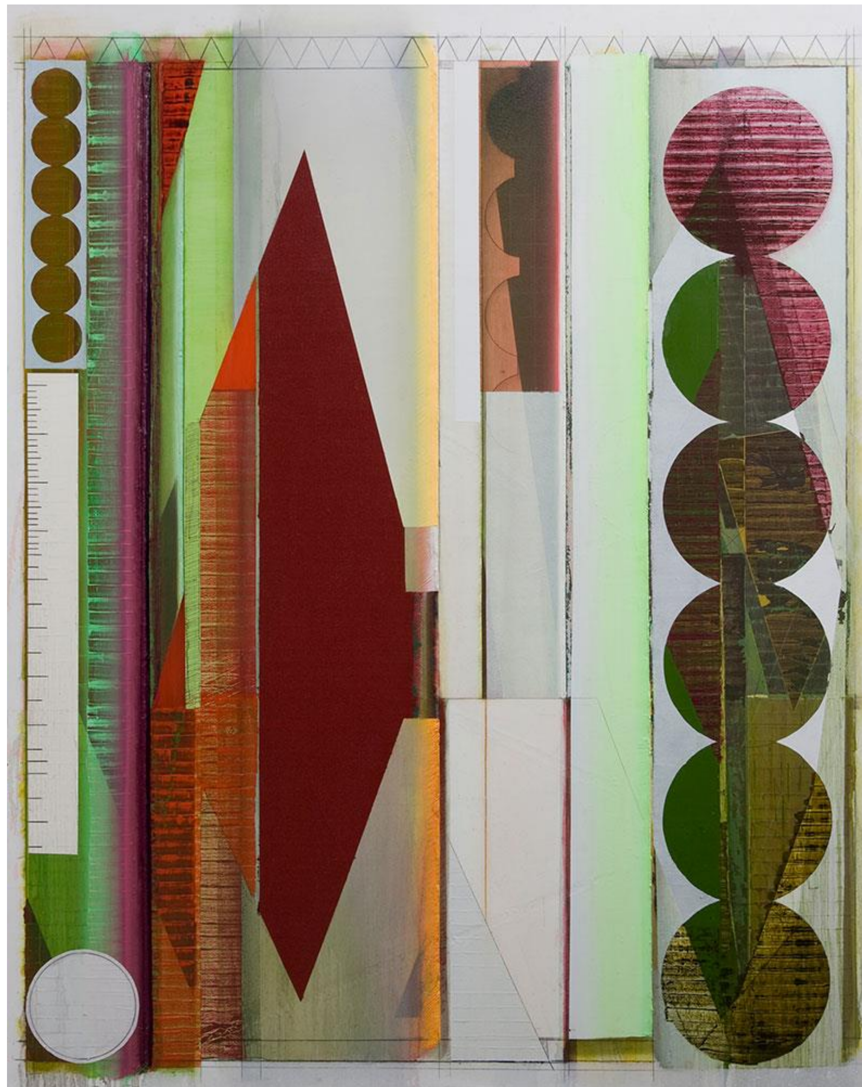
GIVERNY CAPITAL

Annual Letter to our Partners 2016



Dil Hildebrand
This is not what I want but I want this also, 2015
Giverny Capital Collection

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 provide you with 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 2016 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 painting by the Quebec artist Dil Hildebrand entitled "*This is not what I want but I want this also*".

For the year ending December 31st 2016, the return for the Rochon Global Portfolio was 7.3% versus 14.3% for our benchmark, which represents a relative performance of -7.0%. The return of the Rochon Global Portfolio and the one of our benchmark include a loss of approximately 2.8% due to fluctuations in the Canadian currency.

Since its inception on July 1st 1993, our compounded annual growth rate has been 15.9% versus 9.2% for our weighted benchmark, representing an annualized outperformance of 6.7% over this period. Our long-term (and quite ambitious) objective is to maintain an annual return that is 5% higher than our benchmark.

The Rochon Global Portfolio: Returns since July 1st 1993

Year *	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%
2016	**7.3%**	14.3%	**-7.0%**	-3.0%
Total	**3080.3%**	**686.2%**	**2394.1%**	**4.8%**
Annualized	**15.9%**	**9.2%**	**6.7%**	**0.2%**

* 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

Refer to Appendix B for disclosure statements on the Rochon portfolios.

The Rochon US Portfolio

The Rochon US Portfolio corresponds to the American portion of the Rochon Global Portfolio. In 2016, it realized a return of 7.5% compared to 12.0% for our benchmark, the S&P 500. The Rochon US Portfolio therefore underperformed the benchmark by 4.5%.

Since its inception in 1993, the Rochon US Portfolio has returned 2473%, or 14.8% on an annualized basis. During this same period, the S&P 500 has returned 691%, or 9.2% on an annualized basis. Our added value has therefore been 5.6% 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%
2016	7.5%	12.0%	-4.5%
Total	**2472.8%**	**690.6%**	**1782.2%**
Annualized	**14.8%**	**9.2%**	**5.6%**

Refer to Appendix B for disclosure statements on the Rochon portfolios.

For the first time since 2007, the Rochon US Portfolio underperformed its benchmark, the S&P 500. No individual holding contributed significantly to this underperformance. In fact, out of the 20 stocks in the portfolio, 14 underperformed the S&P 500. We have held the stocks in our portfolio for an average of almost seven years and the majority of them have accumulated high returns over the years (justified by their exceptional intrinsic performance). This year, the stocks of our companies as a whole, increased roughly in line with their earnings growth. It is the market indices that grew faster than the profits of their underlying companies (we will return to this in the "Owner's Earnings" section).

You will note that over 23 years, the Rochon US Portfolio underperformed the S&P 500 on seven occasions (or roughly 30% of the time). This is very much in line with our "rule of three" where we

anticipate underperforming the indices at least one year out of three on average. And such an average, if we can maintain it, is much better than that of the average fund manager.

We accept in advance that we will sometimes underperform the S&P 500 in the short term when our style and/or our companies are out of favor (and sometimes for no reason). While it is not always easy, we try to remain impervious to short-term results, both in good times and in bad.

Rochon Canada Portfolio

We introduced a portfolio that is 100% focused on Canadian equities in 2007. This corresponds to the Canadian portion of the Rochon Global Portfolio. In 2016, the Rochon Canada Portfolio returned 11.0% versus 21.1% for the S&P/TSX, therefore underperforming its index by 10.1%.

Since 2007, the Rochon Canada Portfolio has returned 378%, or 16.9% on an annualized basis. During this same period, our benchmark had a gain of 59%, or 4.7% on an annualized basis. Our annual added value is therefore 12.2%.

Year	Rochon Canada	S&P/TSX	+/-
2007	19.7%	9.8%	9.9%
2008	-24,6%	-33,0%	8,4%
2009	28,2%	35,1%	-6,9%
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%
2016	11.0%	21.1%	-10.1%
Total	377.8%	58.7%	319.1%
Annualized	16.9%	4.7%	12.2%

Refer to Appendix B for disclosure statements on the Rochon portfolios.

10 Years of Returns for the Rochon Canada Portfolio

The Rochon Canada portfolio was created in early 2007. It is not a separate portfolio from the Rochon Global portfolio, but rather represents its Canadian component.

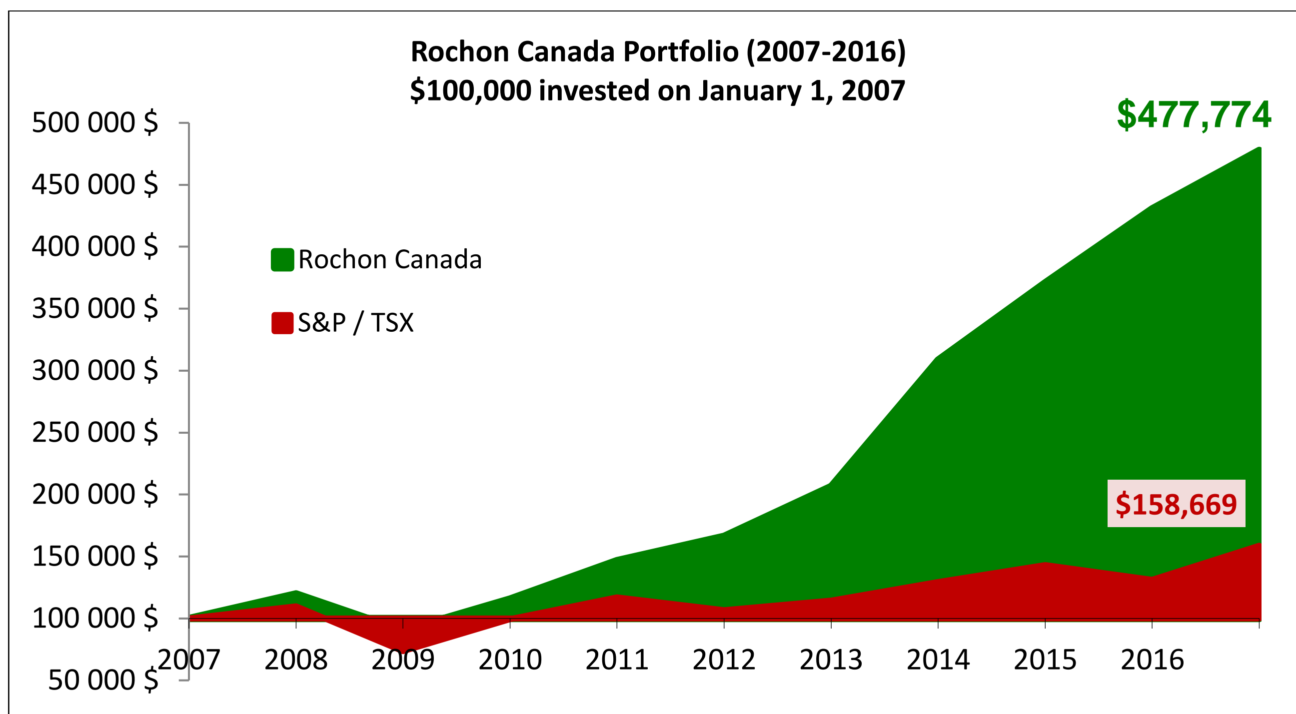
In 2006, some partners wrongly perceived us as managers specialized only in the American market and they concluded, simplistically, that we didn't know the Canadian market well. We have, however, always held Canadian equities in our portfolio. Our overarching goal is to find the best companies for our portfolio, regardless of their location. Consequently, about 80% of our companies have historically been in the US. If you objectively selected 100 North American companies at random, you would likely have about 93 American companies and seven Canadian ones. So a portfolio comprised of 80% American companies is therefore not abnormal on a statistical level. Moreover, our investment philosophy which excludes companies focused on natural resources further reduces investments candidates located in Canada.

In response to the inaccurate perception of certain partners, we therefore launched a separate measure of Canadian securities held in the Global portfolio in January of 2007. The Rochon Canada Portfolio is

therefore highly concentrated, with the vast majority of the portfolio invested in three stocks: MTY Food Group, Constellation Software and Dollarama.

Such a concentrated portfolio results in two consequences. First, it is an insufficient number of holdings to be considered a sufficiently diversified portfolio. Second, the correlation with the Canadian benchmark (the S&P/TSX) is essentially nonexistent, so the stock market performance of this portfolio will always be very different from that of its benchmark.

It's time for a post-mortem after a decade of returns. Here is a chart illustrating the performance of the Rochon Canada Portfolio versus its benchmark, the S&P/TSX:



Refer to Appendix B for disclosure statements on the Rochon portfolios.

Over 10 years, the performance of our Canadian securities has been significantly higher than that of the S&P/TSX and even higher than that of our US stocks. A concentrated portfolio can drastically exceed the performance of the indices but the risks inherent to high concentration is not appropriate for a portfolio that is to be managed prudently. In fact, we consider that a portfolio of about 20 securities is the right balance between having a minimum diversification level to reduce company-specific risk while also having few enough companies to improve the odds of beating the market indices. Since this portfolio represents only a portion (approximately 15%) of the Rochon Global Portfolio, our diversification requirements are met.

The Canadian portfolio has, however, achieved the original objective of invalidating the idea that we were exclusively "American managers".

I would like to add that the three most significant Canadian companies we own in this portfolio are of the utmost quality and all have one thing in common: they are led by exceptional CEOs.

2016

There are three periods that can sum up the year 2016. The beginning of the year was marked by a stock market correction of 13%. After the recovery that followed, the stock market was confronted by the Brexit vote in June (the vote by the United Kingdom to leave the Eurozone) and another stock market correction occurred followed quickly by another rebound in stock prices.

The last stage of the year started on November 8, when the United States elected a new president. Taking all the "experts" by surprise, the stock market rose dramatically in the days following the election. By the end of the year, the S&P 500 generated a return of 12% (including dividends). We have repeatedly stated that the stock market is unpredictable over the short term and the market did everything in 2016 to prove us right.

The Canadian market did even better than its US counterpart in 2016, with the TSX increasing by 21% (including dividends). But it should be pointed out that the TSX made up what it had lost during the previous year. Over the past two years, the TSX has achieved a total return of 11% versus 14% for the S&P 500 (without currency effect).

Looking at economic fundamentals, the profits of American companies stagnated in 2016 for the second year in a row. Several causes explain this stagnation of profits on a global scale and we see this economic sluggishness as temporary. As we wrote in our first quarterly letter, we believe that corporate earnings power in the US is higher than what 2016 suggests.

A longer-term horizon provides more perspective on the profit growth of the companies in the S&P 500. Since I started in 1993, the companies comprising the S&P 500 have increased their profits by 450%, which is equivalent to an annual growth rate of 7.3%. The stock market rose from 423 at the end of 1992 to 2239 at the end of 2016, which is an increase of 429% or 7.2% annually. In the long run, there is a direct correlation between the performance of the stock market and the performance of the underlying companies. If dividends are included, the annual return of the S&P 500 has been over 9% per year since 1993.

Imagine everything that has happened since 1993 (when the Internet was still in its infancy). There were two recessions, six US elections (with three Democratic terms and three Republican terms). There have been wars, economic and political crises, horrendous terrorist attacks and worries of all sorts (remember the "Y2K bug" or concerns about the "US debt ceiling" and the "fiscal cliff" of 2012?) Yet, markets did well for the simple reason that all of the companies that make up the index did well. This was achieved despite all the crises and calamities that plagued our civilization. DESPITE is the key word in this sentence.

It was ten years ago…

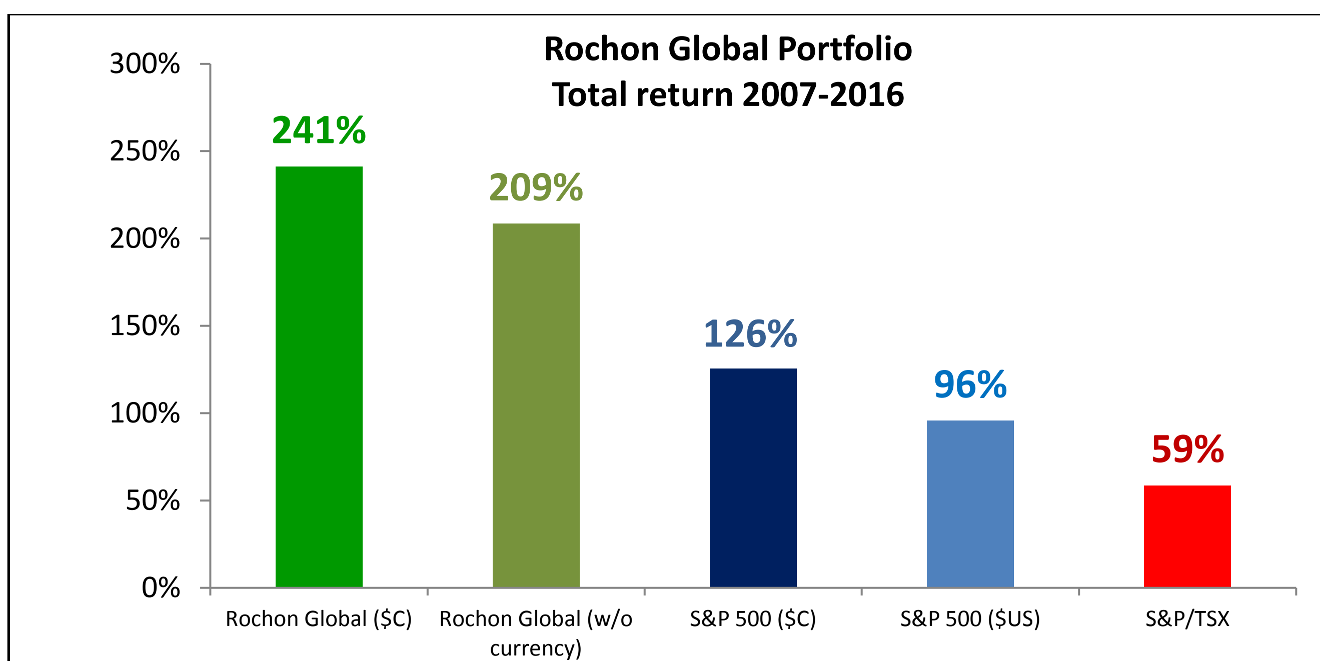
Giverny Capital went through a difficult time in 2006-2007, when we underperformed the indices for two years in a row. In fact, the only sectors that "worked" at the time were those related to natural resources (with oil leading the way). As you know, we have always avoided these types of companies because we believe that it is extremely difficult to have a competitive advantage in these types of industries.

In addition, the dizzying rise of the Canadian dollar at that time also contributed to our weak short-term results. Many investors and "experts" predicted a bleak future for the United States and its currency at

the time. China, Europe (and the Euro) and Canada (and its dollar) were popular with investors around the world.

We stayed the course of our investment philosophy even though we were under a certain (very certain) pressure from several partners to "invest in what worked". We had a similar situation in 1999 when the only sector that buoyed the stock market was technology. With the stock market, you have to be able to do nothing when almost everyone else wants to do something at the same time! We knew then that our philosophy of selecting high quality companies was sound and we also believed that the Canadian dollar trading at par with its US counterpart made no sense. Patience was therefore the key, as we wrote at the time.

This patience proved rewarding for us and our partners. Here is a chart that shows the performance of the Rochon Global portfolio (with and without currency effect) compared to the S&P 500 (with and without currency effect) and the S&P/TSX for the 10-year period beginning January 1, 2007:



Refer to Appendix B for disclosure statements on the Rochon portfolios.

The S&P/TSX achieved a return of only 59% over 10 years, or 4.7% on an annualized basis compared to 126% for the S&P 500 (8.5% annualized) and 241% for the Rochon Global Portfolio, or 13.1% on an annualized basis.

How did the European market fare over this same period? The MSCI Europe Index returned approximately 27%, or 2.4% annualized (in Canadian dollars). Finally, the SSE Index of the Shanghai Stock Exchange achieved only 13% in total over ten years (excluding dividends). And what about the price of oil? It is lower today than it was in early 2007. As is so often the case, following the herd in the financial markets is rarely a winning strategy.

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) and the average dividend yield of the portfolio. We believe that 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 about 9% (8% from the growth in earnings and 1% from the average dividend). Despite some of the changes to our portfolio during the year, we consider the estimate of the EPS growth at our companies during 2016 to adequately reflect their economic reality. The market value of our portfolio increased by roughly 10% (without any currency effect). It was therefore the fourth year (out of 21) where the market performance of our holdings followed closely their intrinsic performance.

The companies in the S&P 500, however, experienced a second consecutive year of weak earnings growth. Still, the index performed better than what can be justified by its fundamentals. So the S&P 500 seems to already reflect a significant improvement in earnings growth for 2017.

	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%
2016	9%	10%	1%	3%	12%	9%
Total	**1210%**	**1266%**	**55%**	**309%**	**436%**	**127%**
Annualized	**13.0%**	**13.3%**	**0.2%**	**6.9%**	**8.3%**	**1.4%**

* Estimated growth in earnings plus dividend yield
** Market performance, inclusive of dividends (refer to Appendix B for disclosure statements on our returns)
*** Results estimated without currency effects

For the last 21 years, our companies have grown their value by about 1210% and their stocks have achieved a total return of approximately 1266%. On an annualized basis, our companies achieved an

intrinsic return of 13.0% versus 13.3% for their stock market performance (dividend included in both cases). The correlation between the two figures over a long period is not accidental since the stock market always reflects the fair value of companies in the long run.

Our stocks have outperformed the S&P 500 by 5% annually over the last 21 years for the simple reason that our companies grew their intrinsic values at a rate that was 5% greater than that of the group of companies that make up the S&P 500.

The Flavor of the Day for 2016

Every year, we present to you what we consider the "flavor of the day" in the financial world. In our opinion, the top prize for 2016 goes to index funds.

It's not a coincidence if you have a feeling of *déjà vu*, since we proclaimed index funds as our "flavor of the day" in our 1998 annual letter. At the time, several investors, both institutional and private, had abdicated from active management and moved towards passive investing. The S&P 500 was then perceived by many investors as "unbeatable" and, as always, the trend of the day eventually subsided. The period from 1999 to 2002 was our best relative period to date, with the Rochon Global portfolio achieving a total return of +46% versus -22% for the S&P 500 over those four years.

At the risk of repeating what I wrote 18 years ago, the basic principle behind the purchase of index funds is perfectly legitimate. Indeed, the vast majority of portfolio managers do not beat their benchmarks so therefore an investment approach that favors investing in all the holdings making up market indices makes a lot of sense for those who do not know how to choose superior companies or managers capable of creating value. Obviously, I would be remiss if I did not point out that because our primary mission is to do better than the indices, which we have done since 1993, we are therefore in favor of an active (and assiduous) stock selection process.

The problem with passive management is that it is not really "passive" for the vast majority of its followers. First, several investors act like weathervanes with the market by buying after good years and selling after bad ones. Indexing will not solve anything for these part-time market players. Second, even those who are always present with the stock market tend to change styles, index fund types, or managers according to what's most in favor. Basically, they tend to sell funds that have underperformed in the short term to buy those that have done well more recently.

It is therefore not surprising that when passive management has done well relative to active management for a few years, investors tend to favor the former. Further, moving out of active management towards passive management, when carried out on a large scale, continues to fuel the divergence between the two approaches. The larger stocks within the indices, now more in demand, continue to increase making active management seems even less effective.

The best parameter to illustrate how passive management can be unsuccessful is the average turnover rate of exchange traded funds (ETFs), which is 880% per year[1]. In other words, average "passive" investors hold their ETFs only about 47 days! It's even worse with the SPY index fund (linked to the S&P 500), with an average holding period of around 12 days, or an annual turnover rate of around 3,000%. This compares with an average turnover rate of 120% for stocks in general. Just to give you an order of magnitude for the purpose of comparison, the turnover rate of our model portfolio is around 14%, which means that we keep our stocks on average for about 2,500 days at Giverny Capital!

---

[1] Source: Financial Times: *Jack Bogle: the lessons we must take from ETFs* (December 11, 2016)

High turnover leads to lower returns (the second principle of thermodynamics applied to the stock market). For example, the SPY index fund has achieved an annual return of 6.9% over the last decade. Yet, the holders of this fund, as a whole, only achieved an annual return of 3.5%[2]. Half of the return has literally "evaporated" into transactional activities.

Of course, Wall Street is always on the lookout for what is popular (and sources of income from issuing shares and trading), and has benefited from the passive investing windfall: there are now more than 6000 different ETFs (Exchange Traded Funds) compared to 1000 a decade ago. The large amount of choice and ease of transaction inherent to ETFs make their owners even more irrational.

In short, whether it is “robots” or passive funds, the problem is not the financial product but rather the self-destructive behavior of investors. By their impatience and willy-nilly behavior, investors are often paradoxically the cause of their own underperformance.

At Giverny Capital, we believe that a cautious selection of securities with a clear long-term horizon will eventually generate higher than average returns. We’ve met this goal so far.

Five-year Post-mortem: 2011

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.

We acquired shares in Google (now Alphabet) in May 2011 when the stock was particularly attractive to us. Since then, the stock has risen by almost 195% versus 65% for the S&P 500. We also made other transactions in the fall of 2011 during the stock market correction of that time. We first sold securities with a more limited appreciation potential to increase our stake in Berkshire Hathaway and Wells Fargo, which we considered quite undervalued. These two stocks rose by approximately 130% versus 100% for the S&P 500 (without dividend) from the end of September 2011 to the end of 2016.

Unfortunately, we didn’t have clairvoyance for all of our portfolio holdings in the fall of 2011. If we had instead increased our holdings in Bank of the Ozarks and/or O'Reilly Automotive instead of increasing our ownership in Wells Fargo, the result would have been considerably better. Shares of Bank of the Ozarks increased by 420% from the end of September 2011 to the end of 2016, while O'Reilly more than quadrupled over the same period.

Revisiting a prediction from 2011

Wall Street strategists have understood something for a long time: the key to predictions is to make them often. As you might have guessed, a strong marketing team is then in charge of flying balloons for those predictions that have proven to come true. We take the opposite approach at Giverny Capital by rarely making predictions and evaluating our prediction regardless of their outcome.

I wrote a column in the Montreal Gazette with a rare prediction on August 30, 2011[3]. The market experienced a crisis between August and October of that year and the equities tumbled 19% from their high of March 2011 (quick quiz: what was one of the main causes of this panic?). I then publicly

[2] Source: Morningstar; www.seeitmarket.com; Credit Suisse
[3] You can find this article on our website, under the “In the News” section.

predicted that within five years (in 2016), the Dow Jones would climb to 17,000 points compared to 11,280 when I wrote the column.

I repeated this prediction in our 2011 annual letter and I promised to come back to you regarding this prediction in 2016. Keeping to my word, five years to the day, on August 30, 2016, the Dow Jones was at 18,454. And that was before the "post-election" stock market rally of November.

We remain highly skeptical about stock market predictions. Yet, when we make them, it is within the scope of a very long time horizon and when the margin of error seems very wide.

Quiz Answer: On August 8, 2011, the Dow Jones declined 635 points to 10,809 as a result of the decision by Standard & Poors to lower the credit rating of US debt from AAA to AA+. This news was in conjunction with the significant problems with government debt in Europe, with Greece at the top of the list.

Our Companies

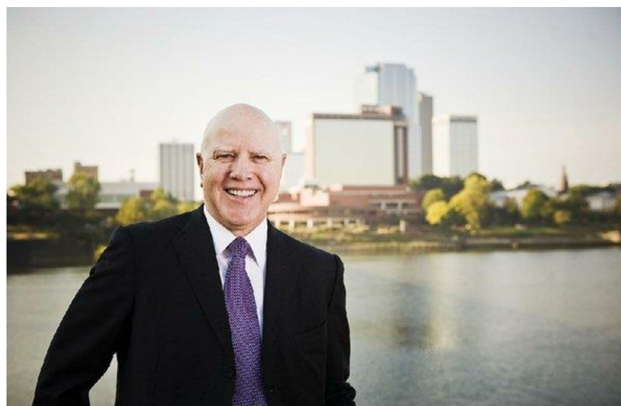
"Money is made by sitting, not trading."

Jesse Livermore

Bank of the Ozarks (OZRK, $53): 10 years in our portfolio

We've now owned shares in Bank of the Ozarks for more than 10 years. The bank, located in Little Rock, Arkansas, was often listed as the top bank in American Banker magazine for its return on assets (among all small banks in the US). Since I had never heard of this company before (and had no idea that the Ozarks is a region of northern Arkansas), I decided to go and meet with the bank's management in November 2006.

President George Gleason greeted me with twenty or so vice presidents in the boardroom of the bank's headquarters in Little Rock (his daughter even picked me up at the airport). Mr. Gleason explained the culture of Bank of the Ozarks to me and its history. What struck me most was that he seemed to know almost every loan on the bank's books.



George Gleason *Source: Democrat Gazette*

We then went to visit several local branches and he showed me some of the buildings that the bank had financed. While the major US banks were adopting complex lending strategies and muddling their balance sheets with esoteric derivatives at the time, Bank of the Ozarks kept its traditional approach to banking. There also was no real estate speculation in Little Rock, with the average price of a house in 2006 coming in at a whopping $130,000.

We decided to buy shares in the bank upon my return to Montreal, when the stock traded at $8 (adjusted for splits). The company earned $0.48 per share in 2006 so its P/E multiple was 17 times. Never would I have thought of paying such a rich ratio for a bank but Bank of the Ozarks was no ordinary bank!

Source: BigCharts.com

As you can see from the chart above, we were not immediately rewarded with this investment. During the 2008 crisis, the stock fell by 50% when all bank stocks were tarred with the same brush. We knew that the bank was very prudently managed and we kept the course.

After four years of stagnation, the stock began to climb and we made about seven times our money in 10 years. The reason for this performance is simple: EPS increased from $0.48 in 2006 to $ 2.62 in 2016, or an annualized growth rate of 18%. To my knowledge, no bank in the United States has achieved such a growth rate during this extremely difficult period for the banking sector. The bank's efficiency ratio (under 36%) is nearly unparalleled and its return on assets (around 1.9%) still ranks among the best. Its bad debt ratio is one of the lowest in the industry.

We have George Gleason to thank for this phenomenal performance. He’s visited us twice in Montreal over the years and we were able to properly welcome him to Quebec, with smoked meat, poutine and *pouding chômeur*.

The growth prospects for Bank of the Ozarks' look solid and the valuation of its stock seems reasonable.

Alphabet Inc. (GOOG, $772)

Alphabet (formerly Google) had an excellent year in 2016. Revenues grew by 21% and adjusted EPS rose by 18%. We include stock options expenses to arrive at our profit estimates for Alphabet, unlike many Wall Street analysts who often like to present figures excluding them.

We have been Google shareholders since 2011 and, in our opinion, the company has an extremely strong competitive advantage. The verb "google" has even entered our vocabulary for searching the Internet and visiting google.com has become a reflex of our thought process.

The idea came to us thanks to Charlie Munger, the longtime partner of Warren Buffett. Mr. Munger explained at a conference that many companies that historically had wide competitive moats had seen their moats "filled up with sand" (an analogy meaning that their competitive advantage was deteriorating). I then asked him if he saw new companies with a wide moat and, after reflection, he replied Google. His comments did not fall on deaf ears and Jean-Philippe and I started looking at the company from a whole new perspective.

We were able to buy the stock at very good prices in 2011 when Wall Street was fearful of the company's transition of its users from PCs to mobile devices. There was a readjustment of profit margins when Google migrated to mobile applications but this transition was a success. Earnings have grown by 12% on an annualized basis since 2011 and the stock has more than tripled since our purchase.

The stock is currently trading at about 24 times its expected profits for 2017. This is a justified valuation, in our opinion, given the high quality of the competitive advantages of Google's wide range of producing assets.

AMETEK (AME, $49)

AMETEK has two divisions. The electronic instruments segment produces instruments for monitoring, measuring, testing, calibrating, displaying, etc. for the aeronautics, energy and various industrial markets. The electromechanical division produces interconnection equipment, motors, motion control systems and thermal management systems.

It was a tough year for Ametek, with revenues decreasing by 3% and EPS falling by 9%. Sales from the energy sector had another difficult year. The company continued to make acquisitions (five in 2016) and developed a number of new products.

The company expects a return to growth in 2017.

Berkshire Hathaway (BRK.B, $163)

We estimate that Berkshire achieved an 11% increase in its intrinsic value, so it was another great year for the conglomerate led by Warren Buffett. Although some divisions experienced a decline in profitability (such as BNSF), Berkshire nevertheless slightly increased its operating profits.

Mr. Buffett and his two assistant investment managers (Ted and Todd) deployed several billion dollars in the purchase of stocks, with approximately $20 billion invested after the US election.

We believe that Berkshire's growth outlook remains above average.

Carmax (KMX, $64)

We have been shareholders in Carmax since 2007. Carmax has revolutionized the used car retail industry and its *raison d'être* is simple: to bring integrity to the world of second-hand cars by being honest and transparent in every transaction. Its brand has become synonymous with a good warranty

and reliability in an industry where consumers previously had very little recourse. The company now operates 169 megastores and has a market share of over 3%.

A friend of ours who's a portfolio manager told us that he went to Carmax to sell his car stipulating that he wanted to be out of there in 10 minutes. He had his check in hand within that time! Carmax had a good year, albeit slightly below our expectations. After the first three quarters, revenues were up 3% and EPS rose 6%. The company opened 15 new stores in 2016 and is planning a similar opening in 2017.

The stock has been volatile in recent months, dropping from a high of $74 in 2015 to less than $45 in early 2016. We took the opportunity to increase our investment and the stock subsequently bounced back to finish the year at $64. We believe that the market valuation of Carmax's shares does not adequately reflect the company's excellent long-term growth prospects.

Constellation Software (CSU-T, $610)

Our Toronto-based software company had another good year, with revenues growing by over 15%. The majority of this growth was attributable to acquisitions and organic revenues, on the other hand, grew by 2%. The company has a significant share of its revenues from maintenance activities, which had organic growth of 4% in 2016. Constellation spent approximately $175 million on acquisitions, compared to $235 million in 2015. EPS in US dollars grew by 6% and we expect growth of around 15% for 2017.

Mark Leonard continues to be an exceptional CEO, though he is extremely low-key and discreet in today's world of flashy corporate CEOs. We are very pleased to be associated with him.

Walt Disney (DIS, $104)

It was a tough year for Disney. For its fiscal year ended September 30, revenues increased by 6% and EPS by 11%. But if we look at the same figures for a calendar year (January to December), EPS increased only by about 2%.

The television revenue division experienced a 1% decline in profitability (with -13% in the September quarter and -11% in the first quarter of 2017). The primary cause was the decline in profitability of the sports channel ESPN, with the increase in licensing costs (including the NFL) and a decline in subscribers and advertising revenue the primary culprits. Worried about this trend, we met last summer with the person who (in our opinion) knows the most about the history of the media industry in the United States. According to him, the situation at ESPN, although far from catastrophic, could be improved but with difficulty. So it is quite possible that Disney and its shareholders will have to accept that this great division could become less and less an important source of profits.

Now let's talk about the good news. The film division experienced a spectacular year with operating profits rising 37%. The movie *Star Wars: The Force Awakens* was a huge success. Three other Disney movies reached the billion dollar mark: *Finding Dory, Captain America: Civil War and Zootopia.*

Finally, the company opened its new theme park in Shanghai and the resort division increased its profits by 9%.

Bob Iger, the fabulous CEO of Disney, is confident that the next few years will be better. We share in his optimism and we expect EPS growth of 9% in 2017. We believe that the core of Disney remains the

production of family-friendly films and this source of revenue, along with amusement parks, will become the primary source of profitability for Disney and offset the gradual decline in television profits.

Dollarama (DOL-T, $98)

We have been shareholders of Dollarama for almost seven years now. We temper our expectations every year and see the company exceed our expectations every year. After three quarters, sales increased by 12% and same-store sales grew by nearly 6%. EPS rose by 22%, helped by a repurchase of approximately 7% of the company's shares outstanding.

On the first of May of last year, Larry Rossy transferred his position as President and Chief Executive Officer to his son Neil, while continuing to serve as Chairman of the Board. Neil (46 years old) has worked at the company since 1992 when the company opened its first stores, and served as Chief Marketing Officer and Member of the Board of Directors since 2004. We believe that the company's culture is part of its DNA (literally and figuratively) and we thank Larry Rossy for his extraordinary work over the last few decades. The partners of Giverny Capital are wealthier thanks to him. We would retire the number on his jersey if he had one.

Fortune Brands Home & Services (FBHS, $54)

Fortune Brands Home & Services operates four manufacturing divisions for the home: cabinets (kitchen and bathroom), plumbing (mainly the Moen brand), doors and security products (padlocks).

FBHS had another excellent year, with sales growing by 9% and EPS increasing by 33%. The company realized a significant improvement in its operating margins and also repurchased approximately 4% of its shares outstanding. We believe that the prospect for earnings growth remains solid and that the stock's valuation is reasonable.

Heico (HEI.A, $68)

We acquired a stake in this Florida-based company over the course of the year. Heico has two manufacturing divisions: equipment for the aviation industry and an electronics group.

The first division is the one that caught our attention. Heico sells alternative aircraft equipment (non-OEM) to aviation companies. The difficulty in obtaining approval from the Federal Aviation Administration (FAA) for these aircraft parts, along with extensive catalog of parts available from the company that was built over several years, provide a very significant competitive advantage for Heico.

Revenues rose 16% and EPS climbed 17% in 2016. EPS has grown by about 19% annually over the last decade—an exceptional performance.

LKQ Corp (LKQ, $31)

LKQ specializes in the distribution of "alternative" car parts, meaning either original or refurbished auto parts, as well specialized accessories primarily for the auto repair market. Basically, the company offer products equivalent to original auto parts at lower costs.

This Chicago-based business had another good year and continued its expansion plan in Europe with a major acquisition in Italy. The company now generates about a third of its revenues from overseas. It also made a sizable acquisition in the United States when it bought Pittsburgh Glass Works (PGW). The

latter specializes, among other things, in the windshield market. LKQ subsequently resold the OEM (Original Equipment Manufacturer) portion of PGW's operations.

Sales increased 19% in 2016 (nearly 5% organically). EPS grew by 21% to $1.80 (13% to $1.69 excluding PGW's discontinued operations). It's worth noting that the company was slightly affected by the decline of the British Pound in its British division (decreasing EPS by approximately of $0.05).

The potential for LKQ increasing its profitability in future years is high, especially if the company fully succeeds in its plan to become as dominant in Europe as in the United States. The company has done an excellent job of consolidating this fragmented industry.

M&T Bank (MTB, $156)

Buffalo-based M&T Bank didn't meet our expectations in 2016. Adjusted EPS increased by 4% and return on assets declined slightly from 1.18% to 1.14%. Still, we believe that several projects bode well for the bank over the next few years. First, the integration of Hudson City Bancorp should help improve operating margins. Also, the new US banking regulatory policy is expected to be very positive for M&T (which has invested enormous resources in recent years in this activity). Finally, a rise in interest rates should help improve its interest income margins.

We therefore expect a 14% increase in EPS in 2017.

Markel Corporation (MKL, $905)

Markel had a good year 2016, but not as good as 2015. While the underwriting ratio of its insurance divisions increased from 89% to 92% (a lower rate is better), this Richmond (Virginia) company remains very profitable.

Book value climbed from $561 to $606 in 2016, or an increase of only 8%. We believe that the company can maintain an increase of about 12% annually over the long term. We have great admiration for Markel's co-CEO, Tom Gayner, and are very pleased to be long-term partners with him.

Mohawk Industries (MHK, $200)

We have owned shares of Mohawk, a floor covering company, since 2007. The Calhoun (Georgia) company had an exceptional year in 2016, with revenues increasing 11% (reaching $ 9 billion) and adjusted EPS rising 24%. Jeff Lorberbaum is a high-caliber CEO and we trust his management style which masterfully combines dynamism and prudence.

MTY Food Group (MTY-T, $51)

MTY Food franchises chain restaurants of all kinds, primarily located in shopping centers. We have been shareholders of MTY Food since 2007 and have great confidence in the qualities of its CEO, Stanley Ma. We believe him to be one of Canada's top executives.

2016 was a very busy year for MTY Food. At the end of May, MTY announced the acquisition of Kahala Brands for approximately US$ 300 million. Kahala is located in Scottsdale, Arizona, and franchises and operates approximately 2,800 locations under 18 brands in 25 countries. This acquisition represented an important milestone for MTY as it solidified its presence in the United States which will become one of the primary avenues for growth for the company, both for the brands already operating

in the United States as well as for other MTY brands. This Montreal company now has a portfolio of approximately 5500 locations under 57 brands.

The company thus increased its revenues from $145 million to $ 196 million in 2016. We estimate its adjusted EPS to be approximately $2.36, or an increase of 27% from 2015.

Since becoming shareholders, EPS has more than quadrupled (an annualized growth rate of 18%) and we believe the company continues to have exceptional future prospects and we are happy to keep our shares.

O'Reilly Automotive (ORLY, $278)

We have been O'Reilly's shareholders since 2004. The Springfield (Missouri) company consistently defies our most optimistic expectations and this was again the case in 2016. Revenues rose 8%, driven by excellent organic growth of 4.8%. EPS grew by 17% to $10.73—representing the eighth consecutive year that O'Reilly increases its EPS by more than 15%.

Our only regret is that we reduced our portfolio allocation to this stock over the years when its valuation seemed too high. But such a valuation is greatly deserved.

Union Pacific (UNP, $104)

Union Pacific had a tough year in 2016. Revenues dropped by 9% and EPS declined by 8%. The good news is that the fourth quarter showed a return to growth (EPS grew by 6%). We believe that the downturn in its business in 2016 is cyclical in nature and that its strong competitive advantages remain intact. Along with BNSF (owned by Berkshire Hathaway), Union Pacific continues to dominate the rail transportation market in the western United States.

Union Pacific's growth prospects for 2017 are better and we expect a return to increased profitability. The stock market has already anticipated this turnaround (the stock rose 33% in 2016) but we believe that the company's solid long-term outlook justifies its current price.

Visa (V, $78)

We bought shares in Visa back in 2010 when Senator Richard Dubin led a legislative overhaul of the fees charged by credit card companies. We believed then that the effects on Visa would be benign and temporary. The fears on Wall Street allowed us to buy shares of this dominant company at an excellent price.

2016 was a transitional year for Visa, following the major acquisition of its European activities. EPS growth was still 12% in 2016. We expect even better growth in 2017. Visa's stock price has increased fivefold since our purchase in the summer of 2010.

Wells Fargo (WFC, $55)

It was a tough year for Wells Fargo. Last September, the company revealed an unacceptable practice in its ranks: bank advisors were opening accounts for customers for the sole purpose of meeting their sales objectives (and getting bonuses that went along with it). Management fired the guilty parties, paid a fine and resolved to put in place a new formula for compensation. Approximately 5% of the accounts in question had fees and were reimbursed to customers (for a total of $2.6 million).

CEO John Stumpf faced the music and has done everything to restore WFC's prestigious reputation in the banking world. Ultimately, Mr. Stumpf decided to take a big part of the blame by announcing his retirement on October 12th.

For the year, revenues grew by 3%, with loans rising by 7% and deposits by 5%. The company succeeded in maintaining its customer base despite its challenges. Adjusted EPS decreased slightly by around 2%.

The new US administration plans to significantly reduce bank regulation. This, along with a reduction in the corporate tax rate and a possible rise in interest rates, greatly improves the profitability prospects for US banks, including Wells Fargo. We believe that the worst is behind for Wells Fargo and that the next few years bode well.

The Podium of Errors

"I like people admitting they were complete stupid horses' asses. I know I'll perform better if I rub my nose in my mistakes. This is a wonderful trick to learn."

Charlie Munger

Following in the "Givernian" tradition, here are our three annual medals for the "best" errors of 2016 (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.

However, the first error for this year fell into the second category.

Bronze Medal: Valeant Pharmaceuticals

We discussed the sale of our shares in Valeant at the beginning of 2016 in great detail in our 2015 annual letter. We also answered a large number of questions about this investment during the annual evenings with our partners. I have nevertheless decided to return to this error and close this chapter by awarding it a medal.

We acquired our first shares in Valeant in 2011 at approximately US$45. At the time, the pharmaceutical company had a fairly simple business model and few of its products had patent protection (and therefore wasn't subject to generic competition). The acquisition of Bausch & Lomb in early 2013 further strengthened our enthusiasm and this company, which we have known for a long time, seemed of the highest quality and with stable and recurring revenues.

We knew that Valeant had aggressive accounting and a higher level of debt than the typical companies in which we invest. So it was not consistent with our usual type of investment. We still decided to invest in the company because of our confidence in its CEO Michael Pearson. We believed that he had a solid plan to improve the profitability of the numerous pharmaceutical companies that Valeant was acquiring. The industry needed (and still needs, in our opinion) to refocus on better returns on capital and Mr. Pearson had a credible plan to make this shift at Valeant.

Realizing that Valeant was more risky than our usual investments, we decided to manage this investment risk by initially allocating a 3% weight to this position and more importantly, limiting the maximum weight in the portfolio to 5% regardless of appreciation in the company's shares or how good its financial results were.

In early 2015, a few months after a failed takeover bid for Allergan, Valeant completed the major $15 billion acquisition of Salix Pharmaceuticals. This acquisition doubled the level of debt for Valeant. Salix had obtained approval from the FDA for a drug that had the potential to become a blockbuster. Valeant also made a smaller acquisition that proved to be a mistake: Marathon Pharmaceuticals. The company then acquired drugs that, according to management, had prices that could be increased drastically. The contribution of these drugs was minor to Valeant's overall operations (about 3-4% of revenues) but the consequence of the sharp rise in prices on the company's image was catastrophic. For a slim financial benefit, the company significantly tarnished its reputation. There is a social dimension to the price of drugs that needs to be considered. The company, and us in parallel, very poorly assessed the impact of rising drug prices on Valeant's image and reputation.

On two occasions, in 2013 and in 2015, we sold Valeant shares as the stock exceeded the 5% limit we had set. In March 2016, the company greatly reduced its profitability estimates for the current year (and therefore the debt-to-profit ratio increased to a worrying level), and we decided that the stock had become too risky for us and sold everything at about US$52. If we include the two sales of the stock over the years and the gains in the US currency, the overall result is that we achieved a return of approximately 190% in five years in Canadian currency. Even without the currency gain, we more than doubled our investment in less than 5 years.

Regardless, this was an important mistake on our part. Our confidence in the CEO was, in retrospect, a serious misjudgment of the person and his leadership qualities. Clearly, under pressure to maintain a high rate of growth, deleterious decisions were made. This was coupled with a significant increase in indebtedness.

It may seem surprising to list as a mistake an investment decision that resulted in doubling our money in five years. We have often stated that the stock selection process is more important than the result. A very important part of our process, the judgment of the qualities of management, proved to be wrong in this case.

Silver Medal: Alimentation Couche-Tard

**** Warning: some of the following statements may be offensive to readers ****

I have followed Alimentation Couche-Tard since my very beginnings in 1993. The history of the convenience store industry in Quebec is complex and I will try to sum it up. For years, laws in Quebec prevented major food chains (such as Steinberg and Provigo) from opening in the evenings and Sundays. The convenience stores stepped in to provide a retail option during hours not covered by the grocery stores. This legislation was repealed in the early 1990s and many predicted the almost end of convenience stores. As the big players left the industry, Alimentation Couche-Tard took advantage of this to slowly consolidate the Canadian market.

I've never been a big fan of part of Couche-Tard's operations: gas retail. This activity is hyper competitive and, in my opinion, lacks any competitive advantage. Despite my skepticism, Couche-Tard

did a remarkable job and achieved solid profitability and the stock rose by about 2000% from 1993 to 2003.

In 2003, the company made a major acquisition in the United States when it bought Circle K. Fascinated by this incursion south of our border, I went to listen to the CEO, Alain Bouchard, at the annual meeting in early 2004. I was very impressed by Mr. Bouchard and decided to buy a small stake in Couche-Tard to better follow the company.

About a year later, I decided to sell our shares for a very simplistic reason: I did not like the way financial results were presented (it is a bit complex to go into details in this letter). Needless to say, it was a stupendous mistake.

I continued to monitor Couche-Tard's progress in the United States and subsequently in Norway. Since 2005, the stock has climbed by nearly 1000%. In 23 years, the stock has multiplied by more than 200 times. You read that correctly… there is not one zero too many.

Mr. Bouchard has certainly been the maestro of this phenomenal performance for over two decades. An autobiography was published this year and I strongly recommend reading it.

This omission mistake has been haunting me for more than 20 years. Although, our return has been satisfactory since 1993, they could have been even better if I had translated my admiration for M. Bouchard into a sizable investment.

Gold Medal: Mohawk Industries (in 2008)

After the majestic silver medal, you may be wondering how I could have possibly done worse for the gold medal. In my defense, Couche-Tard did not perfectly fit our investment philosophy. But this is sadly not the case for this next company.

Our current investment in Mohawk Industries had exceptional results in 2016 which highlighted an error that occurred approximately eight years ago.

I discovered Mohawk when I read an article by Peter Lynch in the magazine *Worth*. He talked about the company in very good terms, comparing it with Shaw Industries. Shaw is a leading company in the carpet manufacturing industry and is the main competitor to Mohawk. I already knew Shaw well enough, as Mr. Lynch had discussed it in the book *Beating the Street* published in 1992 (which I must have read ten times in my youth).

In 1998, I wrote a complimentary article on Shaw Industries in *Le Journal Les Affaires*. A few months later, the company was acquired by Berkshire Hathaway. I then focused on its main competitor, Mohawk. The company, initially focused on carpet manufacturing, has diversified into various forms of floor covering (ceramic tiles, vinyl, laminate flooring, etc.). By studying Mohawk in more detail, I realized the exceptional qualities of its CEO, Jeff Lorberbaum. Along with Shaw, Mohawk has come to dominate the flooring industry (each with about a 22% market share).

In 2007, when the housing market was already in a deep recession, Mohawk's share declined from $102 to $75 and we took the opportunity to buy shares in the company. Today, the stock is trading at $226. We therefore realized a gain of approximately 200% or 12% annualized (before currency gains), representing a 5% annual increase over the S&P 500 over the same period.

But we could have made a much higher return. First my conviction in Mohawk and its president was not reflected in the small allocation of this stock in our portfolio (about 2%). But worse still, the stock fell sharply in the fall of 2008 during the financial crisis to hit a low of $24 (even at $17 for a brief moment). At our annual meeting that year, in November 2008, a partner from Giverny asked whether Mohawk was a bargain at this price. I replied: "as the company earned more than $7 per share before the crisis, and I believe that in the next cycle it will earn at least that much, so yes the stock looks extremely attractive." Unfortunately, I did not convert these beautiful words into dollars. We kept our shares without adding more to our position. If we had only doubled our investment and thus lowered our average cost from $75 to $50, our return on that investment would have been 17% annualized over 9 years. If we had increased the weight of the portfolio to 4% at that time, our annual return on the stock would have been more than 20%.

It is an error of “golden” caliber because I understood Mohawk very well and knew that it fit perfectly within our investment philosophy. I knew that Mr. Lorberbaum was a brilliant manager and that he would lead the company through the recession with brilliance and utmost leadership. I also knew that the stock market valuation in November 2008 was extraordinarily low. We could have taken advantage of the irrational behavior of the stock market at that time to drastically lower our acquisition cost and thus greatly amplify the return on our capital.

Conclusion: What About Politics?

We have received several questions about the newly elected US president, Donald Trump. Our role is to manage and be good stewards of your capital. It would be a mistake to let our political ideas, as valid as they may seem in our point of view, to blurry our investment decisions.

For example, I remember the 2004 US election very well, when the reelection of George W Bush in early November of that year scared many Canadian investors (for whatever reasons). From November 2004 to today, the total return of the Rochon Global portfolio has been over 400% (12% on an annualized basis). Without taking anything away from Mr. Bush, I sincerely believe that this performance has been achieved because of the exceptional companies we have owned over the past twelve years, with the vast majority of them based in the United States.

Investing in the stock market is not about betting on the vicissitudes of the political world (and voters). Rather, investing is about owning businesses and nothing else. Strong companies do well because they create unique products and services that serve their customers and potentially enrich their shareholders. Political trends pass but good companies endure. I believe that the vast majority of companies that are doing well do so not because of politicians but in spite of them.

We will surely face another set of political uncertainties and economic worries over the next decade. They will have one thing in common: they will all be unpredictable. Despite this, what is predictable for a seasoned investor is that owning shares of quality companies will give rise to positive financial rewards over the long run.

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 and we wish a great 2017 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 2016, 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 2016 :

    - Giverny Global Portfolio: TSX 14% Russell 2000 43% S&P 500 43%
    - Giverny US Portfolio : S&P 500 100%
    - Giverny 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.