Giverny Capital Inc.

2001 ANNUAL REPORT

[Note: This annual report has been translated from my native French for the benefit of English Canada, USA managers, friends, and potential clients.]

For the year ending December 31st 2001, our return was 15% compared to 0% for our benchmark (a weighted combination of five indexes, three American and two Canadian) and –6% for the S&P 500. These returns all include around +5% due to the variation of the Canadian dollar.

Since starting the fund, September 1st 1993, our annual return has been 23.5% compared to 13.6% for our benchmark and 15.9% for the S&P 500.

Year	Giverny	Benchmark *	+/-	S&P 500	Vs S&P
1993-1994	**25%**	4%	20%	8%	17%
1995	**50%**	24%	26%	36%	14%
1996	**27%**	23%	4%	21%	6%
1997	**40%**	29%	11%	39%	1%
1998	**20%**	19%	1%	38%	-18%
1999	**13%**	16%	-3%	14%	-1%
2000	**13%**	3%	10%	-6%	19%
2001	**15%**	0%	16%	-6%	21%
Total (in Canadian $)	**481%**	**190%**	**291%**	**242%**	**239%**
Annual return	**23.5%**	**13.6%**	**9.9%**	**15.9%**	**7.6%**

* :   Weighted combination of 5 indexes including the S&P 500 in the US and the TSE 300 in Canada.

These results are good but not as good as they look. The continuous fall of the Canadian currency since 1993 has added around +3% per year to our annual return. It is interesting to note though that our return has been quite similar for our Canadian securities and our U.S. securities, which is about 20% a year.

These results are in line with our initial objectives, which were stated in 1993 as “a 20% annual return and/or 10% better than the indexes”. At that time, there were much more opportunities than today (we could then buy great companies at less than 10 times earnings). Also, I was younger and less realistic than I am today! To illustrate how ambitious (and unrealistic) this objective was, we can remind ourselves that very few money managers over the years have sustained 20% annually. Over the last 10 years, only 7 mutual funds in the U.S. (out of something like 7000) have returned 20% a year. And they are 7 specialized funds. For general equity funds, only 9 funds have returned more than 18% a year for the last decade.

In a recent Fortune article, Warren Buffett explained why stocks in aggregate are destined to return much lower gains in the next decade. Of course, it's hard to come out with precise figures but something like a range of 5 to 8% a year would look realistic to both Mr. Buffett and me. Making 20% a year in such an environment is close to impossible. Even making 5% more than indexes is a very ambitious goal. But this is what we'll aim for in the next decade. So we would be very happy to earn 10-12% on our capital in the next years.

Even if these new objectives look more realistic, I could be wrong in more than one way. I can't promise results, both for stocks in general and for our relative performance. You can be certain of at least one thing though: I have my own money in the same stocks as you. So we're in the same boat! Many investors would concur that they sometimes have their counselors ride in yachts as they are still sailing in rowboats. This is not the case at Giverny Capital.

The Year 2001

The year 2001 was the first one since we've started this fund that "our boat" sailed through the rough water of a recession. As soon as we decide to become a businessman (woman) – and this includes owning part of companies which are commonly know as "stocks" – we have to accept one fact of life: recessions are inevitable in our capitalist system. That's why I look for businesses that should survive these kinds of periods (although thinking they are "immune" is most of time an illusion) and even perhaps increase their market share as weaker competitors go under! It's during these periods that we can distinguish winning companies from the other kind.

The steep decline that followed the September 11 attacks and the subsequent rise of stocks remind us that, in the universe of stock markets, it is better to buy in rainy days than in sunny days. Because when the sky is all blue, stocks are often changing hands at prices that *reflect* the fact that a majority of investors (!) believe that the sky will stay blue forever. In recessions and other crisis, it's the opposite: many will sell their stocks at any price thinking that never again will the blue sky return. To be able to keep in perspective stock market's sunny days from rainy days is a quality that is quite useful to develop.

Technology stocks

In the fascinating world of technology stocks, the depth of the decline in 2001 is only equal to the boom years of 1999-2000. Fabulous excesses (see the 1999 annual report) that existed in the Internet universe have vanished. In fact, not only has the excesses vanished, many companies have vanished themselves. Businesses that are linked to the semi-conductor universe have seen their revenues fall by 50%. Those within the telecom industry have seen similar fall but they were worsened by the high level of leverage. Many of these companies are losing money and for a lot of them, survival is now a daily fight. At this moment, there are few signs of a recovery. But in the long run, there is no reason to believe that the "technological revolution" has ended. It is – in my opinion – probably only a pause but it's a deep and long one. Patience seems in order.

In spite of this, over the years we have done quite well with our technology businesses. We had purchased some at very attractive level. For example, we bought Intel [Q:INTC] at 9 times earnings and Sun Microsystems [Q:SUNW] at 5 times in 1994. Although, we did sell at some point most of our shares of such enterprises (see the 1999 report again!) at prices that carried very high P/Es, the main problem in technology stocks is not valuation in itself. It is the changing nature of the businesses (and so the valuation that is attached subsequently to it). And it's even truer today than any time before: product cycles are now often less than a year. For example, Cisco Systems [Q:CSCO] had to take a $2 billion inventory charge in a single quarter. In such an environment, it is hard to have even a faint idea of what a technology company will look like in 10 years.

I still believe that the Internet is probably the most important industrial revolution in many decades. But we still have to be very selective because a growing industry is not synonymous with profitability. On the contrary. To have a little perspective on that, here is a passage of a *Reader's Digest* article published in October of 1983 entitled "The computer: the servant of the future":

It is believed that annual sales of personal computers will go from $350 million (M) in 1983 to some $2 billion (G) in 1987. In June 1982, Commodore was the market leader with 23,000 units sold for $28M followed by Apple and Tandy with $20M each. But new comers are plenty: Atari, Timex Sinclair and Coleco are now looking for a piece of the action. Also, Osborne is now putting on the market a portable computer that could be stored in an attaché-case.

This article – would you believe? - is only 18 years old. Sales growth of PCs turned out to be much higher than anticipated even by the most optimistic forecasters. And what kind of return would an investor had received would he had bought all the companies mentioned? Probably, he would have lost almost all of his investments? The best stock would have been Apple Computer [Q:AAPL], which is today still the same price as it was 15 years ago (and they stopped paying dividends in 1997).

But it is good to know that some technology companies did manage to do very well over the years and even overcome profound changes in their environment. Companies like Hewlett-Packard [N:HWP], Motorola [N:MOT] and Texas Instruments [N:TXN], which became public in the late 1950's, have rewarded their investors enormously. Motorola, for example, has returned 20,000% over 44 years (a stock that Philip Fisher has held – to my knowledge – since the beginning) even if the stock is at the same level as 8 years ago. Some companies did build business models that are quite solid and moats around their castle that are – in rare case – quite large. Microsoft [N:MSFT], Applied Material [Q:AMAT], Intel and even a smaller company like Cognex [Q:CGNX] comes to my mind.

But like "traditional" businesses, five factors have to be taken into consideration when judging the fundamentals of technology companies:

- The business model (market share, product innovation, etc.).
- The financial (balance sheet and profit margin) structure.
- Quality of management.
- Long-term growth perspectives (which are linked to the first three).
- Market valuation compared to intrinsic value.

Of course, without having clear views of the first four factors, the valuation exercise is futile. Past profits only rewards past investors not today's buyers. And it is future earnings that make up intrinsic value.

Even though it is an hard task, my electrical engineer background has helped us (so far) make decent returns in that universe. So we did take advantage of the "crash" in NASDAQ securities to buy back two companies that we sold almost entirely in 1999-2000: Cisco Systems [Q:CSCO] and JDS-Uniphase [Q:JDSU] (I've written in length about these two companies in the 1997 and 1998 annual reports). So we still have something like 20% of our capital invested within this fascinating universe.

Our businesses

I have the simplest of taste : I only like the best. - Oscar Wilde

M&T Bank [N:MTB]

Our largest holding is - as it was last year - M&T Bank. 2001 was another great year for our Buffalo bank: EPS were up 13%, return on assets were 1.7% and return on equity at 28%. It would be hard to find a better banker than Robert Wilmers (although Fifth Third Bancorp's management is quite outstanding). I've rarely seen such a strong business performance (EPS CAGR of 18% since 1982) that is so unknown. And M&T is much bigger now than a few years back (at that time, it was called First Empire State). M&T has now $27 Billion in assets and a market capitalization of around $5B. And even though they have this superb financial track record, outstanding management and rock-solid balance sheet, the stock still trades at 14 times earnings, even after an increase of 100% in the last months.

Cognex [Q:CGNX]

We have owned Cognex since 1996. I've talked to you about its CEO, Robert Shillman, many times over the years. After a great year in 2000, Cognex could not escape its industry problems in 2001: sales were down 50% and profits almost nil. But what matters really is the moat around its castle. And I can tell you this: before the current downturn, Cognex had little competition (now very few down from 120 when it started). After the current "depression", Cognex should emerge with an almost monopoly. But until that glorious day comes, it is good to keep in mind that the company has no debt and around $300 million in the bank ($6.6 per share versus a year end close of $25.6 for the stock). The company bought back some stock in 2001 and so did we.

Bed Bath & Beyond [Q:BBBY]

The year 2001 was not easy for many retailers. But our most important weighting in that industry did quite well. Bed Bath & Beyond increased its EPS by 27%. We first acquired shares in 1998 during the “Asian” crisis (along with shares of another retailer, Fastenal). Since then, the stock has tripled: high growth in EPS combined with an expanded P/E is a joyful experience.

Those who know me, know how much I like good stories (particularly when the “hero” becomes rich!). The story of BB&B and of its two founders is quite interesting. At the end of the 1960’s, Warren Eisenberg and Leonard Feinstein, two employees of Arlans, decided to start their own houseware store. In 1971, Eisenberg opened a small store in New Jersey near his house. Feinstein did the same in Long Island. The first years were hard (as it is for most businesses) but after six years, they decided to open a third store. Both men had a golden rule: never would the company use debt to finance its expansion. So the growth was – at first – quite slow. The business plan was simple: when they had enough money in the bank, they would open a new store. So in 1985 they had 22 stores and in 1987, the opened their first “superstore”. The secret of the company was simple: they had a decentralized structure combined with a great level of autonomy for their store manager.

With 37 stores in operation, BB&B came public in 1992 at split-adjusted price of $1 per share. In 9 years, stores count increased 10 fold (still without debt). EPS grew 30% per year (12 fold) and market value increased 20 fold. To illustrate how rare such a performance is, we can look at old charts of Wal-Mart’s [N:WMT] and see that they grew from 1985 to 1994 at a 27% annual rate. Even Kohl’s [N:KSS], the latest superstar of retailers, has grown “only” by 28% a year since 1992. But, its growth potential is not as impressive as Wal-Mart’s: management believes that they could grow to 800 stores in the U.S. So for the time being, growth projections are still quite good. Since 1992, the stock has changed hand at quite high P/Es. It looked warranted so far but a few times, every two years or so, the stock loses some ground and we can increase our investment at attractive levels (mostly for new partners). So we bought shares of BB&B again when the market reopened (following 9/11) at the end of September.

Yahoo! [Q:YHOO]

My purchase of a small weighting in Yahoo! at the end of 2000 was – to this day – not particularly rewarding. The company went from a “sure grower for many years” to one with sales down 30% and profits vanished. I still think that the company does have some important franchise value and that the long (long) term perspectives are impressive. But as for all other tech stocks, patience is needed. And it is also a little soon to view Yahoo!’s purchase as a mistake.

Progressive Corp [N:PGR]

In 1999, I've explained in length the reasons behind the purchase of shares of this Ohio car insurer. These reasons are unchanged. We are partners with great people that are building an impressive business that even challenges GEICO in direct selling. Progressive is now the number one car insurance seller on the Internet . After two difficult years, profits were solid in 2001 and the stock has more than doubled since our purchase.

Le Groupe BMTC [T:GBT.A]

In the U.S., there are much more quality companies than in Canada. On the other hand, disparities between intrinsic value and market value are often quite large in Canada. So "value" investors can make a good living in Canada although our own way of seeing value as a long-term economic wealth creation is more an handicap in Canada. That is because very few companies in Canada have sustained high EPS growth for many years. The ideal situation would be to find a great business by U.S. standard at a Canadian price! Many years ago, we did find it in BMTC Group.

We first purchased BMTC in 1995 (the day of the Quebec referendum) at $3.50 per share. In 7 years, the stock has increased 5 fold (26% a year) to close at $17.50 in 2001 (the company made a dutch tender offer of $18.50 to $21 at the beginning of 2002 and the stock climbed to $22). Not bad for a company that a client once referred as "dead wood" (isn't it the kind of wood that makes the best fire?). The secret of the success of BMTC? As most of the time, it is a great CEO: Yves Des Groseillers.

Although we did well over the years, the stock's rise has not been linear at all. At the beginning of 2001, the stock was at $9, its lowest level in three years. During that time frame, EPS had increased from $1.00 to $1.80. Since the company had around $2 a share in cash, BMTC was trading at something like 4 times earnings. It would have been quite a challenge to find such a business in the U.S. at these kinds of ratios. But our patience did prove rewarding. BMTC is now our largest Canadian investment.

The (few) transactions of 2001

We don't like to sell. Like Philip Fisher, we would like to research and buy so well we never have to sell, but we did some selling in 2001. First, we sold what was left of the shares of Hewlett-Packard we did not sell in 1999-2000. The company is in a kind of existential crisis and is looking for new ways to grow, not necessarily intelligent ways! Clearly, the PC business has not been good for HP. So instead of recognizing their mistake and get out, they decided to buy out Compaq (although I sold months before this announcement). Mr. Warren Buffett used to say: "When you're in a hole, the worst thing to do is continue to dig". I'm curious to see how the merger will work out…although we will watch the outcome from the stands.

We also sold, late in the year, our shares of Liquidation World [T:LQW]. We had held these shares for eight years and made five times our money. But I think that there could have been even more potential. When we bought the stock, LW had only 15 stores and they're up to 95 now. But lately, growth has slowed. From 1993 to 1998, annual EPS growth was 33% but from 1998 to 2001, it was only 4%. Philip Fisher insisted on one important factor that often prevents small companies from becoming large companies: depth in management. Liquidation's CEO, Dale Gillespie, is a great businessman (and a great human being) but running 50 stores is one thing; running 250 stores is another. I think that – in its present form - the company can probably grow 7 to 10% a year. That is not enough for us to attain our ambitious objectives.

We acquired shares of two new companies, both in the technology field. The first one is a company I've been following since 1998. In the annual report of that year, I've written in the section "Mistake *du jour*" that I considered buying shares of Vitesse Semiconductor [Q:VTSS] at $9 in October of that year. The stock had doubled quickly afterward. In the years that followed, the company continued to show impressive growth combined with net margins of 30%. The stock touched $100 at the beginning of 2000. It failed to $15 in April of this year and I started to buy some shares. Vitesse is a leader in high-speed integrated circuits. Lately, it has developed a new IC technology for products that could carry information at 48Gbs (48,000,000,000 bits per second) or OC-768. At such speeds, silicon begins to falter. Vitesse is using for such speed a new material called Indium phosphide. Although, Vitesse is a solid company, the risk is far from low. Applied Micro Circuits – for example – has a different approach (entirely based on silicon) and could eat Vitesse's lunch at some point. But up to this point, Vitesse has a tremendous track record.

We also acquired shares of Level 3 Communications [Q:LVLT]. Level 3 has built - at a cost of $14B - one of the World's best optical networks. The company is not profitable yet and has lots of debt. So, it is not typical of our holdings. It is my grand admiration for Walter Scott Jr. that made me break my own rules. James Crowe, Level 3's CEO, built a few years back the successful company MFS Communications (bought out by WorldCom – or was it still named LDDS Communications at that time? – in 1996). Mr. Scott Jr. is on the board of directors of another of our holdings, Warren Buffett's Berkshire Hathaway [N:BRKb].

Level 3 went from $130 in 2000 to $12 at the beginning of 2001. At that price, it seemed to me that the risk-reward ratio was in our favor. I knew that the risk level was high. And I was not wrong. The stock continued its slide to $2 to end the year at $5. Lately, the company bought back around a quarter of its debt at 30 cents on the dollar. So I felt a little more secure and increase our holding. Our cost is now $6.50. But considering the risk involved, I decided to limit the weight in our portfolios to 3%.

Owner's earnings

As you know by now, Giverny Capital is not like other money management firms. We evaluate the quality of an investment by focusing on the growth in intrinsic value instead on market price. Growth in intrinsic value in one year is based on the growth in EPS and changes in the long-term perspective of this variable. In the long run, the stock market tends to reflect those two parameters.

In 2001, our portfolio return was 10% (without changes in currencies). Our owner's earnings were down 10%. It is – by far – our worst year since 1993 but we could find some comfort in the fact that the companies that make up the S&P 500 have seen their earnings, in aggregate, fall by around 23%. Our median ROE was around 18%, which is not too bad. Our long-term objective is a combined ROE of 20%.

For 2002, I expect strong growth in our earnings. Our stocks are trading at around 20 times those predicted earnings. This level of valuation compares to 19 times for long bonds (yield of 5.4%) and to 22 times for the S&P 500. So the near term potential for stocks in general (including our own) looks very limited (of course, it is not a market prediction in any way, a futile activity that is widely spread worldwide).

Our portfolio continues to be highly focused. Ten stocks make up 75% of our fund's value. We owned these ten companies last year. At Giverny Capital, focus and low turnover goes hand in hand. In fact, we have owned four of these ten stocks for more than five years now.

Our investment philosophy doesn't reflect the conventional approach toward portfolio management. To own few stocks, to avoid some industries that we know nothing about and to ignore market fluctuations is a sensible approach but that is far from being widely used in the industry. But that doesn't disturb us a bit: since our beginning we have known that "being different" is the first ingredient of success (although there are many other ingredients needed!). I was very much influenced by John Templeton's maxim: "It is impossible to obtain a performance superior to the average unless you do *something different* from the average".

Mistake *du jour*

This yearly tradition in our annual report was very much influenced by Berkshire Hathaway's 1989 annual report. In it, Warren Buffett itemized his most important mistakes "of the first 25 years". I enjoyed this chapter so much that I decided to work hard to create "material" for this section of our annual report (on an unconscious level).

Seriously, as usual, this section could be quite long. Last year, I decided to attribute three yearly medals in honor of our Olympic tradition!

Bronze Medal: Mattel [N:MAT]

I've had a long relationship with this company. First, as a child, I was in contact with many of its products. Barbie, Fisher-Price and Hot-Wheels are brands that I can understand their strengths and weaknesses (I want to add that I've never owned a Barbie!). When I bought shares of Mattel five years ago, I had studied its history since the beginning (I've even bought a nice pink book on the history of Barbie!). I had read old Value Lines and all the annual reports I could find. So I got to know all about their problems in 1973 and in 1983 and the fantastic turnaround orchestrated by John Amerman in 1988 (in 10 years, earnings went up 10 fold). This turnaround was helped by a brilliant leader at the Barbie division: Jill Barad.

Miss Barad became CEO in 1998. Capital allocation is a different talent than salesmanship (or I should say saleswomanship). That could be the reason that she made a enormous mistake at that time by purchasing *The Learning Co.* I decided to sell all our shares at $24 at that moment. In 1999, the stock fell as low as $10. In our annual report of that year I wrote: “For now, we won’t buy shares even at this depressed level. If there is some cleaning done at some point, we could become shareholders again in the future. We never know!”.

And I’ve continued to follow the story from the stands. Miss Barad was kind of fired and Mr. Robert Eckert, ex-president of the Kraft division at Philip Morris [N:MO], took over. Since I had owned Philip Morris in the past, I was well aware of Mr. Eckert’s brilliant work at Kraft. As Mattel’s CEO, he quickly did the right things: he “gave away” The Learning Co. and focused the company back into promoting and building its strong brands. He also reduced the debt level. Strangely, for months, the stock did nothing and stagnated at $10. To me, the EPS power was at least $1.25 to some point in 2003. So, the stock looked to me as trading at half its intrinsic value. I’ve even talked about it to some friends as an example of a great turnaround. Suddenly, the stock went up 70% to attain $17. You and I did not make a dime on it because I never bought any shares back.

I’d like so much to give you some excuse for this mistake. But I can’t find one.

Silver Medal: Health Management Associates [N:HMA]

We had owned shares of HMA (which owns and manages rural hospitals in Southern United-States) for a year or so in 1999. The company has a focused business plan and a long-term horizon in its management. Most importantly, they take good care of their clients (patients), the communities involved, their employees and their stockholders. I had sold in early 2000 because the company had released a so-so quarter but most importantly because there were some new laws for Medicare reimbursement being discussed in Washington for which I could not precisely weight the effects on HMA. Being a Canadian is a handicap in understanding U.S. legislation (although many Americans would perhaps admit they don’t understand either). But HMA had a business model solid enough to withstand such changes and earnings rebounded. The stock went up 50%, which – in a year of a bear market – is quite impressive. So in light of the recent results and continued strong prospects, I decided to buy our shares back. But we paid 25% more than the price we had sold at. Clearly, I lacked patience toward a good company that deserves our capital.

Gold Medal: First Data Corporation [N:FDC]

Mattel and HMA were minor mistakes compared to my decision to sell First Data in 1999, at $45, a small profit compared to our 1997 purchased price of $35. This was a major mistake. If I had to teach a course on how to build an ideal business model

– with 4 or 5 other examples – I would first teach about First Data. First Data gets of few dollars for almost every card transaction (debit or credit) in the U.S., first from the card issuer and then from the merchant that sold the service or the product. Beyond intrinsic growth in the traditional consumer market, First Data is a strong player in Internet transactions. But – strangely – the best business of First Data is the old Western Union. WU has a near monopoly in the cash-transfer industry. It kind of sounds dull but this market is growing quite fast. Around 20% of Americans do not have a bank account. Most of these are immigrants that still send lots of money back to their former countries, where they often have families that are still there.

Back in 1997, I studied FDC's fundamentals in detailed. I had concluded that it looked like an investment with very promising long-term rewards. I started to buy shares. But in 1998-99, the company had some problems and had to do some changes in its business model. Certain businesses they had acquired from First Financial Management we're divested but still, FDC's growth seemed stalled. I decided to sell and invest in something else! Selling at that time was not that bad a mistake (just a small one!). But at the end of 2000, I was still following FDC and the fundamentals looked good again. Growth had returned to its former level but the stock was still trading at a very reasonable valuation. I then wrote an article in "Les Affaires" newspaper on the improved perspectives of the company. But why didn't I buy back the shares previously sold? I would have paid about 20% higher than the price at which I had sold. Suddenly, the stock moved up and almost doubled in an 18 months time frame.

Patience Patience Patience

In my free time, I listen to some old Wall-Street Week TV shows (I keep quite an extensive personal archive). In 1996, Louis Rukeyser interviewed the legendary Philip Carret and asked him what was the most important lesson of his 75 years of experience. Carret answered just one word: "Patience". As my three medals this year demonstrate clearly, lack of patience is still a main cause for economic losses.

Conclusion : «The Art of Investing »

Pierre Péladeau, the famous Quebec businessman (now deceased), used to say, « Business is an art ». It's a *cliché* but what he probably meant is that being a good businessman requires mind opening, creativity and lots of patience. Also, being a master artist is often being a contrarian (although you rarely see this label on art movements) or in other words: to rebel against what is perceived as conventional. The Montreal artist Marc Séguin said this very short phrase on Art: "It's an affirmation. Period". In that line of thinking, an artistic stock picking method would then be an affirmation by the manager on the kind of companies that are, in his eyes, at the *avant-garde* of businesses: Those companies (and people) that will create the wealth of tomorrow. And with time, the really artistic manager tends to develop his own personal way of selecting stocks and building portfolios. The famous investor Philip Fisher, then 89 years, said in a Forbes interview in 1996: "I want to know: Who is working on the things that others are barely aware of? I want companies that welcome dissent, rather than stifle it, that don't penalize people who criticize what management is doing". Philip Fisher is not just a great artist, he is a master!

Like art, portfolio management can rarely be done in teams (or worst in committees). We can add experience but we lose in personal creativity. Like Warren Buffett once said: "My vision of a group decision is to look into a mirror". Good artists also know that their number one enemy is the comfort that celebrity and success can bring. Marc Séguin added that after a successful show, he then would start on a totally new pictorial path. So to really continue to move forward, as a money manager, we have to find a balance between two emotions that are seemingly opposite: Self-confidence and humility. Of course, self-confidence is crucial to properly judge a company and its leaders. Also, it is the cornerstone of the huge patience often needed for a stock to be rewarding. Moreover, without self-confidence, it can be quite challenging to be able to purchase a stock that Wall Street rejects (and these are sometimes the best buys).

But at the same time, humility is widely needed: at the moment of analysis (to be humble enough to recognize what you know from what you don't), when errors occurs and also – ironically – after one or two great years of performance. The market has a way of punishing, rapidly and severely, lack of humility.

Humility is important because it is the essence of reason. The famous philosopher Eric Fromm explained why in his marvelous book "The Art of Loving":

"*The main condition for the achievement of love is the overcoming of one's narcissism....The opposite pole of narcissism is objectivity; the faculty to see things as they are...The faculty to think objectively is reason; the emotional attitude behind reason is that of humility. To be objective, to use one's reason, is possible only if one has achieved an attitude of humility, if one has emerged from the dreams of omniscience and omnipotence which one has as a child. I must then try to see the difference between my picture of a person and his behavior, as it is narcissistically distorted, and the person's reality as it exists regardless of my interests, needs and fears*."

What can be said about the art of love is true in the art of investing. In fact, genuine love - in a more personal way – is an essential part of any human creation. Woody Allen once said: "In order to be a jazz musician, you have to listen to a lot of jazz. And that's an act of love. You don't think, I'm listening to study it. You just listen because you love it…and gradually you learn. You really learn everything valuable through osmosis. It's the same with play-writing or movie-directing or acting. You love either reading or watching films or plays or listening to music. And in some way, over the years, without making any attempt, it gets into your blood, into the fiber of your body".

The art of investing is made out of the same framework.

I wish you the best of times for 2002.

François Rochon

President and money manager.

Giverny Capital Inc.

We welcome additional clients so please pass this annual report along to interested parties.