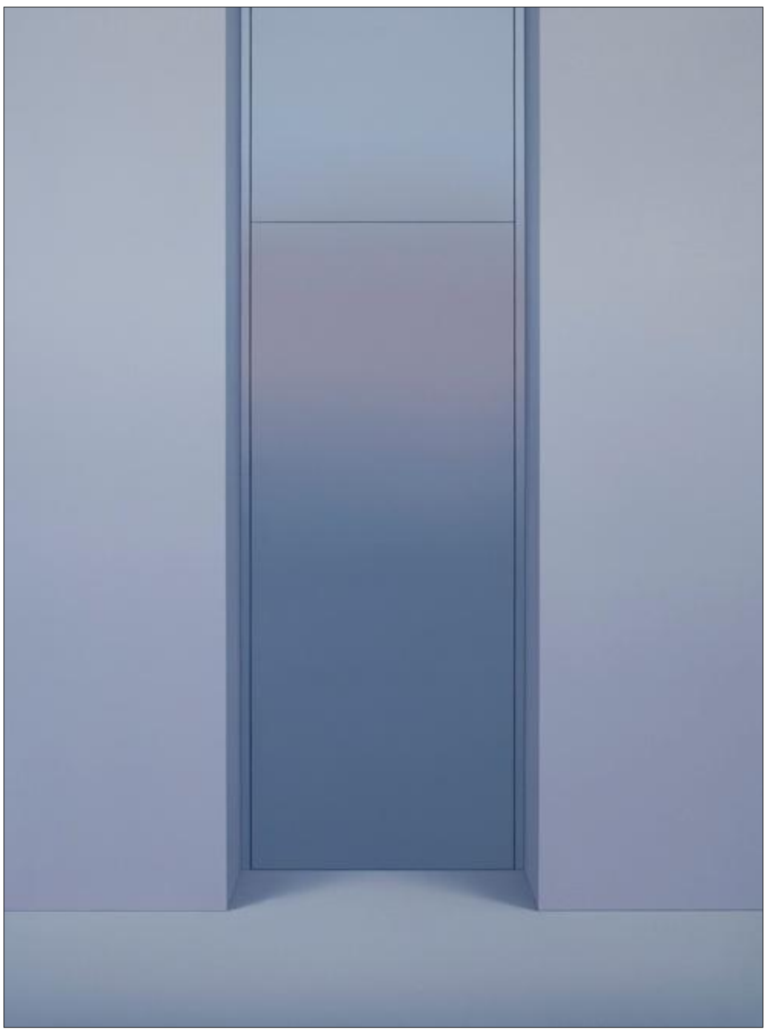
Annual Letter to our Partners
2011



Pierre Dorion
Gate II - 2011
Giverny Capital Collection

For the year ending December 31st 2011, our portfolio's return was +7.8% versus a loss of 1.1% for our benchmark. Our return, including a gain of approximately 2% due to fluctuations in the Canadian currency, therefore outperformed our benchmark by 8.9%.

Since our inception, on July 1st 1993, our compounded annual growth rate has been +13.6% versus +6.6% for our weighed benchmark, or an annualized outperformance of 6.9% over this period. When we exclude the effect caused by the appreciating Canadian currency since our inception, which represents an annualized increase of 1.2% since 1993, our portfolio has returned +15.0% annually versus +7.9% for our benchmark. Our long-term (and ambitious) objective is to maintain an annual return that is 5% higher than our benchmark.

The Artwork on Our Letter

We have illustrated the cover of our letter with a copy of an artwork from our corporate collection since 2004. This year, we selected a work by the Quebecois artist Pierre Dorion entitled "Gate II (22nd Street)".

The Giverny Portfolio (in Canadian dollars): Returns Since July 1st 1993

Return *	Giverny	Index **	+ / -	$ US/Can	S&P 500	+ / -	Giverny ***	Index ***	+ / -
1993 (Q3-Q4)	37.0%	9.5%	27.6%	3.3%	8.4%	28.6%	34.4%	7.4%	27.0%
1994	16.5%	3.7%	12.7%	6.0%	7.3%	9.2%	12.0%	-0.3%	12.3%
1995	41.2%	24.0%	17.2%	-2.7%	32.9%	8.3%	43.8%	26.3%	17.5%
1996	28.0%	22.8%	5.2%	0.3%	22.7%	5.3%	27.7%	22.5%	5.2%
1997	37.8%	28.6%	9.2%	4.3%	36.7%	1.0%	33.4%	24.5%	8.9%
1998	20.6%	18.8%	1.8%	7.1%	37.7%	-17.0%	14.5%	12.8%	1.7%
1999	15.1%	16.3%	-1.2%	-5.7%	14.1%	1.0%	20.6%	21.9%	-1.3%
2000	13.4%	3.2%	10.2%	3.9%	-4.6%	18.0%	9.7%	-0.2%	9.9%
2001	15.1%	-0.4%	15.5%	6.2%	-5.7%	20.8%	9.4%	-5.3%	14.7%
2002	-2.8%	-18.3%	15.6%	-0.8%	-22.0%	19.3%	-2.0%	-17.7%	15.7%
2003	13.6%	14.0%	-0.4%	-17.7%	5.7%	7.9%	33.7%	34.1%	-0.5%
2004	1.6%	6.2%	-4.5%	-7.3%	2.8%	-1.1%	8.3%	13.1%	-4.8%
2005	11.5%	3.6%	7.9%	-3.3%	1.5%	10.0%	14.5%	6.7%	7.8%
2006	3.5%	17.0%	-13.5%	0.2%	15.7%	-12.1%	3.3%	16.8%	-13.5%
2007	-14.4%	-11.6%	-2.8%	-14.9%	-10.0%	-4.2%	-0.3%	2.2%	-2.5%
2008	-5.5%	-22.0%	16.5%	22.9%	-22.2%	16.7%	-21.5%	-35.4%	13.9%
2009	11.8%	12.2%	-0.4%	-13.7%	9.6%	2.2%	27.7%	27.7%	0.1%
2010	16.1%	13.8%	2.3%	-5.3%	9.0%	7.1%	21.7%	19.3%	2.5%
2011	7.8%	-1.1%	8.9%	2.3%	4.4%	3.4%	5.8%	-2.9%	8.7%
Total	**954.7%**	**229.0%**	**725.7%**	**-20.7%**	**217.7%**	**737.1%**	**1222.2%**	**308.5%**	**913.7%**
Annualized	**13.6%**	**6.6%**	**6.9%**	**-1.2%**	**6.4%**	**7.1%**	**15.0%**	**7.9%**	**7.1%**

* Green section: all returns are adjusted to Canadian dollars
** Index is a hybrid index (S&P/TSX, S&P 500, MSCI EAFE, Russell 2000) which reflects the weight of the underlying assets
*** Estimated without the effect of currency
Note: Asset appraisal of the Giverny Global Portfolio performed by PricewaterhouseCoopers, in Canadian dollars.

The Giverny US Portfolio

We have been publishing the returns of the Giverny US Portfolio, which is entirely denominated in US dollars, since 2003. The Giverny US Portfolio corresponds to the American portion of the Giverny Portfolio. In 2011, the Giverny US Portfolio realized a return of +5.0% compared to +2.1% for our benchmark, the S&P 500. The Giverny US Portfolio therefore outperformed our benchmark by 2.9%

Since its inception in 1993, the Giverny US Portfolio has returned +1056.4%, or +14.1% on an annualized basis. During this same period, the S&P 500 has returned +298.9%, or +7.8% on an annualized basis. Our added value has therefore been 6.4% annually.

Year	Giverny US	S&P 500	+/-
1993 (Q3-Q4)	32.7%	5.0%	27.7%
1994	9.9%	1.3%	8.6%
1995	54.8%	37.6%	17.2%
1996	27.0%	23.0%	4.1%
1997	32.9%	33.4%	-0.4%
1998	11.0%	28.6%	-17.6%
1999	15.9%	21.0%	-5.1%
2000	11.3%	-9.1%	20.4%
2001	8.1%	-11.9%	20.0%
2002	-4.4%	-22.1%	17.7%
2003	31.6%	28.7%	2.9%
2004	9.3%	10.9%	-1.6%
2005	12.5%	4.9%	7.5%
2006	3.3%	15.8%	-12.4%
2007	-1.7%	5.5%	-7.2%
2008	-24.3%	-37.0%	12.7%
2009	28.7%	26.5%	2.3%
2010	21.9%	15.1%	6.9%
2011	5.0%	2.1%	2.9%
Total	1056.4%	298.9%	757.5%
Annualized	14.1%	7.8%	6.4%

Note: Asset appraisal of the Giverny US Portfolio performed by PricewaterhouseCoopers
S&P 500 returns provided by Standard & Poors

We outperformed the S&P 500 for a fourth consecutive year, led by strong performances from companies such as Fastenal, Bank of the Ozarks, Buffalo Wild Wings, Visa and O'Reilly Automotive.

Giverny Canada Portfolio

We introduced a portfolio that is 100% focused on Canadian equities in 2007. This corresponds closely to the Canadian portion of the Giverny Portfolio. In 2011, the Giverny Canada Portfolio returned +13.5% versus a loss of 8.7% for our benchmark (the S&P/TSX), therefore outperforming our benchmark by 22.2%.

Since 2007, the Giverny Canada Portfolio has returned +66.4%, or +10.7% on an annualized basis. During this same period, our benchmark had a gain of +5.2%, or a gain of +1.0% on an annualized basis. Our annual added value was therefore 9.7%.

Year	Giverny Canada	S&P/TSX	+/-
2007	19.7%	9.8%	9.9%
2008	-24.6%	-32.9%	8.3%
2009	28.2%	33.1%	-4.9%
2010	26.7%	17.6%	9.1%
2011	13.5%	-8.7%	22.2%
Total	66.4%	5.2%	61.2%
Annualized	10.7%	1.0%	9.7%

Note: Asset appraisal of the Giverny Canada performed by PricewaterhouseCoopers

Our Canadian stocks performed very well in 2011. The all-star in our portfolio was Dollarama which rose 55%. MTY Foods and Computer Modelling Group also had solid years. As a result, we were able to outperform the TSX. Our Giverny Canada Portfolio has nearly no correlation with the TSX and, as the legendary John Templeton was fond of saying, "It is impossible to do better than the average without doing something different from the average."

2011: A Year in Review

The European financial crisis affected stock markets throughout the world, with nearly every major market outside of the US finishing the year in the red. For example, the Chinese market which is perceived as a bastion of economic growth, dropped nearly 20%. The Shanghai market reached a high of 6092 on October 16, 2007 and closed 2011 at 2199—a 64% decline in four years.

The TSX in Canada lost 8.7% in 2011—an underperformance of 10.8% relative to the S&P 500 in the US (actually a 13.1% difference if we consider the appreciating value of the US Dollar during the year). Last year, we wrote that US markets offered brighter prospects than the Canadian markets. We believe this to still be the case.

We are investors, not economic strategists or other soothsayers. From this perspective, 2011 was a "Grand Cru" year. Our companies, as a whole, had exceptional financial results and their stock prices resisted the widespread slump of many equity markets.

The Irony of Treasuries

2011 was a year when the media, and many people with savings (note that the word "investor" is not used), continued their near obsession with the debt problems of Western governments. But I will not engage in the easy game of social criticism. It's like in hockey: from the stands, everything seems so simple to fix.

During these times, corporations have managed their finances in a rational manner (at least for the most part). These companies don't have the luxury of dealing in large long-term liabilities while running short-term deficits. Ironically, corporate securities (stocks) are shunned in favor of governmental debt securities (treasuries)—and this has been the case for many years now. This has therefore created a rare situation where we observe a wide disparity between the valuation of stocks, with the S&P 500 trading at 12 times its earning power (corresponding to a earning yield of 8%), and the valuation of 10-year Treasury notes, which are trading at 50 times their interest payment (or a yield of 2%). During 2011, and despite this disparity, the majority of people sold their equity funds to put their savings into funds holding Treasuries.

The ultimate irony is that these "investors" are avoiding stocks for the simplistic reason that governmental debt is too high. They are ranting against government debt but yet buy more government debt at measly interest rates with their hard-earned dollars. They stand against indebted governments by lending them more money. And they do this with no additional reward to compensate for the inflation risk they assume. To the contrary, a 10-year note yielding 2% annually is almost certain to lose its real value over time. An annual inflation rate of 3% would create a loss of purchasing power of 10% over ten years, even after pocketing the interest.

The ultimate argument by buyers of government debt is that their investment is guaranteed. It is in fact a guarantee…. a guarantee of impoverishment.

Profiting from Pessimism

In August and September, the market was heading for another bear market (a drop of 20% of more). The majority of market participants, still feeling the sting from the crisis of 2008-2009, became drastically pessimistic (in a way that doesn't happen very often historically). From my experience over the last 20 years, I have never seen such a wide disparity between the perception of the market and its underlying economic reality.

We decided to profit from the many bargains that could be found at the time. Though we typically trade very little (with an average holding period of five years), we had a number of buys and sells in 2011. We increased our holdings in existing positions that seemed even more undervalued and also purchased new positions (see subsequent section). We also sold holdings that had less potential. In other words, we sold holdings that were trading at 60% of their intrinsic value (according to our estimate) to buy holdings trading at 40% of their intrinsic value.

A (Rare) Prediction in 2011

> *"I think the future of equities will be roughly the same as their past; in particular, common stock purchases will prove satisfactory when made at appropriate price levels. It may be objected that it is far too cursory and superficial a conclusion; that it fails to take into account the new factors and problems that have entered the economic picture in recent years – especially those of the movement toward less consumption and zero growth. Perhaps I should add to the list the widespread public mistrust of Wall Street as a whole, engendered by its well-night scandalous behavior during recent years in the areas of ethics, financial practices of all sorts, and plain business sense."*

These words perfectly summarize the overall sentiment towards the market these days. These words, however, were spoken by Benjamin Graham during a speech in 1974.[1] In 1973-74, the market had tumbled 50% and pessimism ran high. Western economies were sapped by the parasitic force of soaring inflation. The skyrocketing price of oil, fueled by war in the Middle East, permanently altered the North American model for transportation. Many at the time, with the fall of Saigon in 1975, believed that the end of the American capitalistic hegemony was near.

$10,000 invested in the Dow in 1974 would be worth more than $500,000 today (including the reinvestment of dividends). Over 37 years, the annual return has been 11%, which is pretty much in

[1] Published in *Financial Analyst Journal*, September/October, 1974

line with the 10% historical return of stocks. The prediction of Warren Buffett's mentor proved unquestionably accurate.

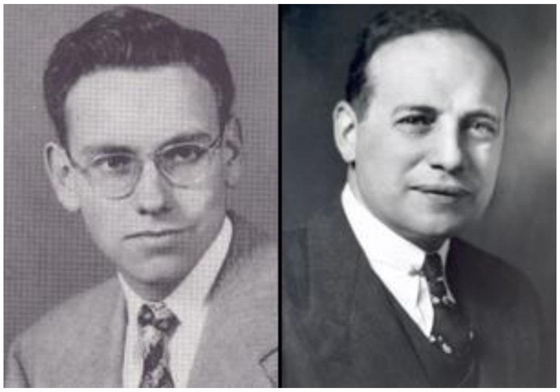


Figure 1: Warren Buffett as a student and Professor Ben Graham
(Source: Columbia University; circa 1951)

I also made a prediction this year which was published in the Montreal Gazette newspaper on August 30th (I have a bi-weekly column since January of 2011). During the panic of August/September, I predicted that within five years (by 2016), the Dow would rise to 17,000. My prediction isn't based on some fancy formula, but rather, by assuming corporate earnings would grow at an annual rate of 6.5% between 2011 and 2016 and then applying a P/E multiple of 15 to those earnings. Including dividends, this translates into an annual return of more than 10%.

Many experts, and many lesser experts, predict all sorts of things without facing their audience once their prediction are proven far-fetched (as they often do). At Giverny Capital, we don't play this game of predictions without a post-mortem assessment. We look forward to revisiting this prediction in the 2016 Annual Letter to our partners.

A Memorable Meeting in February 2011

It's not often you have the opportunity to meet one of your childhood heroes. Twenty years ago, fresh out of university, I started to get interested in the market. In November 1992, after juggling with all sorts of investing approaches, I read "One Up on Wall Street" by Peter Lynch.

Afterwards, I read everything I could find about Mr. Lynch and subsequently, on Warren Buffett (since Mr. Lynch had said that he was the best investor of all). These readings engraved the investment philosophy that has been behind the management of our portfolios since.

Last February, we received a very special invitation: Peter and his wife Carolyn invited us to their apartment in Boston to discuss about the stock market. Nicolas, Jean-Philippe and I had the chance to meet this legendary investor.

Mr. Lynch hasn't been involved in the management of mutual funds for several years now, but he does continue to manage a few portfolios with the same enthusiasm that has always been part of his approach. We talked about our favorite ideas, particularly within the retail and restaurant industries—a sector that Mr. Lynch has always enjoyed following.

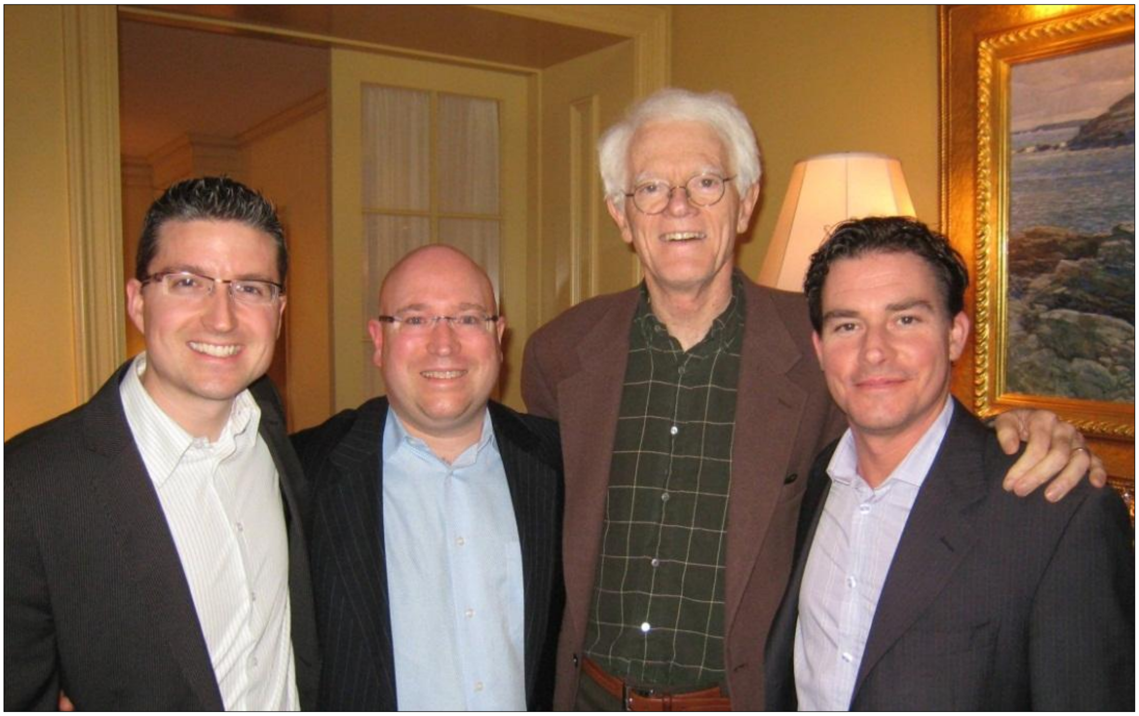


Figure 2 : Jean-Philippe, François, Peter and Nicolas

The Flavor of the Day for 2011

Each year, we elect our "flavor of the day" for the year. In other words, what is popular (and what will eventually likely yield little financial reward). In the last three Annual Letters, I have named the following "flavors": bonds, Canadian real estate and gold. These assets continue to remain popular.

I would dare to say that the "flavor of the day" is to detest stocks and the markets (the "Occupy Wall Street" movement embodies this quite well). Since our premise is to advocate caution and to not let ourselves be charmed by the "flavor of the day", the little sympathy garnered by stocks these days only reinforces our enthusiasm. Our enthusiasm is, of course, tied to the compelling market valuations of the stocks we own. But it is amplified (if not confirmed) by the negativity of most market participants.

Owner's Earnings

At Giverny Capital, we do not evaluate the quality of an investment by the short-term fluctuations in its stock price. Our wiring is such that we consider ourselves <u>owners</u> of the companies in which we invest. Consequently, we study the growth in earnings of our companies and their long-term outlook. Since 1996, we have presented a chart depicting the growth in the intrinsic value of our companies using a measurement developed by Warren Buffett: "owner's earnings". We arrive at our estimate of the increase in intrinsic value of our companies by adding the growth in earnings per share (EPS) and the average dividend yield of our portfolio. This analysis is not exactly precise but approximately correct. In the non-scientific world of the market, and as Keynes said: "it is better to be roughly right than precisely wrong."

This year, the intrinsic value of our companies, as a whole, rose by 17% (16% from the growth in earnings and 1% from the average dividend). Despite changes to our portfolio during the year, we consider this growth in earnings to appropriately reflect the economic reality of our group of companies. The stocks of our companies rose 6% (without the effect of currency), which can only mean one thing: our companies are more undervalued at the current moment than they were at the beginning of the year. And it was the same story for the S&P 500: the underlying earnings growth of its companies was 17% and the index only rose by 2%.

	Giverny			S&P 500		
Year * **	**Value ***	**Stock ****	**Difference**	**Value ***	**Stock ****	**Difference**
1996	14%	29%	15%	13%	23%	10%
1997	17%	35%	18%	11%	33%	22%
1998	11%	12%	1%	-1%	29%	30%
1999	16%	12%	-4%	17%	21%	4%
2000	19%	10%	-9%	9%	-9%	-18%
2001	-9%	10%	19%	-18%	-12%	6%
2002	19%	-2%	-21%	11%	-22%	-33%
2003	31%	34%	3%	15%	29%	14%
2004	21%	8%	-12%	21%	11%	-10%
2005	14%	15%	0%	13%	5%	-8%
2006	14%	3%	-11%	15%	16%	1%
2007	10%	0%	-10%	-4%	5%	9%
2008	-3%	-22%	-19%	-30%	-37%	-7%
2009	0%	28%	28%	3%	26%	23%
2010	22%	22%	0%	45%	15%	-30%
2011	17%	6%	-11%	17%	2%	-15%
Total	594%	474%	-120%	206%	172%	-34%
Annualized	12.9%	11.5%	-1.3%	7.2%	6.5%	-0.8%

*   Estimated growth in earnings plus dividend yield
**   Market performance, inclusive of dividends
***   Results estimated without currency effects

Since 1996, our companies have increased their intrinsic value by 594%, or about a sevenfold increase. Meanwhile, the value of their stocks has increased 474% (without currency effect). During this same period, the companies comprising the S&P 500 increased their aggregated intrinsic value by 206% and saw their stock prices rise by 172%. Market performance and corporate performance are rarely synchronized over the course of a calendar year. But as more time passes, the synchronization between the two begins to reveal itself.

Over 16 years, our portfolio has realized a return that is 5% higher than the S&P 500 for the simple reason that the underlying companies in our portfolio have increased their intrinsic value at a rate that is 5% higher than the average.

Five-year Post-mortem: 2006

Like we do every year, we go through a five-year post-mortem analysis. We believe that studying our decisions in a systematic manner, and with the benefit of hindsight, enables us to learn from both our achievements and our errors. 2006 was a difficult year for our investment style and we had our worst year relative to market indices. Our reaction was to remain loyal to our philosophy. *"If we are on right path, the only thing left to do is to keep walking"* is what we wrote in the beginning of our Annual Letter that year. Many companies in our portfolio saw their stock prices decline despite their

EPS increasing. Fastenal's stock, for example, declined 8% even though its earnings increasing by 21%. Fastenal's stock price has doubled since… because its EPS has doubled.
Over the course of the five years since 2006, our holdings have returned +5.1% annually versus an annual loss of 0.4% for the indices (without considering the effect of currency). During the economic tempest of the last years, the ship built from our portfolio companies held fast and our capital was adequately protected. We are back on the path to reach our ambitious goal of outperforming the indices by 5% on an annual basis.

In 2006, in the "flavor of the day" section, we discussed Canadian banks. Canadian banking stocks were climbing 15% annually at the time and many investors were in love with them. I explained that stocks such as Scotiabank and the Bank of Montreal had done well primarily because their P/E multiples had expanded from 8x in 2000 to 14x in 2006. I added that *"In the long run, in a Canadian economy which grows at 5% per year, it seems to be unrealistic to believe that all the players of the banking industry will be able to do much better than this growth rate."* Since then, over the last five years, the stock of the Bank of Montreal has gone from $69 to $56, while Scotiabank's stock threaded water—going from $52 to $51.

Significant Buys from 2006

In 2006, we bought shares in two new companies: Mohawk Industries located in Georgia, and Bank of the Ozarks located in Arkansas.

Mohawk is the largest floor covering company in the US (includes carpeting, wood flooring, and tiles). I've always admired its CEO, Jeff Lorberbaum. In 2006, the stock dropped and I saw an opportunity to buy shares at $75. Today, the stock is trading around $64. Therefore, this has not been a good investment so far. The company was heavily affected by the depression in residential construction in the US. We were aware at the time that this sector was experiencing some difficulty, but since this segment was only 15% of the company's revenue, we were confident that the company's prospects remained bright. But the recession of 2008-09 affected the company's earning power more than anticipated and—as a result—its stock price followed suit.

EPS dropped from $7.31 in 2006 to $2.53 in 2009, and then bounced back to $3.77 in 2011. The company is still a long ways from the profitability level it enjoyed before the crisis. Despite this, we still like the company's management and are convinced that a rebound in this industry is around the corner.

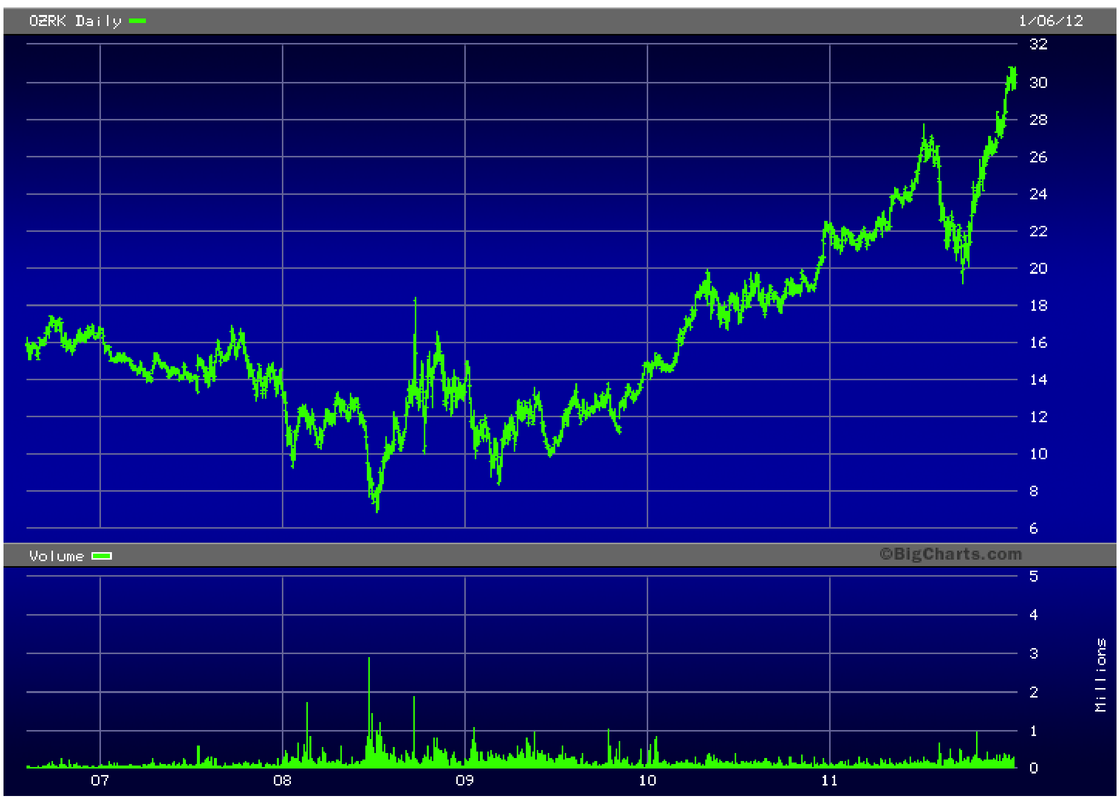
Bank of the Ozarks has been a more rewarding investment. We bought this stock at the end of 2006 and it doubled over the next five years.

Bank of the Ozarks is a bank in Arkansas (the Ozarks is a region in the north of this state). Although Bank of the Ozarks has existed since 1903, it wasn't until 1979 that the company started to shine, when 25-year old George Gleason took control of the bank. The company only had $28 million in assets at the time. It now has more than $3.8 billion in assets. The company went public in 1997 at $2 per share (adjusted for stock splits) and the company's stock price has increased fifteen fold since (an annualized return of 21%).

I met Mr. Gleason in November 2006 at their headquarters in Little Rock. I was very impressed by his easygoing manner and that of his upper management (about fifteen VPs welcomed me that day). I had the feeling that Mr. Gleason knew each loan on the bank's books. Nothing exotic (or esoteric), no subprime mortgages, no incomprehensible derivative products: only traditional banking activities. The company had a low cost structure and very few bad loans. Its conservatism enabled the bank to not only survive the financial crisis of 2008-2009, but to also make excellent acquisitions at very compelling prices in the aftermath.

In fact, Ozarks was able to increase its assets by 50% due to the crisis (thanks to many acquisitions made at bargain prices and aided by the FDIC[2]). We bought shares in 2006 at $15, when the company was earning $.95 per share. We paid a premium to the typical P/E multiple we would pay for a bank but believed it deserved such a premium.

While the majority of banks are earning less in 2011 than they did in 2006, Ozarks has doubled its EPS over five years—and the stock price has followed suit. More interestingly is that Ozarks, with its prudent management, is probably one of the least risky banks in the US. Despite the widespread stereotype, risk and reward don't necessarily always go hand in hand.



Graph 1: Shares of Bank of the Ozarks from 2006 to 2011

Market volatility is a whole other thing. Two years after buying Ozarks, the stock dropped by 50%. If you have a good memory, you will remember that in the quarterly letter from June 2008 (when we were answering questions from our partners), we had this question: *"What explains the crumbling stock of Bank of the Ozarks? In today's trading session alone, for example, the stock lost another 10%."* I responded that nothing explained this drop and that the fundamentals of the bank seemed intact and that we should not let ourselves by affected by short-term market fluctuations.

[2] The Federal Deposit Insurance Corporation (FDIC) is a governmental entity guaranteeing banking deposits in the US and that can, when necessary, take temporary control of struggling banks.

Our Companies

"Wealth is the product of Man's capacity to think."

- Ayn Rand

American Express (AXP, $47)

Amex had an excellent year: revenues climbed 9%, cards issued rose 7%, and EPS increased 22% to $4.09. The average amount spent by cardholders was $14,881—12% higher than in 2010. This figure is about five times more than Visa or MasterCard. But the best news was that the level of write-offs for bad loans has been gradually declining from 4.3% at the end of 2010 to 2.3% during the last quarter of 2011.

Amex earned 21% more in profits than in 2007—the year before the financial crisis. Strangely, its stock price has decreased from $65 to $47: the P/E multiple has therefore been tumbling from 19x to 11x. The financial crisis was a benefit for Amex. The company was able to adopt the structure of bank and lower its borrowing costs (by being able to pay less interest on its deposits). The company was also able to gain market share relative to other card issuers. Above all, Amex demonstrated that it was able to navigate through one of the worst financial crises in history and that its business model (which is more integrated than that of Visa or MasterCard) was intact.

We consider American Express one of the strongest brands worldwide and we believe this company is worth far more than 11 times earnings.

Bank of the Ozarks (OZRK, $30)

For 2011, shares of Bank of the Ozarks rose 17%. Non-performing loans decreased from 1.72% in 2010 to 1.17% in 2011. EPS climbed by 56%, to $2.94, though there were some non-recurring items. I estimate that its earning power is about $2 per share.

Berkshire Hathaway (BRK.B, $76)

The company led by the legendary Warren Buffett was very active in 2011. Berkshire made several significant acquisitions (the largest of which was the $9 billion purchase of Lubrizol). The company also made massive purchases in its stock portfolio and announced a share buyback (see the conclusion of this letter). A second co-manager, Ted Weschler, was hired to potentially succeed Warren Buffett. The financial titan of Omaha is stronger than ever.

With its stock price threading water, Wall Street remains myopic to the company's intrinsic value and its long-term potential (it is still trading for 20% less than it did in 2007). That's just fine with us: we bought more shares throughout the year at very good prices.

Buffalo Wild Wings (BWLD, $68)

We bought shares in this interesting American restaurant chain two years ago. As its name suggests, this company specializes in selling chicken wings and a number of accompanying sauces. The theme of the restaurant is one of a sports bar (a bit like the "Cage aux Sports" which we know quite well here in Quebec). The company is growing quickly and now has 824 restaurants (with 519 operating as franchises). Revenues for 2011 grew by 28% and EPS rose 32%. The company maintains a return on equity of 20% which is excellent for the restaurant industry. From 2007 to 2010, the restaurant industry experienced four consecutive negative years of comparable sales. Buffalo Wild Wings, however, maintained an average organic growth rate of 3%. In 2011, their organic growth rate was 5% while the industry overall grew at only 1%.

Of course, like any company that relies on cloning its concept (for a restaurant or a retail store), there is a maturity plateau that eventually needs to be reckoned with. We believe that the company can at least double its restaurant base before reaching such a saturation point. The company even now has four restaurants in Canada and is aiming to open 16 new locations here in 2012 and hopes to reach 100 restaurants within a couple of years.

Carmax (KMX, $31)

The fiscal year at Carmax ends on the last day of February. We are anticipating EPS and sales growth of 10% for fiscal 2011-2012. The company now has 107 stores in the US but still only has 3% of the used car market. Carmax is planning on opening 10 to 16 stores per year for the next five years (or about a 60% increase in the size of its current retail footprint).

We have been shareholders in Carmax since 2007. Although it hasn't been an easy time for American consumers, Carmax still managed to double its earnings per share since our purchase and the stock has risen by 50%. Few companies have an annual growth potential of 15% for the next decade and when we have the opportunity to buy such a company at less than 15 times earnings (like we did during the year), we become even more enthusiastic.

5N Plus (VNP-T, $5)

2011 was a transformative year for 5N Plus. The company quadrupled in size by acquiring the Belgian company, MCP Group SA. The latter is world's largest producer and distributor of bismuth (with 50% of the market), gallium, indium, selenium, and tellurium. 5N Plus paid $317m for this business by using cash, selling debt and issuing more shares. This allowed 5N Plus to reduce its dependency on the American firm First Solar and on solar energy in general—which experienced a horrible 2011!

Since the acquisition, the company's shares have slid from $8 to $5 due to the falling prices of a number of metals that the 5N Plus sells. The company is the leader in the markets for bismuth and cadmium telluride (used in solar panels) and we believe that the company will be able to maintain attractive margins despite fluctuations in base metal prices. The company adds value through its purification activities. The company is trading at nine times its 2012 estimated earnings and seems undervalued.

Disney (DIS, $38)

Disney had an excellent 2011. Earnings rose by 17% and ESPN continued to spearhead the company's strong earnings. Strong theatrical releases (such as Cars 2, Pirates of the Caribbean 4 and Thor) also contributed significantly. The number of subscribers to the Disney Channel reached 100 million and the company started construction of its theme park in Shanghai.

Bob Iger remains, in my opinion, one of the best CEOs in the US. For 2012, we are estimating EPS of more than $3. The stock is therefore trading at only 13 times estimated earnings.

Dollarama (DOL-T, $45)

Two years ago, we were thrilled by the IPO of a company we had long admired: Dollarama. The reason for this admiration is simple: for us the company's founder and CEO, Larry Rossy, is one of the best businessmen in Canada. We bought shares after the IPO and the stock has done very well—doubling in value since.

Figure 3: Larry Rossy, CEO of Dollarama (Photo: Globe and Mail)

After the first three quarters of 2011 (its fiscal year ends on January 31), revenues rose by 12%, same-store sales increase 4.4%, and EPS surged 46%. We knew that net margin could expand but the performance of 2011 exceeded our expectations. EPS should reach $2.45 in 2012 and the stock seems reasonably valued at the current level. We are keeping our shares with enthusiasm.

Fastenal (FAST, $44)

Fastenal hit a grand slam in 2011. Revenues rose by 22% and EPS climbed by 34%. This company from Winona (Minnesota) opened 122 new stores (selling nuts and bolts) in 2011—the company now operates 2585 stores.

We bought Fastenal in 1998 and it has been our most rewarding investment to date. This company has everything: a most boring primary business activity, a profitability level unrivaled in the industry, and a unique culture. Above all, the company is led by a management team dedicated to creating value with a long-term time horizon while always taking to heart its customers, employees and shareholders.

M&T Bank (MTB, $76)

M&T Bank had a good year. After extraordinary items, we estimate 2011 earnings per share of $6.74 which is 15% higher than 2010. Like Ozarks and Wells Fargo, bad loans are decreasing while profitability is increasing. M&T's return on its assets is about 1.2%. We believe that its return on asset could reach 1.5% in the long term, meaning that EPS could reach $11 in a few years.

MTY Food Group (MTY-T, $15)

MTY continued to acquire more brands in the quick service restaurant industry (with its restaurants primarily located in retail malls). In 2011, the company acquired:

- Koryo Korean BBQ (20 restaurants)
- Mr. Submarine (338)
- Jugo Juice (136)

Figure 4: Stanley Ma, CEO of MTY (Source: Canadian Business; Photo: Sylvain Dumas)

MTY now operates 2263 restaurants throughout Canada. In 2011, revenues rose by 17% and EPS increased 9%. Although the company significantly increased its operating expenses (after the acquisition of a production facility), we believe that these lower margins are temporary.

We remain admirers of Stanley Ma, the CEO of MTY, and we believe that the company's long-term prospects are very bright. The company also distributes now roughly a quarter of its profits in dividends.

Omnicom (OMC, $45)

Omnicom, the largest advertising firm in the world, had an excellent year in 2011. Revenues rose by 11% and EPS by 24% (partly boosted by the company buying back 7% of its shares outstanding during the year). Omnicom also raised its dividend by 25%.

We have been shareholders in Omnicom since 2008 and have earned a good return since. The stock is only trading at 12 times earnings. So, it seems to us that its potential for appreciation is excellent.

O'Reilly Automotive (ORLY, $80)

In 2011, O'Reilly continues to reap the benefits of its courageous acquisition of 1492 CSK stores in 2007-2008 (courageous because this acquisition was completed in an environment of great pessimism towards the retail sector). In four years, the number of stores has increased from 1830 to 3707 and sales have risen from $2.5b to $5.8b. Above all, EPS has climbed from $1.67 to $3.81. In 2011, sales rose by 10%, with 5% coming from same-store sales. EPS increased by 22%.

Since our purchase in the summer for 2004, the total growth in earnings has been 350% (or 20% annually). The stock has quadrupled.

Resmed (RMD, $26)

2011 was a difficult year for Resmed. Revenues rose 12% and EPS increased about 7%. These results are good but we are beginning to see a significant slowdown in the company's growth. Since we bought shares in this Australian company back in 2004, it has grown its revenue from $340m to $1.2b—an annualized growth rate of 20%. It has been a satisfactory investment.

We decreased our position in this company during 2011. The company's growth rate, as mentioned, has been slowing over the last couple of years (while its valuation by the market remained fairly high). The company's founder, Peter Farrell, has also been looking for a successor for some time now—without much success. We would consider increasing our position if we see a clear path to returned growth.

Stryker (SYK, $50)

Sales at Stryker rose by 11% in 2011, to $8.3b, while EPS increased by 14%. The most significant news of the year was Stryker's purchase of the neurovascular division of Boston Scientific. This acquisition enabled Stryker to grow its neurology revenue by 49%. This segment now represents 17% of the company's revenue and Stryker continues to diversify its medical products portfolio.

We anticipate another 10%+ increase in earnings for 2012. In 2013, however, the company will have to begin paying a new 2.3% medical products tax for its US revenue (about two thirds of its business). This will have a minor impact on Stryker and the company, with its excess cash, should be able to acquire new sources of revenue.

Visa (V, $102)

Visa's 2011 revenue and EPS increased by 14% and 24%, respectively. The stock rose from $70 to $102 as the worry about the Durbin financial reforms began to dissipate. Regulations regarding debit card transaction charges turned out to be less harsh than initially anticipated.

Our purchase of Visa, which occurred last year when its shares dropped precipitously, has so far been quite rewarding. The company also benefited from its shares dropping at the time by buying back 43 million shares of its stock at an average price of $75 (effectively returning $3.2b to shareholders). Despite the lower debit card transaction fees anticipated for 2012, Visa estimates that EPS will grow 15% or more during the current fiscal year.

Wells Fargo (WFC, $28)

Wells Fargo had an excellent year. EPS climbed to $2.82—a new record. Deposits increased from $838b to $912b, (with an average interest rate of .22%). Non-performing assets (bad loans) continued to drop during the year and the bank's return on assets continued to increase. Wells Fargo's Tier 1 ratio (an indicator of its financial strength) rose from 8.3% last year to 9.5% at the end of 2011.

We expect EPS of $3.35 for 2012. We therefore continue to believe that the stock is highly undervalued. It's trading at 10% less than what it did at the same time last year even though we think that its earning power has increased by 20%.

<u>New investments for 2011</u>

Google (GOOG, $646)

We bought a position in Google, as we wrote in our quarterly letter from last June. We are generally not fond of technology companies. We have observed over the course of several years a number of technological shifts that rendered obsolete once outrageously dominant companies.

But in our eyes, Google isn't really a tech company. It is first and foremost a service provider with the type of dominant brand we have seldom seen in our careers. Using Google to find something on the Internet has become the norm and has now even become a verb in our language (to "google"). We love these types of dominant brands because they are so well entrenched and because they cannot just be attacked by money and are not as prone to fad.

We bought our shares when the company's stock experienced a market correction during the year.

Valeant Pharmaceuticals (VRX.T, $47)

We have followed the pharmaceutical industry for some years and have owned shares in a diverse group of companies in this space at various times over the last 19 years. For some time now, the economic model of this industry—based on the constant discovery and marketing of new drugs—hasn't been working as well as it once did. A former consultant from McKinsey, Michael Pearson, proposed a new model for the industry. Armed with a pro-shareholder attitude and a value investing mindset, Pearson took over at the helm of Valeant in 2008.

Since then, due to numerous acquisitions coupled with disciplined resource optimization, revenues at Valeant have increased from $872m to more than $2.5b. Operating margins have risen from 19% to 35%. Mr. Pearson seems to be an exceptional CEO, despite the inherent complexity of this industry, and he has our vote of confidence to continue creating shareholder value. When the stock price had a correction last fall, the company bought back its own shares (and Mr. Pearson himself also increased his ownership). We did the same: we first bought shares in Valeant at the beginning of the summer and doubled our position during the fall.

Due to its merger with Biovail, Valeant became a Canadian corporation. Despite the company's excellent performance on the market (tripling in two years), we believe that this stock is still undervalued. With our estimated profit of $4 per share for 2012, the stock's P/E is still only 12 times.

IBM (IBM, $184)

In 1995, I wrote an article for the Journal Les Affaires entitled *"IBM's Turnaround Largely Goes Unnoticed by Wall Street"*. For those who might remember, the company had some very serious problems a couple of years prior. In 1993, Louis V. Gerstner became CEO and orchestrated one of the greatest turnarounds in corporate history. At the beginning, Wall Street—still licking its wounds with the company—avoided the stock. IBM was trading at $20 (adjusted for splits) at the time, which was eight times its EPS. I considered this a very a very compelling valuation. For some odd reason, I only bought shares for one partner (who is still with us today and who must recognize himself) and I only kept those shares for a brief period of time. I don't really have an explanation for not buying more shares aside that I must have found other even more appealing companies at the time.

But I continued to follow the work of Mr. Gerstner until his retirement in 2002. The stock had risen from $20 in 1995 to $135 in 2000 (at the top of the tech bubble) and then tumbled back to $60 in 2002. I continued to follow the company under the new management team. EPS went from $2.76 in 1995 to $6.01 in 2006 (a 7% annual growth rate). Then, in the five years that followed, EPS more than doubled and topped $13 in 2011 (a 17% annual growth rate). The company's accelerating earnings growth during the last years is the fruit of an optimal (and exemplary) use of its corporate and financial resources. Aside from brilliantly managing its operating activities, IBM also aggressively bought back its own shares.

In 2011, I finally stepped on my pride and we decided to buy shares in IBM, after comparing it with other blue chips we owned in our portfolio. It seemed to us that IBM was better managed while its market valuation was just as compelling as the other companies.

It is worth noting that, aside from 1995-1996 and 2008-2009, IBM's P/E has never been as low as it is now (12 times). It seems to us that Wall Street still hasn't fully realized the extent of the company's performance.

The Podium of Errors

"A life spent making mistakes is not only more honorable, but more useful than a life spent doing nothing."

- George Bernard Shaw

Following in the "Givernian" tradition, here are our three annual medals for the "best" errors of 2011 (or from past years). It is with a constructive attitude, in order to always improve as investors, that we provide this detailed analysis. As is often the case with stocks, errors from omission (non-purchases) are often more costly than errors from commission (purchases)… even if we don't see those on our statements.

Bronze Medal: Hansen Natural (now Monster Beverage)

About five years ago, a longtime friend, Jean-Louis Gauvreau, spoke to me with great enthusiasm about Hansen Natural. The company manufactures and markets an energy drink called Monster. The company's products are very popular and Hansen is highly profitable. Although Red Bull is the leader in this market, there seems to be ample space for other beverages in this industry. Jean-Philippe and I decided to push our research beyond its financial statements: we drank this beverage. After finding the taste rather strange, we just couldn't see the appeal of the product. But we decided to continue to study the company anyway!

In 2008, Hansen ran into a couple of tough quarters but managed to reinvigorate its growth due to, among other things, a distribution deal with Anheuser-Bush from 2007 and the introduction of new products. I knew that the deal with the behemoth behind Budweiser would prove highly beneficial and Hansen's plummeting stock price (which cratered from $34 to $11) offered an excellent occasion for us to buy. But I decided to pass.

In 2011, the company is twice as profitable as it was four years before. The stock has recently reached \$50—about four times the price at which I had considered buying. I should have drank more of their product to stay awake!

Silver Medal: Healthcare Services Group

This error has been a long time in the making. In 1994, I discovered this interesting business: Healthcare Services Group. HSG is a provider of cleaning and janitorial services primarily for hospitals and healthcare facilities. It is difficult to find a more boring business. No one on Wall Street followed this company. But the company had terrific potential with little competition and a very reasonable valuation (with a P/E of 14x). The company had solid sales growth but its margins were low (and weakening). Its return on equity was therefore modest (return on equity is a key criteria at Giverny Capital). I lost interest.

HSG recently appeared in Value Line and I noticed the progress the company had made during the 16 years after I stopped following it. During many years, margins continued to weaken (reaching a low of 2% in 2000) and EPS went nowhere. Starting in 2001, however, the company started to grow again and EPS increased fivefold over the next 10 years. Even better, the company started paying a dividend in 2003 and has increased its payment every year since. Today, all of the company's earnings are actually paid out in dividends. For a company to continue to grow while no capital is retained is quite an accomplishment.

Over 10 years, revenues have risen from \$284m to \$865m and EPS rose from \$.13 to \$.60. The stock has risen from \$1.40 to \$19—a 1200% increase. The current market valuation is high (27 times its estimated earnings for 2012) but the dividend payment helps maintain such a rich valuation. High tech companies generating lots of cash and not giving any of it back to shareholders would have a lot to learn by looking at the Value Line report on HSG.

What was my error? It was to stop following this company. Starting in 2005, it would have been obvious that the company was significantly improving its business model. I would have missed the first wave of appreciation in the stock but we still would have tripled our investment in six years. Not counting an average dividend payment of 3%.

Gold Medal: Restaurant Companies in 2008

At the beginning of 2008, all sectors linked to consumer spending in the US (retail chains, restaurants, etc.) were depressed. Wall Street was worried—with reason—about a deep recession caused by the high debt levels of American families. Stocks in these sectors had dropped significantly.

In February 2008, well before the great market decline from the fall of that year, restaurant stocks seemed attractively priced and I went ahead and made a list of three potential candidates. The list was published in an article in the Journal Les Affaires about the restaurant sector. I was quoted as saying: *"Mr. Rochon believes that the worry concerning consumer spending will create purchasing opportunities in the US. He likes Cheesecake Factory, Buffalo Wild Wings and Panera Bread. Their concepts are working well and they can open many more locations."*

I knew Cheesecake Factory well. It's a chain I discovered while I was in Kansas City in 2004 (during my trip to Missouri to visit O'Reilly Automotive). I had also been a fan of Panera Bread for many years. Here is the performance of these three stocks relative to the S&P 500 (since the date that the article in Journal Les Affaires was published almost three years ago):

Stock	Feb 15, 2008	Dec 31, 2011	Gain *
Buffalo Wild Wings Inc.	$25.0	$67.5	170%
Cheesecake Factory	$20.5	$29.4	43%
Panera Bread	$38.3	$141.5	269%
Average			161%
S&P 500	1350	1258	-7%

* market returns not including dividends

These three stocks have, on average, risen 161% over 46 months. This is a phenomenal performance, especially when compared to the S&P 500 which decreased 7% during the same period (not inclusive of dividends). Sadly, we only slightly benefited from this surge by buying Buffalo Wild Wings in 2009 at $40—and then only putting to work a very modest sum of capital (about 2% our portfolio).

I knew that it was a perfect occasion to buy these high growth companies at good prices. But unfortunately, I remained seated in the bleachers and didn't act on my enthusiasm.

Conclusion: the First Share Buyback for Warren Buffett in 47 years!

The financial crisis of 2008-09 created the opportunity for Mr. Buffett to make billions of dollars by making sound investments at good prices and shareholders in Berkshire Hathaway profited enormously from these purchases. The value of these investments has already been realized in some cases (such as preferred shares he already resold in 2011), and others are still being realized. Regardless, the assets recently purchased at well below their intrinsic values will be a source of great financial reward in the years to come.

Strangely, the market has yet to adequately reflect the growth in intrinsic value at Berkshire Hathaway since 2008. During last September, the stock was trading near the level of $70. At that time, we increased our position in Berkshire by 50% and we consider this perhaps one of the best occasions to have bought this stock in our lifetime. If Mr. Buffett was a few years younger, we probably would have bought even more.

Warren Buffett also announced at the time that Berkshire Hathaway would be buying back some of its own shares. The reason he provided was very simple: "the stock seems undervalued". Mr. Buffett had announced a buyback in March of 2000 but the stock proceeded to climb so quickly that he was never able to carry out his announcement. This time around, we were a bit more "lucky": the stock didn't rise much and the company was able to buy back a good portion of its stock for the first time since Mr. Buffett became president in 1965. This should prove very rewarding to us.

To Our Partners

The rigor of our investment selection process enabled us to get past the great crisis of 2008-09 and also through the market correction of last summer. Our companies have the balance sheets and management teams in place to not only survive these types of crises, but to also increase their market share and competitiveness during these difficult times. The outlook for our companies is excellent and we believe that this is an opportune time to invest should you have excess capital.

We also want you to know that we are fully aware and grateful for your vote of confidence. It is imperative for us to not only select outstanding companies for our portfolios, but to also remain outstanding stewards of your capital.

The entire team at Giverny Capital thanks you.

We wish a great 2012 to all our partners.

François Rochon

François Rochon and the Giverny Capital team

APPENDIX 1

Investment philosophy

Note: This section is repeated from prior annual letters and is aimed at new partners.

In 2011, we saw a large increase in the number of Giverny Capital partners (the term we use for our clients). With all these newcomers, it is imperative that we write again (and again) about our investment philosophy.

Here are the key points:

- We believe that over the long run, stocks are the best class of investments.
- It is futile to predict when it will be the best time to begin buying (or selling) stocks.
- A stock return will eventually echo the increase in per share intrinsic value of the underlying company (usually linked to the return on equity).
- We choose companies that have high (and sustainable) margins and high returns on equity, good long term prospects and are managed by brilliant, honest, dedicated and altruistic people.
- Once a company has been selected for its exceptional qualities, a realistic valuation of its intrinsic value has to be approximately assessed.
- The stock market is dominated by participants that perceive stocks as casino chips. With that knowledge, we can then sometimes buy great businesses well below their intrinsic values.
- There can be quite some time before the market recognizes the true value of our companies. But if we're right on the business, we will eventually be right on the stock.

Experience and common sense teach us that an investment philosophy based on buying shares in companies that are undervalued, and holding these companies for several years, will not generate linear returns. Some years, our portfolio will have a return that is below average. This is a certainty that we must accept.

Another important point: the significant volatility of the market is often perceived negatively by many investors. It's actually the contrary. When we see stock prices as *"what other people believe the company is worth"* rather than the real value (at least in the short term), these fluctuations become our allies in our noble quest for creating wealth. Instead of fearing them, we can profit from them by acquiring superb businesses at attractive prices. The more that markets (the "other" participants) are irrational, the more likely we are to reach our ambitious performance objectives.

Benjamin Graham liked to say that the irrationality of the market was an extraordinary advantage to the intelligent investor. The person, however, who becomes affected by short-term market fluctuations (less than 5 years) and who take decisions based on them transforms this advantage into a disadvantage. His or her own perception of stock quotes becomes their own worst enemy. Our approach at Giverny Capital is to judge the quality of an investment over a long period of time.

So patience – ours AND that of our partners – becomes the keystone for success.

APPENDIX 2

Notes on the returns of the Giverny portfolios

- The Giverny portfolio is a private family group of accounts managed by François Rochon since 1993. The returns of the period from 1993 to 1999 were realized before registration of Giverny Capital Inc. at the AMF in June of 2000.
- The Giverny portfolio serves as a model for Giverny Capital's clients. But returns from one client to the other can vary depending on a multitude of factors, such as the timing of the opening and funding of a client's account.
- Past results do not guarantee future results.
- The returns indicated include trading commissions, dividends and other income but do not include management fees.
- The index benchmark group is selected at the beginning of the year and tends to be a good reflection of the asset composition of the portfolio. In 2010 :

  - Giverny Global Portfolio: TSX 14% Russell 2000 39% S&P 500 39% MSCI EAFE 8%
  - Giverny US Portfolio : S&P 500 100%
  - Giverny Canada Portfolio : S&P/TSX 100%

- An asset appraisal of the three portfolios is performed by PricewaterhouseCoopers (PwC) at the end of each year for each portfolio. PwC has audited all yearly statements since 1993.
- The PwC data are those provided by our custodian TD Waterhouse.
- An appraisal of each portfolio under management is sent by TD Waterhouse on a monthly basis.
- The PwC reports are available upon request.
- For more information, please see the "returns" section of our website.