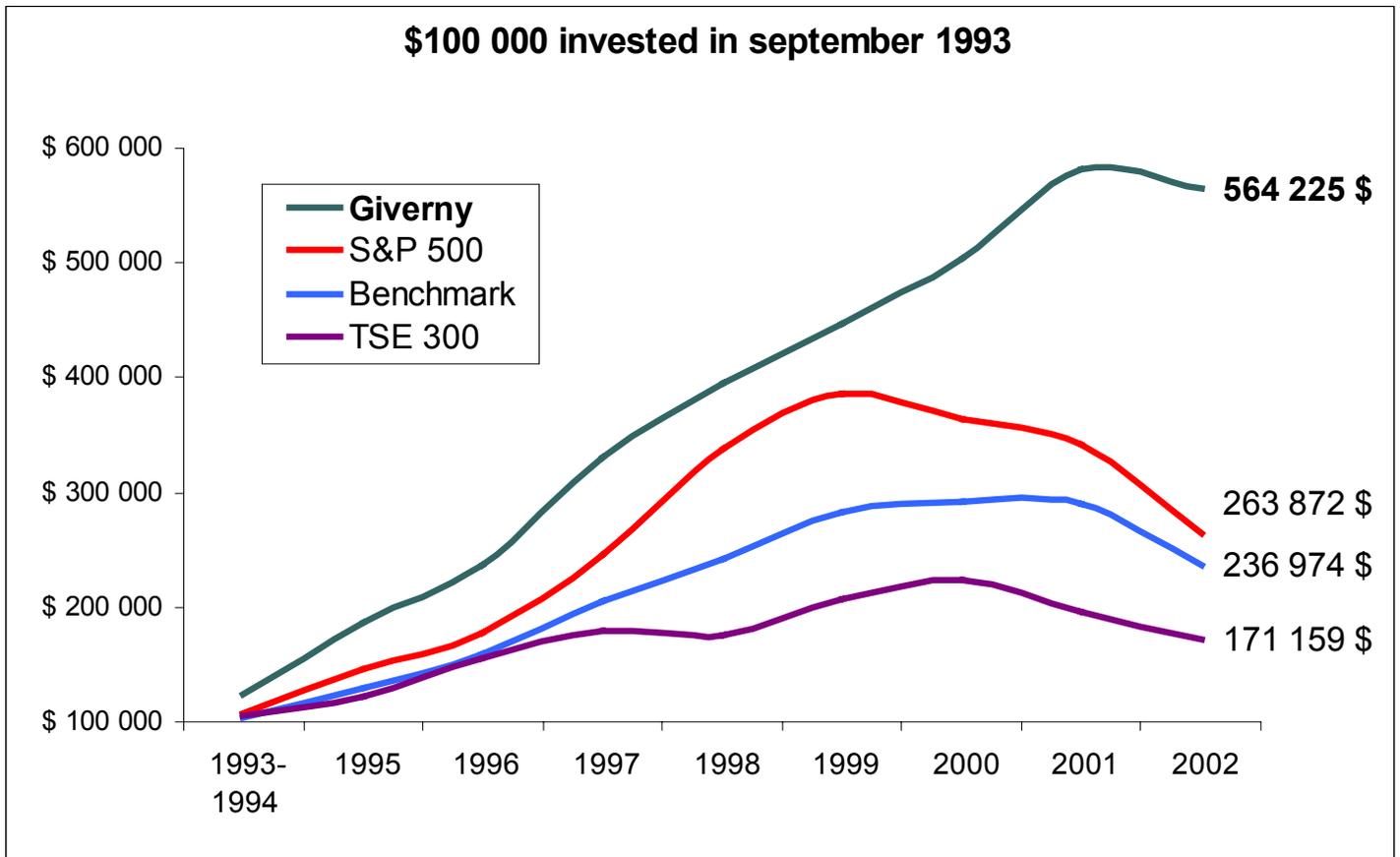


# Giverny Capital Inc.



Annual Report 2002

## Giverny Portfolio – Annual Report 2002

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For the year ending December 31st 2002, our return was -3% compared to -18% for our benchmark and -23% for the S&P 500. These returns all include around -1% due to the fluctuation of the Canadian dollar.

Since starting the fund, September 1st 1993, our annual return has been 20% compared to 10% for our benchmark and 11 % for the S&P 500.

Year	Giverny	Benchmark *	+/-	\$ Can/US	S&P 500	Vs S&P
<b>1993-1994</b>	25%	4%	<b>20%</b>	7%	8%	<b>17%</b>
<b>1995</b>	50%	24%	<b>26%</b>	-1%	36%	<b>14%</b>
<b>1996</b>	27%	23%	<b>4%</b>	-1%	21%	<b>6%</b>
<b>1997</b>	40%	29%	<b>11%</b>	4%	39%	<b>1%</b>
<b>1998</b>	20%	19%	<b>1%</b>	7%	38%	<b>-18%</b>
<b>1999</b>	13%	16%	<b>-3%</b>	1%	14%	<b>-1%</b>
<b>2000</b>	13%	3%	<b>10%</b>	4%	-6%	<b>19%</b>
<b>2001</b>	15%	0%	<b>16%</b>	6%	-6%	<b>21%</b>
<b>2002</b>	-3%	-18%	<b>15%</b>	-1%	-23%	<b>20%</b>
<b>Total (in Can \$)</b>	<b>464%</b>	<b>137%</b>	<b>327%</b>	<b>29%</b>	<b>164%</b>	<b>300%</b>
<b>Annual return</b>	<b>20.4%</b>	<b>9.7%</b>	<b>10.7%</b>	<b>2.7%</b>	<b>11.0%</b>	<b>9.4%</b>

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

As I said last year, these results are good but not as good as they look. The continuous fall of the Canadian currency since 1993 has added around +2.7% 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 18% a year.

### The year 2002

As you may have noticed, the year 2002 was again difficult, for corporations and investors alike. At the bottom of September, the total lost for the S&P 500 since March 2000 was more than 50%, its biggest decline since 1973-74.

On the other hand, our portfolio's return – although not positive in absolute dollars – was 15% better than our benchmark. These results should be considered satisfactory since our long-term objective is to obtain an annual return 5% better than the indexes. Also, for the third year in a row, we did almost 20% better than the S&P 500, a phenomenon we will probably never live again in our lifetime.

In a bear market, we can read all sorts of stories to explain stocks collapse. But in fact, the abrupt fall of the S&P 500 and the NASDAQ in the last three years can be linked primarily to a general shrinkage in P/E ratios. In the 1998 annual report, I explained why I believed that the “smaller stocks” would do better in the future than the largest capitalization of the S&P 500. I noted at that time that the valuation differences were astronomical. The largest 40 companies in market cap – which represented

50% of the weight of the index - were trading at 33 times earnings and all the other 460 were trading at around 18 times. Lately, this gap has been rectified. Now, stocks in general trade at around 17 times earnings which – in an environment of long-term bonds of 5% – looks quite reasonable.

As I often mentioned in the past, I must add this warning: It would be unrealistic to think that odds favor us in maintaining a 20% annual return in the future or even a 5% added value versus the indexes, our ambitious goal. But as I promised you since day one, I have my own money in the same stocks as you do, so we're in the same boat. Our boat, I must add, is bigger than last year. From 1993 to 1997, we were four partners (at that time the model portfolio was called the Key Fund). When I founded Giverny Capital in 1998, we were eight partners (the name we give to "clients"). At the end of last year, we were up to 20. At the end of 2002, we are now up to more than 100 partners (knock on wood!).

### **The Rule of Three**

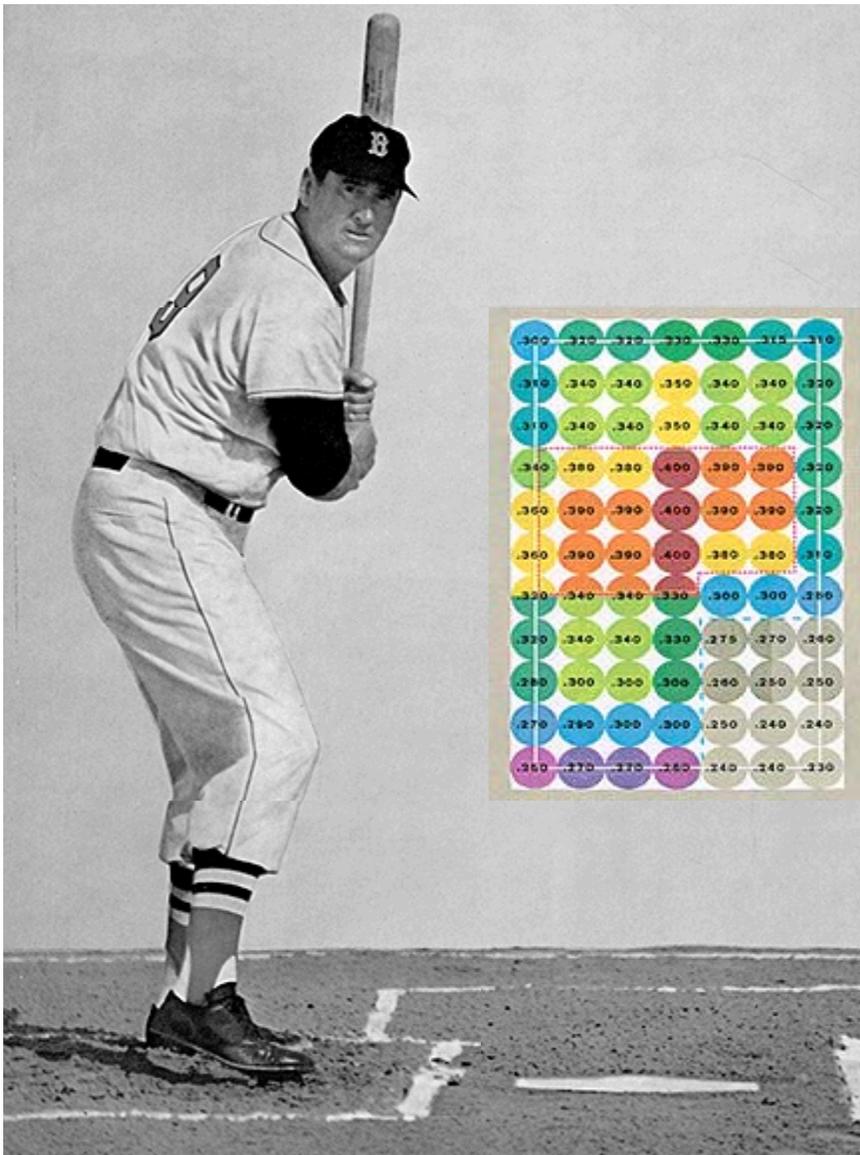
In every bear market, we see lots of investors throwing out the towel! They swear to never touch stocks again...until the next bull market. Since day one, I emphasized how inevitable stock market corrections are. I even wrote many times that they were "partners" in our quest for superior returns. So, we should not fear them but acknowledge right from the start that we will live through many corrections over the years. We should even try to benefit from them as much as we can.

In fact, I believe that there are stock market realities that should be accepted when we decide to become equity holders. I named those "The Rule of Three": One year out of three, the market will go down (by more than 10%). On stock out of three that we will buy will be somewhat disappointing. And one year out of three, we will under perform the indexes. I don't have scientific facts to offer you to explain this rule. That is why it is an empirical conclusion: it can be observed, it can't be explained. But it can be psychologically useful as knowing this rule will help us navigate through market storms. By accepting in advance that we will have tough years (in absolute terms or relative terms) and that stock mistakes are a cost of being in business, we are better prepared what they do happen. Being better prepared will help us to act in a rational way in such instances. Also, it is futile to try to predict the sequence of events. The best strategy is to be always invested in stocks and to focus on improving our selection process.

Another point: the Rule of Three is not linear. We can have three good years in a row (like 2000-2002) and then under perform for two or three years. For example, the Sequoia Fund – managed brilliantly by Bill Ruane's team – under performed the S&P 500 in the first four years of its existence from 1970 to 1973. After that, it delivered one of the best performances of all time. Another example is the Chest Fund managed by John Maynard Keynes from 1928 to 1945. After three years, its total performance was -48% compared to -36% for the British stock market. But over 18 years, he obtained an annual return of 9% compared to -1% for the British market. Keynes under performed six of those 18 years or one year out of three.

### **Ted Williams and the Art of hitting**

Being selective and discipline are two essential qualities to become a good investor. And no one has illustrated it better than the fantastic baseball player Ted Williams, who sadly passed away in 2002.



Source: The Science of Hitting

Ted Williams played with the Boston Red Sox from 1939 to 1960. Ted was obsessed by the art of hitting a baseball. He wanted to be the best at it. Obviously, he had great physical strengths but first and foremost he had great mental strengths.

He carefully studied each of his batting presence. He divided the strike zone into 77 sub-zones corresponding to a baseball surface (see figure above) and calculated his batting average for each zone. He then he became extremely discipline, swinging only the balls he knew were in his favorite spots. He finished his career with a .344 batting average, fourth on the all time list. He was also the last player to hit better than .400.

Ted's philosophy is not out of fashion in today's baseball, an era of homerun quests. If you followed Barry Bond's achievements lately (73 homeruns in 2001 and a batting average of .370 in 2002), you could notice how discipline a hitter Barry is. In 2002, he broke all historical records by obtaining 198 base on balls. The way he calmly looks at every pitch without swinging on bad balls is a pleasure for the eyes...and a nightmare for opposite pitchers.

For stocks investors, the lesson is simple: to maintain a superior average, we have to buy stocks that are in our favorite zone, that we can value. And the stock market gives us an incredible advantage that neither Ted or Barry could ever dreamed of: We can decide to let go a pitch that is in the center of the strike zone without having a strike being called upon us. Every day, the market throws us pitches: Bombardier at \$5, GE at \$30, Intel at \$18, etc. We have the luxury to wait for a ball that is – for us – big as beach ball. And as Barry Bonds does it so well, there is nothing wrong in looking at pitches that are simply not in our favorite zone. For example, oil and gold stocks aren't in my radar, whatever their prices or the geopolitical climate.

## **Our businesses**

*Quality means doing it right when no one is looking. - Henry Ford*

### **M&T Bank [N: MTB]**

Our Buffalo Bank had another great year. Its return on assets reached 1.7% and its return on equity (ROE), 29%. Earnings per share (EPS) were up 11%. M&T also announced an important acquisition last fall: Allfirst Financial. It is difficult to evaluate the future impact of this merger but I have great confidence in the judgment of Robert Wilmers, M&T's CEO. In the banking industry, I trust Mr. Wilmers' judgment more than anyone else's. M&T stock did well in 2002, climbing 10% in line with intrinsic value. This superb bank is still our biggest holding.

### **Groupe BMTC [T: GBT.A]**

Our furniture retailer had another great year in 2002. EPS were up by more than 50%. The strong real-estate market in the Province of Quebec gave a good push to sales but BMTC did also very well in tougher years. Since we first acquired shares in 1995, EPS are up 26% annually, or by a factor of five folds. The stock has faithfully rewarded shareholders by climbing from \$2 to \$14 in 7 years. The company is still debt-free with excess cash. Competition is increasing (more honey brings more bees) but I would not think of fighting in the same market as Mr. Des Groseillers, BMTC's CEO. He's the best at what it does. The newspaper *Les Affaires* recently published an all-star list of four Quebecker stocks. BMTC was one of them. And even after all this, the stock is still trading at around 10 times earnings. Some things never change! BMTC is still our biggest Canadian holding.

### **Progressive Corp [N: PGR]**

Progressive is a car insurer located in Mayfield Village, Ohio. It was probably our company that had the best intrinsic performance in 2002. Premiums were up 30% and the combined ratio was down to 92%, an exceptional ratio. The industry's average is higher than 100%. EPS were 45% higher and its ROE reached 20%. Strangely, the stock was unchanged in 2002 (although in a year when the S&P 500 is down 22% it's not that bad). Still, PGR is twice the level we acquired it at the end of 1999. Long-term perspectives still look very good.

### **Cognex [Q: CGNX]**

It's been six years since we first acquired shares of Cognex. So far, we had ups and downs but it has not been very rewarding yet. It was another tough year for our "machine vision systems" company. Cognex could not escape the depression that has hit the entire high-technology field. It lost money for the first time in its history. In spite of all this, I still have great confidence in Robert Shillman,

Cognex's CEO. I believe that Cognex is increasing its market share and when the market recovers, it will fully benefit from its efforts and patience. No top manager got a bonus in 2001 and Mr. Shillman reduced his salary from \$310 000 to \$89 000. Stock options were also down. Mr. Shillman still owns 13% of the outstanding shares, so he's in the same boat as ours.

I really understand this company (after six years, you would hope so) and when the stock went under \$15, it seemed to me like a ball right in the center of my favorite batting zone!. Cognex is our second largest holding. The only thing left to do it to be patient. The industry will turn, it's not a matter of "if", it's a matter of "when". Cognex has the balance sheet and cost structure to withstand the crisis.

### **Bed Bath & Beyond [Q: BBY]**

It was our fourth year of ownership in shares of Bed Bath & Beyond. The company had a fantastic year with EPS up 40% (after 10 years of consecutive growth of 30%). Since our first purchase in 1998, EPS are up three fold. The stock is up by 250% since then. We had acquired most of our shares during a market correction linked to an Asian crisis in October 1998. Hey, who remembers that one today? We did take double advantage of this correction by buying another of our retailer, Fastenal, at a third of its current quote.

Like I said before, market corrections do have their bright sides!

### **Transactions of the year**

In 2002, no market sector was more depressed than technology. Although our purchases in this sector so far in this bear market has not prove very rewarding, I still believe that the "technological revolution" is not over. Andy Grove, Intel's chairman, said last year: "Just wait five years and you'll see!". And I can wait. But it is imperative that we do choose companies that have strong moats that will permit them to be still market leaders in five years. Many companies – which I believe are of that caliber – were trading at quite attractive level this year. It was even difficult to decide which ones to choose. So I decided to adopt a "basket" approach and buy eight of these businesses. I bought back shares of Intel I had sold a few years back. And for the first time, I bought shares of Microsoft and Applied Materials, two enterprises which I had admired for so many years. So, we still have around a quarter of our portfolio in technology companies.

Our focus approach, though, is still intact. We have around 70% of our assets invested in 10 stocks.

### **Johnson & Johnson [N: JNJ]**

If you have a good memory, you'll remember that in 1994, I almost bought shares of J&J. At that time, growth prospects were great and market valuation very low (around 12 times earnings). My inaction was a terrible mistake. And I even found a way to do worse. I had bought shares of Cordis Corp in 1993 at around \$27. In September 1995, J&J acquired Cordis in a stock transaction worth \$109 per Cordis share. But since J&J had doubled that year, I thought that the stock was too expensive and decided to sell our stocks instead of exchanging shares (and I paid huge amounts of income taxes).

Since then, J&J is up 200% compared with an increase of 50% for the S&P 500. If I had took J&J's stock, we would have a total return on our Cordis purchase of more than 1100% in a period of almost 10 years (this is 28% annually). And we still would have not paid a single penny to the governments

besides taxes on dividends. In spite of heavy remorse toward J&J, for obvious reasons, I had always continued to follow the company closely. And last summer, we had a chance to acquire shares at a good price when there was an FDA investigation at their Puerto Rico plant.

J&J has tripled its earning power in the last 8 years and its growth prospects are still impressive. My only consolation is to say to myself that it is never too late to invest intelligently.

### **Sales in 2002**

We did not do much selling in 2002. Sometimes, I decide to sell one stock because I simply found another company I want to acquire shares of. When I believed that Cognex was at a very attractive price, I sold shares of Yahoo!. It seemed to me that when valuations when taken into account, Cognex's stock was a better use of our capital.

### **Postmortem 1997**

One of the things I admire at J&J is that the company always does a postmortem after an acquisition. Few companies do so for obvious reasons: in most cases, they would have to conclude that an error was perpetrated. It's not all managers that are "able" to assume such responsibilities.

In the section "Mistake du jour" in my annual reports, I force myself to review past purchases (and non-purchases) that did not turn as good as expected. It is good also to review past sells after a sufficient lapse of time has gone by. This year, I would like to do postmortems on two important selling decisions of 1997: Bombardier [T: BBD.B] and Sun Microsystems [Q:SUNW].

In 1997, Bombardier made up around 20% of our portfolio but in mid-year, I decided to cut this weight to 2%. This is what I wrote then to explain this bold move:

*...lately, we sold most of our shares for three reasons:*

- 1. It seems that the future prospects are not as solid as in the last five years as the company looks more sensitive to economic slowdown.*
- 2. The market valuation has become high, in spite of the point 1.*
- 3. The departure of Raymond Royer – whom I consider the real brain behind the success of Bombardier – is definitively not positive.*

After, we had sold 90% of our stocks, Bombardier shares went up 300% in the three years that followed. I then considered this sale as a mistake and it was recognized as such in the "Mistake du jour" section in the 1999 annual report. But I added this comment at the end of the phrase: "*...But the real test for the long term business model of Bombardier would be a recession.*"

In 2001-2002, a deep recession did hit the airline sector and Bombardier was strongly affected. The recessionary environment was amplified by the higher level of debt at Bombardier and some problems with acquisitions in the transport division (Adtranz). The stock fell from \$25 to \$5, a lower level than the one we sold at in 1997. Bombardier Capital also had "diworsefy" (Peter Lynch's expression for bad diversification) and had to take lots of charges. It is far from clear, as I write those lines, how long it will take for Bombardier to get back on the growth path.

There are lots of conclusions from this epic. First, it takes years to measure the impact of a top managerial change. So it can take years to judge the quality of an investment decision. Those who believe that they are quite witty because of a few years of strong performance – for a stock or for the owl portfolio – should develop a strong auto-scepticism reflex (and if from time to time I forget it, Bernard Mooney, my long-term friend and partner, is not far to put me back in line).

There is another important conclusion toward Bombardier or the stock market in general. In 1993, when growth prospects for the five years to come were strong, the stock was trading at around 10 times earnings. In 2001, with more leverage on the balance sheet and a tough environment starting to unfold, the stock was trading at 30 times. Too often, investors are more inclined to look at the rearview mirror than the windshield.

On Sun Microsystems, in 1997, I wrote this phrase: “...In 1994, we acquired shares of Sun Microsystems at \$5.25. At that time, the company was earning \$0.50 a share and had \$2.50 in cash (no debt). So the real P/E was around 5x. With new high-margin products being put on the market (servers), Sun prospects were better than ever. But its stock was trading at the lowest level it ever traded. In the three years that followed, EPS went up to \$1.89, a 278% jump. In spite of this, I decided to sell our shares because I believed that Sun’s future could be affected by Intel-HP alliance in developing a new 64 bits CPU (central processing unit). And Sun’s stock is now trading at \$52, a 900% rise. The uncertainty is not reflected in its higher P/E. I now prefer Intel’s stock....”

After this sale in 1997, Sun’s stock went up ANOTHER 1000% in the three years that followed. At its October 2000 high, Sun’s P/E had reached 100x. And that was a few months before EPS started to decline. The P/E was 10 times the level of 1994 in spite of quite lower growth prospects in the years to come. When I say that the market is manic-depressive, here is a clear example. And the re-evaluation that followed was abrupt for Sun’s stockholders: the shares went from \$60 to \$3 in the last 24 months.

As for Intel, we did make a satisfactory profit even though the stock is now the same price as in 1997. When the stock reached high valuations in 2000, I started to sell. What is interesting is that it’s only in 2002 that Intel finally put on the market its 64 bits chip (named Itanium) and is now threatening Sun’s market share (Dell Computer servers are gaining market share at a rapid pace). Again, as for Bombardier, it took five years for the reasons I sold our shares to materialize. As the legendary investor Phil Fisher would say: “*It is easier to know WHAT will happen than WHEN it will happen.*”

Now I am not proud that these two companies have fallen from grace. That means that my initial buying was not that brilliant! I owned Bombardier and Sun for five and three years respectively. For a while, these were great businesses. But the lesson for me is that things change. Seldom do businesses stay great for decades. So we have to always keep an opened mind and not lose track of the fundamentals of a company we own shares in.

### **Owner’s earnings**

As you know, Giverny Capital is different from the other money management firm in some respect. We measure the quality of an investment not on short-term market gains but by focusing on yearly earnings growth and long-term fundamental prospects. Over a five years period, the stock market will tend to reflect those two variables. Warren Buffett has long used this method to measure the intrinsic value contribution of Berkshire’s stock holdings. Besides W.P. Stewart & Co, I seldom seen other firms make such a calculation. For most of our competitors, the short-term market performance is the supreme judge. We try to be ourselves the judge of our underlying business performance.

In 2002, our stock's quotations were on average mostly unchanged. But our owner's earnings were up around 18-20% and our ROE was 18%, which is a very strong global performance from our businesses.

In some cases, the discrepancy between market performance for one of our stock and its underlying increase in intrinsic value was quite large. For example, as I wrote above, Bed Bath & Beyond increased its EPS by 40% but its stock was up only 3% for the year. Health Management Associates grew its earnings by 21% and the stock was actually down 3%. But in the long run, if the company does well, the market's quotation will eventually catch on. At Giverny Capital, we like such temporary gaps in valuations and we try – within a reasonable level of transactions – to profit from them.

**\*\*\* WARNING \*\*\***

**The following section contains sentences that could offend some readers**

### **Mistake du jour**

*If you close the door to mistakes, the truth will stay outside* - Rabindranâth Tagore

This section, as always, could be very long. I limit myself to Olympic like medals that are yearly attributed to the top three mistakes of the year. In 2002, we make a backward assessment of mistakes that happened in 1999-2000 but whose consequences on our return this year were awful.

### **Bronze medal: Heartland Express [Q:HTLD]**

It's the second time that this company is mentioned in the "mistake" section. In 1999, I wrote: "...*Our adventures into the marvelous world of trucking, with the investment in Heartland Express, were not very profitable. I should have learned my lessons about the competitive nature of the industry after we had been shareholders of Groupe Goyette in 1993. But as Malcom Forbes once said: To make a mistake is human. To repeat it is human too!...*"

The funny thing, retrospectively, is that the mistake was not to have invested in the trucking industry but – again – a cruel lack of patience.

I had invested in HTLD in 1998. I then believed that Heartland was an enterprise of the type I like to label "Oasis in the desert": a great company in a lousy industry. Net margins stood at 12% compared with 2-3% for the industry. Not counting the excess cash, Heartland was earning 40% on equity.

Such an extraordinary business performance was linked to Heartland's low cost operation. And the company was acquiring lots of competitors to sustain a high growth rate: In the last 15 years, the annual growth in EPS had been 20%. As usual, such an accomplishment was made possible by brilliant management. Heartland was led by Russel Gerdin, its CEO. Mr. Gerdin was earning \$300 000 a year with no bonuses, a salary unchanged since 1986. He owned 40% of the outstanding shares. And the company had no stock options plan (I like that). Mr. Gerdin was clearly in the same boat as its shareholders.

So why – oh why – did I sold our shares in 1999? The company had a few flat quarters as management could not find acquisition candidate at a reasonable price. I then thought that Heartland was becoming a

slow grower and I decided to sell. I simply lack patience. The company finally did make some acquisitions and EPS went from \$0.57 in 1999 to \$0.85 in 2002. The stock has increased by 200% in 3 years. Mr. Gerdin and the more patient shareholders were highly rewarded. But not us!

### **Silver Medal: Expedia [Q:EXPE]**

When the stock market goes down 50%, there are few places to “hide”. But Expedia’s stock is up 500% in the last two years. I started to follow the company as soon as it went public in 1999. I knew the company well as I used their Internet site (plane ticket retailing at discount) quite often. The company was founded by Microsoft and looked well managed on its own. But I have this rule to wait for a small company to show a profit before investing. Nevertheless, I followed Expedia closely.

In the fall of 2000, the company had its first quarter with a positive cash flow and I believed that the company could become profitable in a quarter or two. The stock had fallen from \$60 to \$10. The company had \$5 in cash and I believed it could earn \$1 per share in a not too distant future. So at \$10, the stock looked quite attractive. And as I was studying the company, a client called me to ask where to invest some excess cash. And I talked to him about Expedia and he acquired some shares at \$10. And before I could decide what to sell in my other accounts to buy Expedia for all clients (including me), the stock started to climb. It reached \$15 in a few weeks.

In a very childish reflex, I said to myself: “I missed it”. So I waited – in vain – for the stock to fall back to \$10. Expedia earned \$0.89 in 2001 and around \$1.80 in 2002. The stock is now at \$65. Beside the client that called me that day, no one of us made money on it. It is interesting to note that I was disciplined in waiting for the company to make a profit but I should have been more perspicacious. Because if discipline is to respect one’s own rules, wisdom is to know when to break them!

### **Gold Medal: Richelieu [T:RCH]**

Five years ago, my good friend Bernard Mooney spoke to me about a company in which he had invested : Richelieu Hardware. The company is a distributor of various home products. I look at the numbers and they are impressive: Richelieu has a strong balance sheet and earns around 30% on equity. The growth rate is surprisingly high, more than 25% a year, with quite high margins for such an industry. Of course, there is always great people behind great numbers. Bernard tells me about his admiration for Richard Lord, Richelieu’s CEO. Mr. Lord has a defined plan and a common sense managerial approach focused on the company’s strengths. And another little thing to notice, the stock was trading at \$3 (adjusted for splits) at a P/E ratio of only 9x.

It took me three years to decide to acquire some shares at the end of 2000. And I was worried that the recession that was starting out would affect the company and I decided to buy slowly, only for clients with cash in their accounts (I did want to sell some other stock). I started to buy at \$5.5 but the stock climbed above \$6 quickly and I did not want to pay a few points more. The stock then doubled in 2001, a down year for markets.

At the beginning of 2002, Bernard set up a meeting with Mr. Lord and us. I was very impressed by him but again I wanted to wait for a “lower” valuation before acquiring other shares. The stock has climbed another 50% since then (and 2002 was a worse year for the markets than 2001). So Richelieu’s stock is now five times the level it was five years ago and almost three times the level of 2000. And I understood the company well (Bernard was an expert on the business) so there is no excuse. This mistake is gold caliber! But believe it or not, that is not all...

There are some strange coincidences in life. In 1993, I had bought my house in La Prairie. And the door lock is from Richelieu (it's even written on it). Every day for the last 9 years, the first thing I see when I get home is the name of the company! After Bernard talked to me about Richelieu, so often I said to myself I should study the company more closely. My punishment for my lack of perseverance was to see the name of the company again and again for the most part of 2002. I say "the most part" because in July, I changed my lock and this time I made sure to buy one without a name written on it!

### **Conclusion : « The gardener and the investor »**

Last year, I described an analogy between investing and art. Three years ago, I used analogies with the psychology field. Charles Munger, Warren Buffett's wise sidekick and CEO of Wesco Financial, said many times how important it is not to see the world through one mold but to have many different analytical models. For example, Ted Williams' analogy, is extremely pertinent.

When I named my money management firm Giverny Capital, it was in honor of Claude Monet and its creations, both his garden and his paintings. But there was also an analogy between the craft of investing and the work of building majestic gardens as the one Monet created in Giverny (France). To build such gardens, you first need a deep love for the gardening craft. You also have to really know the environment where you're setting up the garden: temperatures cycles, the sun's direction, the insects present, the soil, etc. Some plants just can't grow in Quebec. It's the same thing in investing: some sectors can't be understood by one money manager (as the aluminum and paper industry for me).

And it's a dynamic process: you always have to follow closely the flowers and trees that are cultivated in the garden. Some will blossom, some others not. Adjustments have to be made on a regular basis to maximize the space at our disposal. It's the same thing with our capital.

Peter Lynch once said that it is imperative that "*you do not remove the flowers and water the weed*". In stock language it means that we should not sell our winners to buy more of our losers. Furthermore, it is not illogical to make some experiments on a small soil surface to see what happens. A wise investor can acquire a few shares of a company to become more familiar with it.

But where the analogy is the most relevant is on the virtues of time and patience. Warren Buffett noted to Robert P. Miles (the author of the marvelous book *The Warren Buffett CEO*) that one of the main reasons that Berkshire was such a success is that he was CEO for a very long time (Mr. Buffett took control of Berkshire in 1965). Too often, a CEO is appointed late in his career and stays at the head of the business for 10 years or so, sometimes less. Frequently, great achievements are done over many decades. For example, at General Electric, the best performance was realized in the second decade that Jack Welch was CEO. That is why I like to invest with companies that exist for more than 10 years and are still managed by the founder(s) like Fastenal, Cognex, Bed Bath & Beyond, Applied Materials, Gentex, Costco, etc. A great garden needs years to become a masterpiece.

The legendary impatience of Wall-Street investors is a handicap to such blooming. Can you imagine a great gardener that would plant a tree and remove it after six months because it has not grown fast enough? Trees take time to grow; Companies are made from the same wood! Great entrepreneurs and great gardeners often have similar dreams: building a garden of tall trees that will give shades to many people for generations to come. And the gardener that genuinely love his craft, one day, realizes that his sense of purpose and happiness does not lie in the final results but in the daily journey.

Managing our portfolios give me such fulfillments.

I thank you again for your trust and I wish you a great year in 2003

François Rochon  
President  
Giverny Capital Inc.