.9%
U.S. Options	0.5%

Sector	
Technology	30.8%
Financial Services	17.6%
Insurance	16.1%
Cash & Equivalents	9.9%
Healthcare & Pharma	7.8%
Consumer & Retail	6.9%
Industrial	5.1%
Energy	2.8%
Communication & Media	2.5%
Other	0.5%

* Based on corporate domicile.

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GreensKeeper Value Fund

Portfolio Manager

Michael McCloskey
B Sc, JD, MBA, CIM, AR
Founder, President &
Chief Investment Officer
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michael@greenskeeper.ca

Our founder is among our largest investors and has over 70% of his family's net worth invested alongside our clients.

- Former Investment Banker (2002-2010)
- Former Lawyer (Partner), Securities and M&A (1995-2002)

Statistical Analysis [3]

	Value Fund	S&P/TSX	S&P500 ($CAD)
Fund Beta vs. Selected Index	n/a	0.39	0.47
Standard Deviation	6.2%	8.3%	10.0%
Sharpe Ratio	1.23	0.57	1.59
Best Month	4.7%	5.3%	6.9%
Worst Month	-5.1%	-6.3%	-6.6%
Percentage Positive Months	72.1%	62.8%	72.1%
Maximum Drawdown	-7.1%	-14.3%	-9.0%
CAGR Since Inception	8.6%	5.3%	17.6%

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 December 31, 2018. [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.

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GreensKeeper Value Fund

Disciplined

Value Investing is simple, but not easy. At GreensKeeper we put in the work and have the proper temperament to succeed in the stock market.

Alignment of Interests

Our founder is among our largest investors and has over 70% of his family's net worth invested alongside our clients. Does your investment manager have any of his/her own money invested alongside yours?

Owner Managed

Our clients deal directly with the people actually making the investment decisions. Do you know who is managing your money?

#DemandMore

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GreensKeeper Value Fund

Testimonials

Don't just take our word for it. See what our clients are saying :

"My family has known Michael for over 20 years and we have invested in the Value Fund. He has a track record of success and we sleep soundly at night knowing that he is growing our investments safely."

Dr. Erin Ray,
Anesthesiologist
Royal Victoria Hospital

"I have known Michael for over 15 years and consider him a valued and trusted adviser. His prudent investment approach for the long term that ignores the short term market volatility is the reason we have invested much of our long term savings with him."

Erik de Witte
Entrepreneur, Former President
TD Financing Services

"Michael has a conservative yet productive approach to selecting companies to invest one's hard earned cash. I will be increasing my level of funds with Michael."

Peter McDonnell
Retired, Former President
Adcom Inc

"We began investing with GreensKeeper in 2013. A large portion of our three grandchildren's education money is guided by Michael McCloskey and his patient advice. We have a long-term view towards investing and trust in the fund's risk aversion strategy for preservation of capital. I recommend GreensKeeper to my friends and family."

Timothy A. Brown
President & CEO
ROI Corporation

The foregoing testimonials are from existing GreensKeeper client families and may not be representative of the views of all people or investors. Certain testimonials were provided unsolicited and others were provided by request.

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Appendix

Audited Financial Statements

(Clients)

GreensKeeper
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