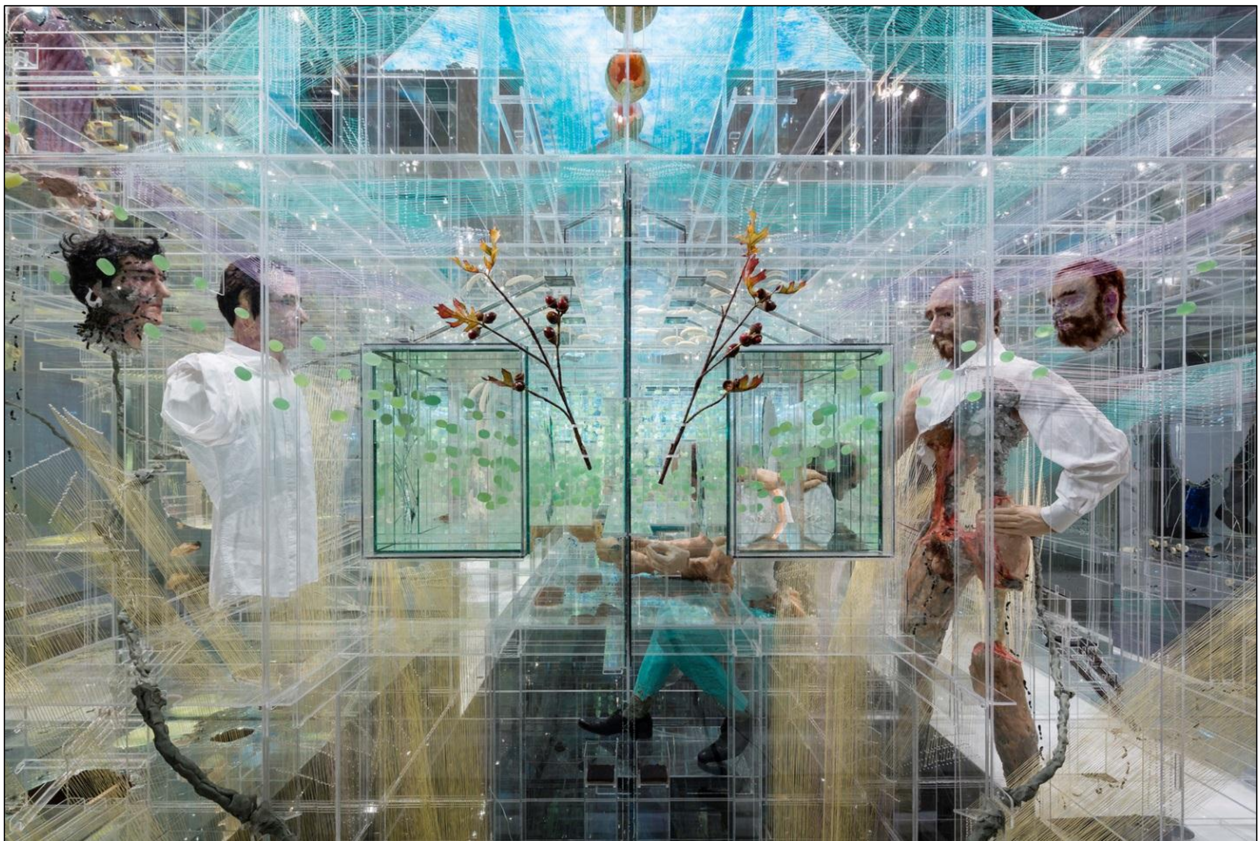
GIVERNY CAPITAL

Annual Letter to our Partners 2015



David Altmejd
The Flux and the Puddle (detail), 2014
Giverny Capital Collection
On Loan to the Musée National des Beaux-Arts du Québec

Historical Summary

It has been more than two decades since I discovered the writings of Warren Buffett, Benjamin Graham, John Templeton, Philip Fisher and Peter Lynch. I then decided to begin managing a family portfolio based on an investment approach synthesized from these great money managers. By the end of 1998, after five years of satisfactory results, I decided to launch an investment management firm offering asset management services aligned with my own investment philosophy. Giverny Capital Inc. came into existence.

In 2002, Giverny hired its first employee: Jean-Philippe Bouchard (JP for those who know him well). A few years later, JP became a partner and participates actively in the investment selection process for the Giverny portfolio. In 2005, two new persons joined the firm who eventually became partners: Nicolas L'Écuyer and Karine Primeau. Finally, in 2009, we launched a US office in Princeton, New Jersey. The director of our Princeton office, Patrick Léger, shares in the culture and long-term time horizon inherent to Giverny.

We are Partners!

From the very first days of Giverny, the cornerstone of our portfolio management philosophy was to manage client portfolios in the same way that I was managing my own money. Thus, the family portfolio I've managed since 1993 (the "Rochon Global Portfolio") serves as a model for our client accounts. It is crucial to me that clients of Giverny and its portfolio managers are in the same boat! That is why we call our clients "partners".

The Purpose of our Annual Letter

The primary objective of this annual letter is to discuss the results of our portfolio companies over the course of the prior year. But even more importantly, our goal is to explain in detail the long-term investment philosophy behind the selection process for the companies in our portfolio. Our wish is for our partners to fully understand the nature of our investment process since long-term portfolio returns are the fruits of this philosophy. Over the short term, the stock market is irrational and unpredictable (though some may think otherwise). Over the long term, however, the market adequately reflects the intrinsic value of companies. If the stock selection process is sound and rational, investment returns will eventually follow. Through this letter, we give you the information required to understand this process. You will hopefully notice that we are transparent and comprehensive in our discussion. The reason for this is very simple: we treat you the way we would want to be treated if our roles were reversed.

The Artwork on Our 2015 Letter

Since 2004, we have illustrated the cover of our letters with a copy of artwork from our corporate collection. This year we selected a detail of a sculptural installation by the Quebec artist David Altmejd entitled "The Flux and the Puddle". After a summer at the Musée d'art contemporain de Montréal, this work by Mr. Altmejd was exhibited at the Louisiana Museum in Denmark last Fall and will be on exhibit for the next 10 years at the Musée National des Beaux-Arts du Québec beginning on June 24, 2016.

For the year ending December 31st 2015, the return for the Rochon Global Portfolio was 20.2% versus 13.4% for our benchmark, which represents an outperformance of 6.8%. The return of the Rochon Global Portfolio and the one of our benchmark include a gain of approximately 16.3% due to fluctuations in the Canadian currency.

Since its inception on July 1st 1993, the compounded annual return of the Global Rochon Portoflio has been 16.3% versus 9.0% for our weighted benchmark, representing an annualized outperformance of 7.3% over this period. Our ambitious long-term objective is to maintain an annual return that is 5% higher than our benchmark.

The Rochon Global Portfolio: Returns since July 1st 1993

Return *	Rochon	Index **	+ / -	$ US/Can ***
1993 (Q3-Q4)	**37.0%**	9.5%	**27.6%**	3.3%
1994	**16.5%**	3.7%	**12.7%**	6.0%
1995	**41.2%**	24.0%	**17.2%**	-2.7%
1996	**28.0%**	22.8%	**5.2%**	0.3%
1997	**37.8%**	28.6%	**9.2%**	4.3%
1998	**20.6%**	18.8%	**1.8%**	7.1%
1999	**15.1%**	16.3%	**-1.2%**	-5.7%
2000	**13.4%**	3.2%	**10.2%**	3.9%
2001	**15.1%**	-0.4%	**15.5%**	6.2%
2002	**-2.8%**	-18.3%	**15.6%**	-0.8%
2003	**13.6%**	14.0%	**-0.4%**	-17.7%
2004	**1.6%**	6.2%	**-4.5%**	-7.3%
2005	**11.5%**	3.6%	**7.9%**	-3.3%
2006	**3.5%**	17.0%	**-13.5%**	0.2%
2007	**-14.4%**	-11.6%	**-2.8%**	-14.9%
2008	**-5.5%**	-22.0%	**16.5%**	22.9%
2009	**11.8%**	12.2%	**-0.4%**	-13.7%
2010	**16.1%**	13.8%	**2.3%**	-5.3%
2011	**7.6%**	-1.1%	**8.7%**	2.2%
2012	**21.2%**	12.5%	**8.7%**	-2.2%
2013	**50.2%**	38.9%	**11.3%**	6.9%
2014	**28.1%**	17.8%	**10.2%**	9.1%
2015	**20.2%**	13.4%	**6.8%**	19.3%
Total	**2864.3%**	**588.1%**	**2276.2%**	**8.0%**
Annualized	**16.3%**	**9.0%**	**7.3%**	**0.3%**

* 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
*** Variation of the US dollar compared to the Canadian dollar

Note: Refer to Appendix B for disclosure statements on the Rochon portfolios and their corresponding indices.

The Rochon US Portfolio

We have been publishing the returns of the Rochon US Portfolio, which is entirely denominated in US dollars, since 2003. The Rochon US Portfolio corresponds to the American portion of the Rochon Global Portfolio. In 2015, it realized a return of 1.7% compared to 1.4% for our benchmark, the S&P 500. The Rochon US Portfolio therefore outperformed our benchmark by 0.4%

Since its inception in 1993, the Rochon US Portfolio has returned 2294%, or 15.2% on an annualized basis. During this same period, the S&P 500 has returned 606%, or 9.1% on an annualized basis. Our added value has therefore been 6.1% annually.

Year	Rochon 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	4.7%	2.1%	2.6%
2012	22.3%	16.0%	6.3%
2013	40.6%	32.4%	8.2%
2014	18.0%	13.7%	4.3%
2015	1.7%	1.4%	0.4%
Total	**2293.6%**	**606.2%**	**1687.4%**
Annualized	**15.2%**	**9.1%**	**6.1%**

Note: Please refer to Appendix B for disclosure statements on the Rochon portfolios and their corresponding indices.

We outperformed the S&P 500 for an eighth consecutive year (just barely). Our objective is to outperform the S&P 500 over the long term.

You will notice that over the 22 years of its track record, our US portfolio has underperformed the S&P 500 on six occasions (or 27% of the time). This is in line with our "Rule of Three" which stipulates that we accept to underperform the index one year out of three on average. This average, if we can maintain it, would be far superior to the overall performance of portfolio managers. It is a difficult task to maintain outperforming the S&P 500 but it is our mission.

We must accept the fact that we will sometimes underperform the index over the short term when our investment style or specific companies are out of favor with mainstream thinking. And we try to welcome rewarding periods of portfolio outperformance with humility.

While it is not always easy, we try to remain impervious to short term results, both good and bad.

Rochon Canada Portfolio

We introduced a portfolio that is 100% focused on Canadian equities in 2007. This corresponds roughly to the Canadian portion of the Rochon Global Portfolio. In 2014, the Rochon Canada Portfolio returned 16.0% versus -8.3% for the S&P/TSX, therefore outperforming the index by 24.3%.

Since 2007, the Rochon Canada Portfolio has returned 331%, or 17.6% on an annualized basis. During this same period, our Canadian benchmark had a gain of 31%, or 3.0% on an annualized basis. Our annual added value is therefore 14.6%.

Year	Rochon 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%
2012	24.0%	7.2%	16.8%
2013	49.4%	13.0%	36.4%
2014	20.3%	10.6%	9.7%
2015	16.0%	-8.3%	24.3%
Total	**330.5%**	**31.0%**	**299.4%**
Annualized	**17.6%**	**3.0%**	**14.6%**

Note: Please refer to Appendix B for disclosure statements on the Rochon portfolios and their corresponding indices.

Our main Canadian holdings performed very well in 2015 and the all-star in our portfolio was Constellation Software which rose 67%. Dollarama also performed well, rising 35%. Of course, the stock dominating the headlines in Canada in 2015 was Valeant Pharmaceuticals (the stock decreased by 15%). We'll come back to that story later on.

For eight out of the last nine years, the Rochon Canada Portfolio outperformed the TSX. It is also worth repeating that our Canadian portfolio is highly concentrated and has little correlation to the TSX. So the relative performance, whether positive or negative, will therefore often be high.

2015

2015 was a difficult year for investors in the stock market. The dramatic drop in oil prices weakened the economy of many countries from East to West. In fact, nearly all industries linked to natural resources experienced a disastrous year. Consequently, many companies with revenue streams tied to these industries also had a portion of their revenue affected.

Additionally, the strength of the US dollar also had a negative effect on the profitability of many US companies doing business abroad. The combination of these factors created a stagnation in profits for

the companies in the S&P 500—a trend which was ultimately reflected in the market indices (with the Russell 2000 small cap Index suffering a little more, with a decline of 8%).

The situation was worse in Canada. The S&P/TSX declined from a high of 15,625 in 2014 to end 2015 at 13,010. The Canadian market is roughly at the same level it was back in 2007.

2015 was a good year for us. Our companies increased their intrinsic values by approximately 11% (dividend included) which is well above the average rate of earnings growth. And our stocks rose approximately 4% which is also above average. Since this modest absolute performance was still better than our benchmark, we are satisfied with our results.

The recent modest market performance of our companies only means that they have become more undervalued than they were at the same time last year.

Tender Offer for Precision Castparts

It is with mixed emotions that we welcomed the acquisition of Precision Castparts (PCP) by Berkshire Hathaway. As shareholders in Berkshire, we believe that this represents the acquisition of an extraordinary business for a very reasonable price. It's difficult for Berkshire to grow the immense level of capital it manages, and PCP provides both a sizeable capital base as well as a company with significant competitive advantages. The company's growth potential over the long term strikes us as vastly superior to the average and, in our opinion, the company should become a significant division within Berkshire.

As shareholders in PCP, we found ourselves in the difficult position of having to replace a company of rare quality. We resolved the problem pragmatically, by buying more shares in companies already in our portfolio… including Berkshire.

Effect of the Canadian Currency

It should be highlighted that the steep decline in the value of the Canadian dollar contributed significantly to the excellent appreciation of our portfolio in 2015. Our view is that the Canadian dollar has returned to a level that is more in line with its fair value, so we don't anticipate much as far as currency gains in the years to come. This does not mean that a Canadian investor should avoid US companies. It simply means that we don't have the opportunity to buy US companies at an additional discount such as the one that was offered to us in the recent past.

With more than 22 years of historical perspective, we can highlight the fact that the Rochon Global portfolio returned 16.3% on an annualized basis and that the decline in the Canadian currency contributed to only 0.3% of this return. The Loonie has experienced wild fluctuations throughout the years, but ultimately has had a negligible impact on our returns over the long term.

Portfolio Turnover

Our portfolio turnover was less than 10% in 2015 and we estimate that our average turnover during the last several years has been around 15%. In other words, we keep our stocks for 6 to 7 years on average. This compares to an average holding period of 6 months for the average investor (professional or not). So we keep our shares something like 12 times longer than the average investor. Our long holding period is also consistent with our investment philosophy: to generate exceptional returns over the long term, you must own exceptional companies over the long term.

We can ascertain two facts if we look at the 15 most significant holdings in our portfolio. The first is that these holdings represent about 80% of the value of our portfolio. We therefore have a concentrated investment approach. Second, we can see the average holding period for these stocks exceeds 7 years. Here are the details:

Company	Since	Years
Berkshire Hathaway B	2000	15
Bank of the Ozarks	2006	9
Disney (Walt) Co.	2005	10
Carmax Inc.	2007	8
LKQ Corp.	2012	3
Wells-Fargo	2005	10
Visa Inc.	2010	5
M&T Bank	2009	6
O'Reilly Automotive	2004	11
MTY Food Group	2007	8
Markel Corp	2013	2
Dollarama Inc.	2010	5
Ametek Inc.	2015	0
Union-Pacific	2012	3
Constellation Software	2014	1
Top 15 (average)		7

The Keystone of our Philosophy

We believe that exceptional returns can only be obtained by owning assets that intrinsically generate exceptional returns. There are all sorts of assets that an investor can own. In our opinion, the best assets to own are productive assets—ones that are a source of continuous wealth creation. We've learned throughout the years that a company with a durable competitive advantage is an asset that falls in this category.

The basis of our investment approach is that we consider stocks as fractional ownership in real businesses. While this may seem perfectly obvious, the majority of market participants do not approach stocks in this manner (whether consciously or not) and the emphasis is placed almost exclusively on short-term stock quotes. From our perspective, we prefer to remain impervious to stock quotes and favor an analysis based on the intrinsic performance of our companies.

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 owners 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) of our entire group of companies and the average dividend yield of the portfolio. We believe that this analysis is not exactly precise but approximately correct. In the non-scientific world of the stock market, we believe in the old saying: "It is better to be roughly right than precisely wrong."

This year, the intrinsic value of our companies, as a whole, rose by 11% (10% from the growth in earnings per share and 1% from the average dividend). Despite some of the changes to our portfolio during the year, we consider this estimate to adequately reflect its underlying economic reality.

The market performance of our portfolio was a gain of roughly 4% (including dividends and estimated without currency effects).

	Rochon Global Portfolio			S&P 500		
Year * **	**Value ***	**Market ** **	**Difference**	**Value ***	**Market ** **	**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%
2012	19%	23%	4%	7%	16%	9%
2013	16%	42%	26%	9%	32%	23%
2014	13%	19%	6%	9%	14%	5%
2015	11%	4%	-7%	1%	1%	0%
Total	**1102%**	**1141%**	**39%**	**297%**	**380%**	**84%**
Annualized	**13.2%**	**13.4%**	**0.2%**	**7.1%**	**8.2%**	**1.0%**

* Estimated growth in earnings plus dividend yield
** Market performance, dividend included (please refer to Appendix B for disclosure statements on the Rochon portfolios)
*** All results estimated without currency effects

20 Years of Owner's Earnings

We have presented this chart for 20 years now. As it demonstrates, market performance and company performance are rarely in sync over the course of a single year. In fact, the aggregate stock price for our portfolio has only been within 1% of the change in aggregate (estimated) intrinsic value for any given year for only 3 years out of 20. But as more time passes, the synchronization between the two inevitably begins to reveal itself.

Significant and educational conclusions can be drawn from a 20-year period. Since 1996, our companies have increased their intrinsic value by 1102%, or close to a twelvefold increase. Meanwhile, the value of their stocks has increased 1141% (net of estimated currency effects). On an annualized basis, our

companies increased their intrinsic value by 13.2% and our stock portfolio returned 13.4% per year. The similarity between those two numbers is not a coincidence.

During this same period, the companies comprising the S&P 500 increased their aggregated intrinsic value by 297% and saw their stock prices rise by 380% (dividend included), or 7.1% and 8.2% annually, respectively.

We could split this 20-year period into two distinct decades. The first from 1996 to 2005, and the second from 2006 to 2015. We can see in the chart below that the performance of our stocks during the second period was inferior than that of the first period, in regards to their stock performance as well as the S&P 500. In our opinion, this reflects that corporate profits were slightly higher than their true long-term earning power during 2005-2006 (probably due to higher than normal profits generated from residential real estate). On the other hand, we believe that corporate profits in 2015 were slightly below their long-term earning potential. This combination led to the second decade having slightly lower profits growth than the historical average.

	Rochon Global Portfolio			S&P 500		
Période * **	**Value ***	**Market ****	**+/-**	**Value ***	**Market ****	**+/-**
1996-2005	**14.9%**	**15.7%**	**0.8%**	**8.5%**	**9.1%**	**0.5%**
2006-2015	**11.6%**	**11.2%**	**-0.4%**	**5.8%**	**7.3%**	**1.5%**

* Estimated growth in earnings plus dividend yield
** Market performance, dividend included (please refer to Appendix B for disclosure statements on the Rochon portfolios)
*** All results estimated without currency effects

The Sound Conclusion

Over 20 years, our stocks have outperformed the S&P 500 by 5% annually for the simple reason that the underlying companies in our portfolio have increased their intrinsic value at a rate that is 5% superior than the average. It is in this matter that we intend to continue reaching our goals of outperformance rather than any sort of speculation on the highs and lows of the market, the economy, and/or the political environment. We leave this futile activity to those who don't realize that a stock is simply an ownership stake in a business.

The Flavor of the Day for 2015

Since 2015 was a difficult year for stocks, we were hard pressed to find popular segments of the market. Once again, it's in regards to bonds that we're seeing unbridled optimism. We'll come back to this at the end of our letter.

Housing prices in Canada have also continued to increase in 2015, primarily in British Columbia and Ontario. The average home price in Vancouver now exceeds one million dollars[1]. In Toronto, the average price is $631,000. A significant drop in Canadian real estate prices could have major consequences on various segments of the Canadian economy. We consequently try to stay clear of any businesses that could be affected.

2016 Outlook

As you likely know, we have a minimalistic attitude towards making economic predictions (and a nihilistic attitude regarding short-term stock market predictions). Our opinion is that the outlook for

[1] According to the Canadian Real Estate Association website for January 2016.

economic growth on most parts of the globe will be modest for the year to come. A highly selective investment process for finding truly above-average companies is as critical as ever.

In the US, the strength of the dollar should have less of a dampening effect on the growth of earnings in 2016 versus 2015. We believe that US companies should grow their profits by roughly 6-8% annually. The S&P 500 is now trading at 15-16 times its anticipated profit for the year to come which seems to us a reasonable ratio.

More important to our financial well-being, we believe that our companies should increase their profits by about 12-16% this year, a rate that is roughly twice the one of the average company in the S&P 500. Our stocks are trading at approximately 14-15 times estimated profits. So, not only are our companies offering better-than-average growth prospects in our view, but their shares are actually trading at a slight discount to the P/E of the market.

Closer to home, the economic outlook in Canada seems bleak. Various forces affecting the Canadian economy, such as weak commodity prices, the elevated level of Canadian real estate and a rise in income tax rates do not bode well and are unlikely to improve in the year to come. The significant increase in the federal budget deficit could soften this short-term situation, but it does not seem constructive (to us) over the long term. We are, however, satisfied with the Canadian companies held in our portfolio. Their long-term growth prospects seem very solid.

The year 2016 kicked off with market volatility. We welcome volatility because it allows us to acquire shares of the companies we like at more attractive valuations. We can either invest new capital at good prices or rebalance our portfolio to take advantage of compelling relative opportunities. It’s perfectly rational to sell a stock trading at 67% of its fair value to invest the proceed in an existing holding trading at 50% of its fair value. We are all richer today because of past market corrections.

Five-year Post-mortem: 2010

Like we do every year, we go through a five-year post-mortem analysis. We believe that studying our decisions in such a systematic manner, and with the benefit of hindsight, enables us to learn from both our achievements and our errors.

First, in the 2010 Annual Letter, we labeled the price of gold as the “flavor of the day” when it was nearing $1400 per ounce. Five years later, gold is trading at $1065, or 24% lower than the 2010 level. We had no idea how to evaluate the price of gold but we had observed a craze that seemed worthy of highlighting in 2010. We could add that since I started in 1993, the price of gold has risen from $392 to $1065, which is an annual return of 4.6%. This is roughly half the annual return of the S&P 500 over the same period.

In the 2010 letter, we presented two new portfolio purchases: Dollarama and Visa.

Dollarama

Dollarama is the largest dollar store chain in Canada, with over 1000 locations across the country. Founded in 1992, the company’s stores offer a vast inventory of consumer products, general merchandise and seasonal items. Products are sold individually or in bulk at fixed prices up to a maximum of $3.

We had gotten to know the company quite well even before it became a public company since Dollarama is a Montreal-based company. We knew that the company’s founder and president, Larry Rossy, was

an exceptional businessman and we were saddened when the company was sold to the private equity firm Bain Capital in 2004 instead of going public.

The good news is that there's no sense losing hope in the world of the stock market and Dollarama finally went public in 2009 at $17.50 per share ($8.75 when we adjust for a stock split). A few months later, in 2010, we became shareholders in the company despite the company having a P/E of 18x and having some debt on its balance sheet. This was an act of faith based on Mr. Rossy. EPS rose from $0.82 in 2010 to $2.96 in 2015 (estimated), which represents a 29% annual growth rate. The company's stock rose from $12 to $80 (an annual return of 46%). Dollarama is one of our best investments since the inception of this portfolio 22 ½ years ago. All partners at Giverny Capital owe a debt of gratitude to Larry Rossy.

Visa

We were shareholders of American Express from 1995 to 2013 so we understood quite well the solid competitive advantages of credit card companies. MasterCard went public in 2006 and was an exceptional investment (one which we lamentably missed). We were anxiously waiting for Visa to also go public, which occurred with its 2008 initial public offering. We waited on the sidelines as its shares were trading at $20 when the company was earning $0.62 per share (a P/E of more than 30x).

The stock tumbled to $13 during the crisis of 2008-2009 and then climbed back to $23 in 2010. However, during the summer of 2010, the stock dropped 25% when Senator Dick Durbin introduced a bill which amended the Dodd-Frank bill to limit debit card transaction fees for retailers (interchange fees). The stock fell to $17 and we purchased shares. At that time, the company was earning $1.06 so the P/E had fallen from 23x to 17x within a few weeks. This was a very compelling valuation for this business as we believed that the company's long-term prospects seemed exceptional.

Source du graphique : Bigcharts.com

EPS 2010	EPS 2011	EPS 2012	EPS 2013	EPS 2014	EPS 2015
$1.06	$1.31	$1.62	$1.96	$2.35	$2.68

In the chart above, you can see the incredible performance of Visa over the last five years: EPS has risen from $1.06 to $2.68—or a 20% annual growth rate. You can also see that the company's shares rose from $17 to $78 during this period, or a 350% increase. This has been a very satisfying investment.

I must add a post-script to this port-mortem. We were <u>lucky</u> to have made this investment. Our luck was to have had the 25% drop linked to the Durbin reform as it's highly unlikely that we would have purchased this stock without this unexpected fall. I had followed the company closely and held my nose at the P/E of 23x which was prevalent before the stock's correction in the summer of 2010.

Is the fact that I didn't buy the stock in the beginning of 2010 an error? Absolutely. Imagine if the company's shares hadn't dropped in 2010: by buying at $23, we still would have tripled our money in 5 years. We will still savor the fruits of this investment even if it's a stroke of luck that eventually camouflaged this error.

Our Companies

The Walt Disney Company (DIS, $105): 10 years in our portfolio

We have held shares in Walt Disney for a decade now. Actually, we first bought shares in the company in 1996, following the acquisition of Capital Cities ABC. We sold our shares in early 2000, however. Then, in September 2005, a new CEO was named: Bob Iger. We knew Mr. Iger through his reputation and had great respect for him. He struck us as the perfect leader to bring Disney back to the path of earnings growth. We bought shares in Disney the very day he was named to his new post.

The first challenge he tackled was Pixar. The partnership agreement was about to end and it was it was imperative (this is too weak a word) that it should be renewed. Disney decided to simply acquire Pixar with the approval of its then president, Steve Jobs. This is likely the most important acquisition in the history of Disney. The company's dominance in the production of animated films literally returned to its former glory.

Mr. Iger eventually also acquired Marvel. He understood that with the technical capabilities that now existed, superheroes such as *Iron-Man, Hulk, Thor and Captain America* could take on a totally new dimension at the cinema. This was a homerun for Disney and Marvel's superhero franchises became significant sources of profits for the company.

Lastly, three years ago, Disney acquired Lucasfilm and became the owner of the brand Star Wars. The seventh episode, *The Force Awakens*, premiered on December 18th of last year and within 12 days surpassed the billion dollar mark at the box office on its way to becoming the greatest financial success in the film industry (surpassing *Avatar*).

So within a few years, the entire corporate culture at Disney was transformed and the company found the magic it once had during the decades it was led by its founder. The culmination of this new culture was the creation of *Frozen* which became the greatest success in the history of animated films (I have tears of joy in my eyes when I see all the beautiful Frozen related merchandise sold in stores).

This transformation at Disney is reflected in its financial performance. From 2005 to 2015, EPS surged from $1.33 to $5.51, representing an annualized growth rate of 15%—a phenomenal performance for a company of its size. The company's stock rose from $24 to $105, or a 16% annualized growth rate (not including dividends).

Source: BigCharts.com

Though the incredible performance at Disney is based on the hard work of thousands of people, Bob Iger deserves to be singled out as deserving the credit for leading the company's turnaround. In our opinion, more than $100 billion in shareholder value was created as a result of his leadership.

Walt Disney would likely add: "I only hope that we don't lose sight of one thing - that it was all started by a mouse."

Anecdote on Bob Iger

Before joining Disney, Bob Iger worked with Tom Murphy at Capital Cities ABC. Mr. Murphy is now retired but sits on the board of Berkshire Hathaway. Warren Buffett once said that he was one of the greatest CEO he had ever known in his career (it's tough to get a better compliment). During the 2006 Berkshire shareholder meeting, Jean-Philippe and I crossed paths with Mr. Murphy in the lobby of our hotel. After saluting him with admiration, we dared ask him what he thought of the recent appointment of Bob Iger as CEO of Disney. He spoke about him with great enthusiasm which confirmed our initial judgement. As you can see, our annual visits to Omaha are educational on many fronts.

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Alphabet Inc. (GOOG, $759)

Alphabet (formerly Google) had an excellent year in 2015. Revenues were up 13% despite more than half of its sales originating outside the United States (and therefore strongly affected by the rising US dollar). Adjusted EPS grew by 16% which is a spectacular performance for a large US multinational. The company continued its transition to mobile and profit margins appear to have stabilized. The enormous competitive advantage of Google's web search seems to have transposed itself from desktop (PC) to mobile. This is great news for the intrinsic long-term value of the company.

We maintain a modest weight (about 2-3%) in Alphabet as we find the company to be very generous with its stock option program. We might also add that we would appreciate better allocation of excess capital. Aside from these two factors, Alphabet seems to be an exceptional company.

Ametek (AME, $54)

Ametek is one of two new companies in our portfolio for 2015. This manufacturer of electronic instruments and electromechanical devices was founded in Pennsylvania in 1930 as American Machine and Metals. The company changed its name to Ametek in the early 1960s and is one of the oldest companies listed on the New York Stock Exchange (since its inception in 1930). Yet the company remains largely unknown and isn't closely followed. Its electronic instruments division manufactures products used for monitoring, measuring, testing, and calibrating for markets including aerospace and energy. The electromechanical devices division produces interconnection equipment, engines and systems.

Over the last decade, revenues increased from $1.4 billion to $4 billion and EPS climbed from $0.59 to $2.73, or an annual growth rate of 17%. The company is growing in part by new product introductions and also through acquisitions (23 since 2011).

As is often the case with exceptional companies, it's the corporate culture that really stands out. The first of the four pillars of its business model is "operational excellence" and the company is diligent in reducing its cost structure and improving efficiency while managing its asset base.

The company believes it can double revenues within five years and we share their optimism.

Bank of the Ozarks (OZRK, $49)

2015 was an exceptional year for Bank of the Ozarks, our bank from Little Rock, Arkansas. The company generated a 38% growth in EPS, reaching $2.09. Here are the highlights from 2015:

- The bank's efficiency ratio (a measure of its cost structure), was an impressive 38%.
- Return on Assets reached 2.11%.
- The bank's balance sheet continued to strengthen with returns on equity of 14.8%.
- In February, Ozarks completed its acquisition of Intervest National Bank.
- In August, Ozarks acquired Bank of the Carolinas.
- In October, Ozarks announced its largest acquisition to date: Community & Southern Bank (with 47 branches in Georgia and Florida).
- Deposits increased by 45% to $8.0 billion.
- Total assets grew by 46% to $9.9 billion.

Over the last decade, Ozarks has grown EPS by an annual compounded rate of 16%. Few banks can tout this kind of performance given the difficult economic context of the past years. We anticipate a solid increase in EPS in 2016 and remain optimistic about the company's prospect for continued growth.

Berkshire Hathaway (BRK.B, $132)

The company led by the legendary Warren Buffett had an excellent year in 2015. It's difficult to precisely measure the increase in the company's intrinsic value for the year, but we believe that it was

within the order of 6-8%. The most important news of 2015 was the acquisition of Precision Castparts (see the beginning of the letter).

We believe that Berkshire's shares are undervalued by the market.

Buffalo Wild Wings (BWLD, $160)

Buffalo Wild Wings (BWW) is a sports-oriented restaurant chain which primarily serves chicken wings, as its name suggests. We have been shareholders in the BWW for six years. The number of restaurant locations reached 1175 in 2015, with 93 opening within the last year. The company grew revenue by 21% in 2015, same-store sales rose by 4.2% (2.5% for franchised locations) but its EPS remained flat at $4.97. The company had to deal with pressure on its net margins in 2015 but we believe the situation to be temporary.

The company anticipates opening 87 to 100 new restaurants in 2016 and we forecast that earnings will grow at more than 20% for the coming year.

Carmax (KMX, $54)

Carmax's fiscal year ends in February and we estimate that sales and EPS will grow by about 8% for 2015-16. While the company operates 160 stores in the US, it only has roughly 3% of the used car market. So we see lots of room for growth in this business.

The company's stock fell in 2015 (a fall which continued in the beginning of 2016). The stock seems to be greatly undervalued and we took advantage of the recent decrease to increase our holding.

Constellation Software (CSU-T, $577)

We've been shareholders in Constellation Software for two years. We consider the CEO of Constellation, Mark Leonard, an exceptional businessman. Past performance has been impressive at Constellation and we believe that the long-term prospects are equally excellent. While the company is based in Canada, the majority of its revenue is based in the US and financial results are reported in US dollars.

Revenues grew by 10% in 2015 and losses on currency reduced organic growth by 6%. EPS climbed by 35% and the stock did quite well, surging 67% for the year (in Canadian dollars).

Dollarama (DOL-T, $80)

After its first three quarters of 2015 (the company's fiscal year ends on January 31st), revenues rose by 13% and same-store sales increased by 7.1%. EPS climbed 39% and we anticipate a rise of 34% for the year 2015.

Dollarama now has more than 1005 stores in Canada and we consider the company to be one of the best managed businesses in Canada.

Knight Transportation (KNX, $24)

Older partners might remember being shareholders of Knight Transportation for several years from 2003 to 2011. Knight Transportation is a large trucking company based in Phoenix (AZ). In addition to

offering road transportation services over short and medium distances, it also offers logistic services. We had sold our shares of Knight in 2011 to purchase another security that seemed more undervalued.

The company appointed a new CEO, David A. Jackson in early 2015 and we met him shortly thereafter. As the company's CFO before taking the CEO role, Mr. Jackson reinvigorated the growth strategy for Knight. We were very impressed with this young leader (40) and decided to become shareholders once again.

2015 was difficult for the trucking business (more than we would have thought given an environment of low gas prices). Knight's revenues grew by 7.3% (14.7% excluding the effect of fuel surcharges) and EPS grew by 17%. 2015 ended with a slight decline in profitability that is likely to last a few more quarters. Still, we believe that the company's long-term growth prospects are solid.

LKQ Corp (LKQ, $28)

We invested in LKQ in 2012. This Chicago-based company refurbishes used automotive parts. The company became the leader in its industry by offering very compelling prices relative to new parts (which pleases the insurance companies) along with an unrivaled distribution network. LKQ has diversified in Europe over the last years by making acquisitions in the United Kingdom, Belgium, France, the Netherlands and, more recently, Italy.

From 2008 to 2015, revenues grew at an annualized rate of 20%, from less than $2 billion to $7.2 billion. In 2015, EPS rose by 11% compared to the prior year. The appreciation of the US dollar affected profitability, along with lower prices for scrap metal (what's left of the cars when the company has taken out all the parts to refurbish).

In 2016, we expect EPS growth of 12-15%, We believe that the company has excellent long-term growth prospects and the stock's valuation on the market has rarely been so low!

M&T Bank (MTB, $121)

After three years of regulatory delays, the merger between M&T Bank and Hudson City Bank was finalized in November of 2015. M&T acquired nearly $35 billion in assets.

In 2015, adjusted EPS grew 2%, to $7.74. We believe that M&T Bank should now be able to earn higher returns going forward. We anticipate a significant improvement on the bank's return on assets in 2016, fueled by a lower efficiency ratio and the anticipated synergies from the integration of Hudson City. We believe that the company can generate EPS in excess of $9 in the coming year.

Markel Corporation (MKL, $883)

We first bought shares in Markel in 2013 when the company announced its large acquisition of Alterra Reinsurance Company. Wall Street was skeptical of the benefits of this acquisition and the stock was trading at a compelling valuation. We seized the opportunity to become shareholders.

2015 was an excellent year for Markel. The combined ratio decreased from 95% to 89% (the lower the better). More importantly, the newly-acquired reinsurance division saw its combined ratio improve from 96% to 90%. Book value, however, only increased by 3%. It's worth noting that the market value of the company's stock portfolio has a direct impact on the company's book value. In 2015, Markel took

a $300 million write down on some of its investments, but we believe that these are temporary in nature and will eventually be transformed to gains.

Mohawk Industries (MHK, $189)

We have been shareholders in Mohawk since 2006. 2015 was another good year for Mohawk: revenues grew 3% (10% without a loss related to exchange rates) and EPS rose 25% to $10.51 (adjusted for the amortization of intangible assets).

Mohawk has become a world leader in the floor covering business and we believe that the company is stronger than ever.

MTY Food Group (MTY-T, $32)

Stanley Ma, founder of MTY Group, opened his first restaurant in Montreal in 1979 which was called The Paradise of the Pacific. Then in 1983, MTY developed Tiki-Ming which serves Chinese cuisine. In 1999, the company made its first acquisition when it bought Fontaine Santé which soon assumed the name Veggirama and was gradually converted into restaurants called Cultures. MTY now has 30 brands with nearly 2800 locations in its network of restaurants.

It was another remarkable year for MTY Food. Revenues grew by 26% to $145 million and adjusted EPS rose by 18%. The company's balance sheet remains strong, with nearly no debt and $33 million in cash ready to be used for acquisitions.

One day, I was told that MTY did not spend enough on R&D. I replied that it was the beauty of an egg roll from Tiki-Ming: it hasn't changed in 30 years. There's no need to modernize it. We like companies with simple products that aren't threatened by obsolescence. Notwithstanding, MTY has done a remarkable job with culinary innovation at Thaï Express and Sushi Shop.

We have been shareholders in MTY for eight years. From 2007 to 2015, adjusted EPS increased from $0.51 to $1.87, or an annualized growth rate of 18%. We are huge fans of Stanley Ma, CEO of MTY and believe the company's long term prospects remain excellent.

MTY's stock is currently trading at the same level it did two years ago so we think its valuation has become even more attractive.

O'Reilly Automotive (ORLY, $253)

O'Reilly had another sensational year. Revenue grew by 10% to reach $8 billion, with same store sale growth of 7.5%. Net income rose by 20% and EPS increased 25%, to $9.17 (with 5% of the EPS growth coming from the company's share buyback program).

We anticipate a more moderate EPS growth for 2016, though still within the 12-14% range. We should also add that O'Reilly has made our estimates look too conservative throughout the years!

Stericycle (SRCL, $121)

We decided to become shareholders in Stericycle in 2015 after following the company for many years. The industrial waste division was affected by weakness in the energy sector and the stock fell 20% after

announcing results that disappointed Wall Street. We look further ahead than a quarter or two and believe that the long-term growth prospects of the business are still solid.

Stericycle acquired the Canadian company Shred-it for $2.3 billion in 2015. Shred-it is a leader in the document destruction industry and we know the quality of this company firsthand since we use its services at Giverny Capital. Shred-it was to have an IPO in 2015 and we were looking forward to the roadshow after reading the prospectus, but Stericycle decided to acquire the company just before its IPO.

Stericycle's revenues climbed 17% in 2015 (mainly due to the acquisition of Shred-it). Adjusted EPS, however, rose only 6%. 2016 will probably be similar to 2015 in terms of growth (as the company will continue the integration of Shred-it) but we expect a return to a higher level of growth in 2017.

Union Pacific (UNP, $78)

It was a difficult year for the rail industry and Union Pacific was not spared. UP saw its revenues decline by 9% and its EPS drop by 5%. It should be noted, however, that with dividends and share buybacks, UP returned more than $5.8 billion to shareholders in 2015.

The good news is that the company was able to increase its prices by about 3.5% in 2015 which is a better growth rate than in 2014. UP also achieved an operating ratio of 63.1% in 2015 and the company is more efficient than ever.

UP and BNSF (owned by Berkshire Hathaway) have the equivalent of a duopoly in the western railroad market of the United States. First, a duopoly is the second best thing after a monopoly. But to have a rational competitor is also definitely a good thing over the long run. Still, BNSF had a better year in 2015 than UP after a few years of the reverse situation.

We expect 2016 will still be difficult for UP but we continue to believe that the company has great potential for higher returns on its capital over the long term. The stock has fallen in the stock market over recent quarters and seems to us to be quite undervalued.

Valeant Pharmaceuticals (VRX, $102)

In 22 ½ years of portfolio management, I have never liked to own companies that are in the headlines of newspapers (and/or the Internet). We like "low profile". For most of the first 22 years, we were fortunate to have this wish granted. However, we had a turbulent end of 2015 with our shares in Valeant (and the beginning of 2016 was certainly similar).

We became shareholders in Valeant in 2011. Michael Pearson took over Valeant in 2008 and we followed the phenomenal transformation he led with the company. Instead of spending a large portion of revenues on R&D that often generated low returns on invested capital (something which is almost done out of tradition in this industry), Pearson instead relied on the acquisition of drugs and consumer products that were stable and/or whose likelihood of success was high. The company does spend on R&D (unlike what many say) but only when it believes that the odds are high to achieve success. It is actually one of the most productive companies in the industry in terms of R&D as measured by the number of approvals for new compounds per billion dollars spent.

The optimization of financial resources at the businesses it acquired enabled Valeant to achieve very high operating margins and returns on equity. EPS grew from $2.93 in 2011 to $10.16 in 2015—an

annualized growth rate of 36% over four years. Initially, analysts expected EPS of about $16 for 2016. This explains why the stock went from $40[2] during our initial purchase to a high of $264 last summer.

Valeant also used debt to fuel its growth plan. Following the acquisition of Salix Pharmaceuticals in early 2015 for $11 billion, the level of debt had risen considerably. Due primarily to its debt level, we knew the risk in Valeant was higher than our other investments. So, as the stock rose, we decided to reduce our position on two occasions to limit its weight in the portfolio to about 5%.

At the end of last summer, Valeant had become the target of politicians concerned with the rising price of some of its newly acquired drugs. It should be noted that such increases are often tempered by discounts negotiated by different purchasing groups. Ultimately, despite the income of the three drugs in question corresponded to only 4% of revenues of the company, the public image of Valeant was severely tarnished. In our view, the high price increases of certain drugs, justified or not, fueled the anger of the general public and was unnecessary. Its consequences are far more negative than positive for the company.

Then in October, some short seller suggested that the company had questionable books based on the "complicity" of one of its distributors, Philidor. The company decided to terminate its relationship with this distributor and a few weeks later signed a major distribution agreement with Walgreen's. The company then reduced its estimated profits for 2016 to around $13.50. To make matters worse, Mr. Pearson became seriously ill in late December and was on medical leave for two months.

We waited a few weeks to publish this letter because we wanted to have an update on the financial condition of the company before making a decision about our shares and give you the most accurate information available. At last, the company released its results for 2015 and, more importantly, updated its estimates for 2016. Valeant now expects $9.50 to $10.50 in EPS for the year ahead.

We consider this level of profitability as no longer meeting our criteria in regards to the company's earnings power relative to its debt. So we took the difficult decision to sell our shares in Valeant.

Clearly, we would have liked to have sold earlier but we were bound by the facts rather than the rumors. In light of the updated forecast, we believe that the risk inherent to the company is now too high for us.

Visa (V, $78)

Visa had another good year, with EPS growing by 14% despite a significant decline in revenues due to the strong US dollar. The company announced in November that it was acquiring its European division (Visa Europe) for over $23 billion.

The stock is trading at a P/E that is slightly higher than our other holdings, but its long-term growth prospects are excellent. The company is highly profitable and uses its enormous cash flow to repurchase shares.

Wells Fargo (WFC, $54)

Wells Fargo had a somewhat disappointing year in 2015. EPS was flat in comparison to 2014. This is not an easy time for banks since very low interest rates reduce the profit margin between the rates banks

[2] All figures for Valeant are listed in US dollars

charge customers relative to the rates paid to lenders (such as for deposits). Thus, net interest margin fell from 3.11% in 2014 to 2.95% in 2015.

Adjusted return on assets was 1.3% and the return on equity of 12.7%. We believe the company has the ability to be much more profitable in a more “normal” interest rate environment.

Sales in 2015

Fastenal

We sold our remaining shares of Fastenal in early 2016, after having held the company in our portfolio for over 17 years. Fastenal is a large retailer of fasteners and other equipment mainly used in manufacturing. Fastenal was founded in 1967 by Robert Kierlin in the small town of Winona, Minnesota (population 27,000). The company has over 2600 locations across the United States, Canada and Mexico.

In 1998, we had been following the company for many years and had great admiration for its CEO, Robert Kierlin. Unfortunately, the stock was always trading at very high valuations (with a P/E in the 30s or even more). But we had our chance during the Asian crisis in October 1998 (few people remember this one!) as the stock market declined by almost 20%. Fastenal’s stock tumbled from $7 to $3 (price adjusted for subsequent stock splits). We paid 18 times earnings for our first shares in Fastenal—an attractive valuation for a company that was growing at 20% annually.

Having Robert Kierlin as president of one of the companies in our portfolio was a great moment in my investor’s life. He was one of the best businessmen of his time and he knew how to establish a phenomenal corporate culture. Fastenal generated strong profit margins and exceptional returns on capital in a very competitive industry. His attention to operating costs became legendary. In 1997, an article was published on Mr. Kierlin in Inc. magazine entitled "The Cheapest CEO in America". The author explained that net margins at Fastenal were 11.3% in 1996 compared to 5.9% for one of its main competitors, W. W. Grainger. This was a very significant difference.

Mr. Kierlin also led by example: he was paid a salary of only $120,000 per year and the company had no stock option program. Most importantly, Mr. Kierlin owned about 12% of the shares of Fastenal. He was very much in the same boat as his fellow shareholders.

The values of Mr. Kierlin went far beyond frugality. Soon after we became shareholders, members of the management team suggested that Fastenal provide a stock option program for employees. Mr. Kierlin agreed but decided to give his own shares in the company to fund the program rather than issuing options that would dilute all shareholders. The number of shares thus remained the same. We had never seen such a thing in a public company and this strengthened our enthusiasm to be partners with Mr. Kierlin.

After Mr. Kierlin stepped down in 2002, it was the turn of Willard Oberton to take over the helm at Fastenal. He also did an outstanding job. Over the 17 years we were shareholders of Fastenal, EPS increased from $0.18 to $1.77—a tenfold increase (equivalent to an annualized growth rate of 15%). We sold our shares for more than 12 times the initial price that was paid in 1998. The company no longer has the same growth rate as in the past and we concluded that, relative to other securities in our portfolio, the company’s shares seemed fairly valued. But it is not to say that we will not return again as shareholders one day...

Other Sales

In 2015 and early 2016, we also sold our shares of Cabela's, PRA Group and IBM. Similar to the case of Fastenal, we sold these positions primarily for the simple reason that we were more confident that other securities in our portfolio offered better growth prospects.

The Podium of Errors

Following in the "Givernian" tradition, here are our three annual medals for the "best" errors of 2015 (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: Amazon

I have been an avid fan of Amazon since the launch of its retail website. However, it was very difficult to see when the company would become profitable when it went public in 1997. Sales increased rapidly but losses followed suit. Slowly, the company has become slightly profitable. The company has a policy of investing heavily in its future and is always willing to sacrifice short-term profits. Amazon spends billions of dollars on a very important activity and a potential source of wealth: to dig a huge economic moat around its business to keep far away competitors. This is the best way that a CEO can spend money (when the moat is real and not imaginary as is so often the case). In our opinion, Jeff Bezos is one of the greatest businessmen in history and we would have liked to become partners with him for many years now.

Historically, Amazon has benefited from Wall Street's support of its bold strategy focused on the long term. In 2014, the stock had corrected from $400 to under $300. With EPS of little over $1, the stock seemed very far from a bargain. I nonetheless took the time to look more closely into their business model and tried to assess the earning power going forward to 2020. My estimates seemed plausible: I arrived at an EPS potential of $28 in 2020. Using a P/E ratio of 25 times, this would justify a stock price of $700 six years later (a potential annualized return of 15%). But hoping for a greater margin of safety, I preferred to wait for a lower price. Today, a little over a year after my analysis, the stock is at $575, or 92% more than the price at which I considered buying shares.

I realize fully that the company is difficult to value with its current level of profitability. The "value investor" in me makes me reluctant to bet too much on the future. But I have often said that "being disciplined is to follow your rules; but being wise is knowing when to break them." Buying shares of Amazon requires an act of faith in Jeff Bezos. With a good enough margin of safety, it might be wise to invest with him.

And we missed that opportunity in 2014.

Silver Medal: O'Reilly Automotive

We have been shareholders in O'Reilly Automotive since 2004 and acquired our first shares for about $20. Shares are trading at $263 as I write this letter. Yet, the stock is only about 4% of the value of our portfolios. If we had kept all our shares, the stock would represent about 11-12% of our portfolios. The

reason is simple: over the years, I have repeatedly reduced our holding in this extraordinary company. My excuse is simple: I found the stock, at times, to be slightly expensive.

My motivation to reduce the number of our shares may seem noble: do not expose too much of our capital to a single stock. First, I could have stuck to our rule of having a maximum weight of 10% for any given holding (with the exception of Berkshire Hathaway). But I thought I should optimize the management of our capital by selling a portion of our position in O'Reilly to buy shares of another company that seemed more undervalued (important nuance: that *seemed* more undervalued).

In 1930, Philip Carrett wrote one of the first books on the stock market entitled "The Art of Speculation." In this book, he lists 12 Commandments of Investing. One in particular has always stuck in my head: "Be quick to take losses and reluctant to take profits." Peter Lynch also mentioned this rule in his own words in 1989 (in the book "One Up on Wall Street") by writing: "Don't pull out the flowers to water the weeds."

I followed this rule only partially with O'Reilly and we paid a high price for this even though it doesn't show up in our account statements.

Gold Medal: Stella Jones

In early 2008, I discovered a Quebec company called Stella Jones. This Montreal-based enterprise is a leader in the production and marketing of pressure treated wood products. Stella Jones provides railway ties and timbers to North American railway operators, as well as posts to electrical utilities and telecommunications companies. Sella Jones also provides lumber for residential use as well as industrial products. Its CEO, Brian McManus, then seemed to be of very high caliber.

As a shareholder at the time in Burlington Northern Santa Fe (subsequently acquired by Berkshire in 2010), I was aware of the strong fundamentals of the railway industry, which is the primary customer base of Stella Jones. The sale of railway ties and poles is my kind of business (glamorous!) The stock was trading around $6-7 in mid-2008 when the company had earned $0.51 for 2007. The P/E of 12-13x was not particularly high, but my fear was that the company was cyclical and would be affected by the recession that had begun. In other words, I wanted a lower P/E. Well, I had my chance: the stock fell to $3.50 in March 2009 but I still ignored the stock despite the P/E having dropped to 6x (because EPS not only did not shrink in 2008, they increased to $0.58 and again in 2009 to $0.62).

Later, in June 2012, Jean-Philippe Décarie of La Presse wrote an excellent article on Mr. McManus. It read: "Brian McManus is a follower of the slimming diet. As proof, the headquarters of the company in the borough of Saint-Laurent has 14 employees to supervise 19 plants, 1 tar distillery, 3 centers for used railways tie collection, 2 distribution centers, 3 plants use for pole production, in 6 provinces and 15 US states." It was music to my ears! The stock was then trading at $14.

Ultimately, Brian McManus continued to manage the business masterfully and took advantage of gloomy times to make many smart acquisitions. In 2015, EPS reached $2, or four times the level of 2007 (a growth rate of 19% on an annualized basis). The stock is now trading at around $45.

Conclusion: The Financial Maginot Line

There is an old military adage that "generals are always ready to fight the previous war". It means that often generals base their strategy on lessons learned during the prior war. Of course, subsequent wars are often different and so such strategies learned from the past can turn out to be ineffective.

After the First World War (called the "Great War" before the second), France decided to set in motion a plan to thwart a future invasion by Germany. The Maginot Line was built. It was a line of fortifications along the border of France and Belgium, Luxembourg, Germany, Switzerland and Italy. In total, the Maginot Line cost over five billion francs when it was built from 1930 to 1936. Unfortunately, during the German invasion of May-June 1940, the Maginot Line brought only little protection to France. Technological advances (primarily the aviation) had rendered this type of fortification almost obsolete.

What is the link with the world of finance? After every financial crisis, our civilization attempts to implement mechanisms to prevent the recurrence of another crisis. This is often set in place through various government regulations. The goal is laudable and the motivations are sincere, but like the Maginot Line, they often prove futile when there are new factors leading to the next financial crisis.

For example, one of the lessons from the 1987 crash was to put mechanisms in place to prevent automated trading programs from potentially crashing the market. So, after falling 500 points on the Dow Jones, the Stock Exchange shuts down (much like a circuit breaker) in the hope of calming the emotions. This did not prevent the tech bubble crash of 2000-2002 or the long bear market of 2008-2009. The manic-depressive behavior of stock market investors is immutable. It is inherent to the nature of human beings and no system is going to change that.

One of the lessons of the latest financial crisis is that US banks should be severely reined in (at least when they exceed $50 billion in assets and become considered "too big to fail"). The goals are quite valid. However, a side effect of these measures is that US big banks are now spending billions of dollars to meet these new regulations—billions that are not devoted to economic growth (through loans and investments). If we look to history for guidance, it is unlikely that the next crisis will have the same origin as the crisis of 2008-2009.

Investors have also created their own form of a Maginot Line. Traumatized by the large market declines of 2008-2009, many investors see a repeat of the previous financial crisis in each market correction. This happened in the fall of 2011 when equities reached very attractive valuations. In our opinion, this is the case again in the beginning of 2016.

The very low interest rates currently available reflect a level of demand for bonds that is absurdly high. Safety at all costs becomes the paramount motivation. Many investors are flocking to GICs (Guaranteed Investment Certificates) and bonds. The emphasis, from both the buyer and the seller, is entirely placed on the "G" in the acronym. Yet, in our opinion, the only thing that is guaranteed with a bond that has a lower interest rate than the rate of inflation is impoverishment. Generating negative real returns goes against the very concept of investment. With each passing year, the holders of this asset class have their capital slowly crumble. From our perspective, the certainty of capital loss in purchasing power is the very definition of risk.

The danger for many bond investors is higher interest rates (more *when* than *if*). A return to a more "normal" economic environment could drive up interest rates on 10-year note from 1.75% to 5% (important note: this is not a prediction). A 10-year note with a coupon of 1.75% in a 5% rate environment would lose a quarter of its market value. Now imagine a 30-year bond with a coupon of 2.5% (the current rate). A rapid rise of rates to 5% would create a decrease in market value of around 38%. Many investors and financial institutions who believe their capital is safe in this type of asset could quickly fall back to Earth.

So, as the Maginot Line in the interwar period, a fortified portfolio of long-term bonds might not keep its promise (or illusion?) of future protection.

P.S.

What would happen to stocks in the event of a significant increase in interest rates? Obviously, we are not soothsayers. Some businesses will be adversely affected by rising interest rates and others will benefit from them. In terms of market valuations in general, with an average P/E of 15-16 times, stocks already reflect long-term interest rates of 6.5% (1 divided by 15.5). So even with a rise of long term interest rates to 5%, stocks would still be attractive relative to bonds. This goes to show the great disparity between these two asset classes at the moment.

To Our Partners

Using rationality, along with our unwavering optimism, we trust that the companies we own are exceptional, led by top-notch people, and destined for a great future. They should continue to prudently navigate the often troubled waters of the global economy. Furthermore, the valuation assigned by the market to these outstanding companies is very similar to the valuation of an average company in the S&P 500, despite the fact that our companies have better growth prospects than average. Therefore we consider the appreciation potential for our portfolio, both in absolute and relative terms, to be well above average, especially when compared to other alternative asset classes, such as bonds.

We also want you to know that we are fully aware of and grateful for your votes 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. We certainly like to achieve good returns and have developed a taste for it, but it must not come at the cost of taking undue risk. Our philosophy to favor companies with solid balance sheets and dominant business models, along with purchasing these companies at reasonable valuations, is central to the risk management of our portfolios.

Thank you from the entire Giverny Capital team.

We wish a great 2016 to all our partners.

François Rochon and the Giverny Capital team

APPENDIX A

Investment philosophy

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

In 2015, 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 provides an extraordinary advantage to the intelligent investor. The person, however, who becomes affected by short-term market fluctuations (less than 5 years) and who makes 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 B

Notes on the returns of the Rochon portfolios

- The Rochon 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 Rochon Global 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. The returns indicated include trading commissions, dividends (including foreign withholding income taxes) and other income but do not include management fees. Portfolio returns of the Rochon Global portfolio have been generated in a different environment than Giverny Capital's clients and this environment is considered controlled. For example, cash deposits and withdrawals can increase the returns of the Rochon Global portfolio. Thus, the portfolio returns of the Rochon Global portfolio are often higher than the returns realized by clients of Giverny Capital.
- Past results do not guarantee future results.
- The Rochon Canada and Rochon US portfolios are parts of the Rochon Global portfolio.
- 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. Weighted indices presented may not be representative of the Rochon Global portfolio. In 2015 :

  - Rochon Global Portfolio: TSX 16% Russell 2000 42% S&P 500 42%
  - Rochon US Portfolio : S&P 500 100%
  - Rochon Canada Portfolio : S&P/TSX 100%

- The returns for the S&P 500 (in $USD) are provided by Standard & Poors.
- The returns for the various indices used for comparable purposes are deemed reliable by Giverny Capital.
- It should be noted that currency effects on the returns of the Rochon portfolio and indices are estimated to our best effort.
- The custodian of our client portfolios is National Bank Correspondent Network (NBCN) in Canada and TD Ameritrade Institutional in the US.
- The financial statements of the three portfolios are audited at the end of each year. The auditor's data are those provided by our custodian (NBCN). The auditor's annual reports are available upon request.
- For more information, please see the "returns" section of our website.