July 22, 2021

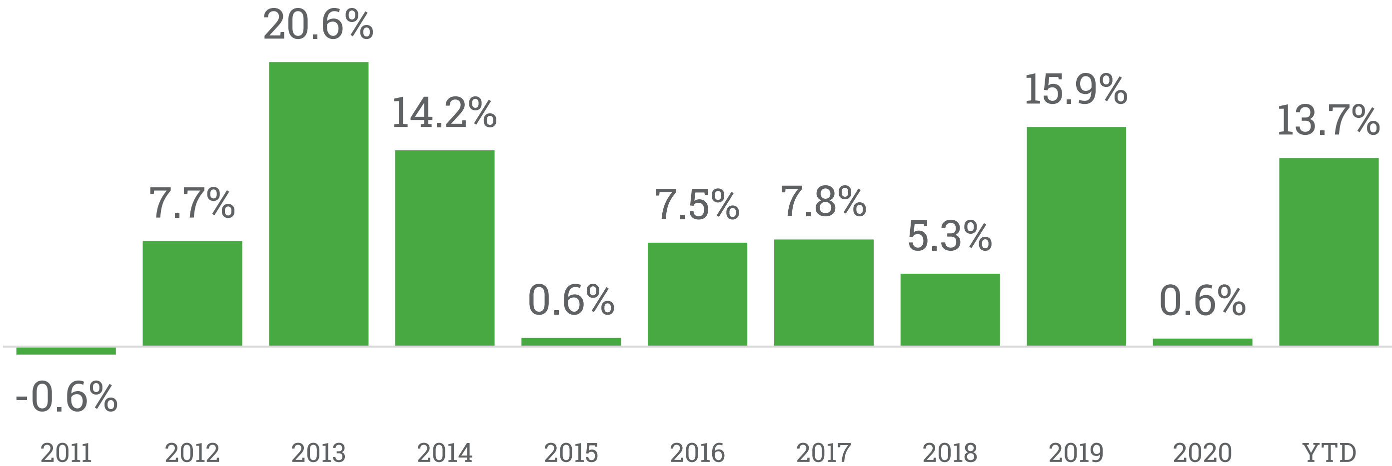
Bedrock

The Value Fund was up +7.2% in Q2 and is up +13.7% year-to-date (YTD) net of fees and expenses. The weakening US dollar lowered our returns by approximately (1.3%) in the quarter and (2.5%) YTD. As of June 30, the S&P/TSX Total Return Index was up +17.3% and the S&P500 Total Return Index ($CAD) was up +12.2%.

Our best performing stock in Q2 was our investment in **TVA Group** (TSX:TVA.B) +38.3% which we discussed in Scorecard #33. The company recently announced a project to build a new $53 million soundstage in Montreal which is scheduled to open in 2023. This is the company's highest margin segment and as a recent article in the Wall Street Journal highlights, soundstages are in short supply given rising demand for filmed content. Despite the stock's move, we continue to believe it is undervalued.

Our holdings in tech behemoths **Alphabet** (GOOG) +21.2% and **Facebook** (FB) +18.1% rounded out the top three contributors for the quarter. We hope to hold these long-term compounders for many years to come.

Our only detractor during the quarter was our investment in **Intel** (INTC) -12.3%. Intel is a turnaround story that will likely take years to play out. We believe that new CEO Pat Gelsinger is making intelligent decisions and at current valuations, are content continuing to own the stock.



The only major portfolio move during the quarter was the sale of our entire stake in **Organon** (OGN). Organon was a spinoff (dividend) from our holding in **Merck** (MRK). As with many drug spinoffs, Organon was loaded up with debt and slow growing, so we headed for the exits shortly after receiving the shares.

We are off to a good start in 2021 and as of writing, July has continued that positive trend. That said, we remain wary of lurking risks given the market's overall valuation.

Portfolio "Look Through"

To survive Mother Nature's inevitable storms, a house must be built on a solid foundation with quality materials. We teach this to our children via the fable of The Three Little Pigs. Yet in the current bull market, many adults seem to have forgotten that childhood lesson when it comes to their financial house.

Seeking quick riches and egged on by the media and envy, we see many investment portfolios that are built of straw (Bitcoin and other speculative assets) and sticks (unprofitable companies trading at insane valuations). We prefer our investment portfolios to be constructed of brick.

In order to verify that our investment foundation is solid, we recently analyzed the Value Fund's holdings quantitatively and compared them to the S&P 500 Index. Instead of presenting the Value Fund as a mutual fund, we aggregated its underlying holdings at different periods of time and presented the portfolio as if it were a company (called a "look-through" analysis). We then did the same with the S&P 500 Index. The results are presented in the table below.

		GreensKeeper Value Fund					S&P500
		2017	2018	2019	2020	2021*	2020
Quality	Return on Equity	28%	39%	39%	23%	29%	11%
	Gross Margin	52%	49%	53%	58%	59%	44%
	Operating Margin	27%	24%	30%	29%	33%	12%
	Cash Conversion	127%	109%	93%	120%	118%	94%
Safety	Interest Coverage	18x	14x	15x	22x	22x	6x
Valuation	Free Cash Flow Yield	7.2%	7.1%	5.0%	5.3%	6.1%	3.7%

Source: Greenskeeper Asset Management / Bloomberg / S&P Captial IQ. Return on Equity, Gross Margin, Operating Margin, Cash Conversion and Free Cash Flow Yield are the weighted mean of the underlying companies invested in by the Greenskeeper Value Fund and the mean for the S&P 500 Index. The S&P 500 Index figures exclude financial stocks except for ROE which includes all sectors. Interest coverage figures are median and exclude financial stocks. Ratios are based on last reported fiscal year accounts as at the respective dates and as defined by S&P Capital IQ. Cash Conversion compares Free Cash Flow with Net Income. Free Cash Flow Yield for the S&P500 uses the period-end median. *2021 figures as of June 30.

So, what do the numbers above tell us? First, the Value Fund "company" is above average in quality:

- Returns on Equity employed are far in excess of the broader market. As a result, our "company" generates more cash for each dollar of equity capital required to operate and grow the business. That cash can then be redeployed in the business at favourable rates or returned to shareholders.

- Gross margins are comfortably higher than the market average. We own businesses with pricing power that can charge more for their goods and services than the typical business due to their moat (brand, network effects, switching costs, etc.). This will prove to be handy should inflation persist.

- Operating Margins are also significantly higher than the market average. Our companies usually benefit from scale and efficiency.

- Cash conversion is another tell of quality. Our companies typically generate free cash flow that exceeds their accounting net income (currently about $1.18 for each $1.00 of accounting income versus $0.94 for the broader market).

Next, we recognize that Return on Equity can be increased merely by adding financial leverage. But surprisingly, our companies generate higher ROEs while having *lower* financial leverage. Whereas the broader market has operating earnings (EBIT) of about 6x their underlying interest expense, our companies currently cover their interest obligation by over 22x and use debt sparingly. In other words, our companies are more conservatively financed.

Given the quantitatively superior business quality and lower financial leverage, one would expect that our portfolio of companies would trade at a premium to the market. But they don't. We use free cash flow as a proxy for our preferred measure of business earnings (Owner Earnings). Reported earnings are subject to vagaries of accounting conventions and management judgment but cash is hard to manipulate.

- As of year-end 2020, the Value Fund holdings were delivering a free cash flow yield of 5.3% based on prevailing market prices. This compares with the broader market at 3.7%. At market prices, we were paying less for each dollar of free cash flow than the market overall. It is also worth pointing out that many of portfolio holdings have appreciated materially in value since purchase. That implies that the yield at the time of purchase was even higher.

Superior business economics, lower financial leverage and undervalued relative to the market. That's the bedrock that our portfolios are built upon.

Trying to predict and successfully time when the next storm will arrive is not a substitute for sturdy construction. Financial storms tend to arrive with little warning. The key to resilience is to know that they will inevitably come and to prepare in advance.

GreensKeeper Value Fund

Top 10 Holdings *	Sector
Alphabet Inc.	Technology
American Express Company	Financial Services
Anthem, Inc.	Healthcare & Pharma
Berkshire Hathaway Inc.	Insurance
Facebook, Inc.	Technology
Intel Corporation	Technology
Merck & Co., Inc.	Healthcare & Pharma
Pfizer Inc.	Healthcare & Pharma
TVA Group Inc.	Communications & Media
Visa Inc.	Financial Services

** As of June 30, 2021. The Value Fund's holdings are subject to change and are not recommendations to buy or sell any security.*

Putting in the Work

Our recent video series was a big hit – thank you for all the positive feedback and to Michelle and James for helping to make it happen.

Recent business school graduates Wonhee Cho and Mark Fortino have been a welcome addition to the firm's research team for the summer. The look-through analysis above and a deep dive on our investment in **TVA Group** are but two examples of projects that they have been working on. A summer of stock picking is my idea of fun. Their bios and those of the rest of our team can be found here.

Enjoy the summer!

Michael P. McCloskey

President, Founder &
Chief Investment Officer