Annual Letter to our Partners 2017

Anthony Burnham
Beside itself, 2017
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 2017 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 recent painting by the Quebec artist Anthony Burnham entitled "*Beside itself*".

For the year ending December 31st 2017, the return for the Rochon Global Portfolio was 13.1% versus 10.2% for our benchmark, which represents a relative outperformance of 2.9%. The return of the Rochon Global Portfolio and the one of our benchmark include a loss of approximately 7% due to fluctuations in the Canadian currency.

Since its inception on July 1st 1993, our compounded annual growth rate has been 15.7% versus 9.2% for our weighted benchmark, representing an annualized outperformance of 6.5% over this period. It's worth noting that the effect of the fluctuations in the value of the US Dollar has been nearly nonexistent on our returns. Over 24 years, the US currency has depreciated by 2.1% relative to the Canadian Dollar, which corresponds to an effect of -0.1% on our annualized returns. Our long-term – and quite ambitious – objective is to maintain an annual return 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%
2017	**13.1%**	10.3%	**2.9%**	-6.6%
Total	**3498.5%**	**767.0%**	**2731.0%**	**-2.1%**
Annualized	**15.7%**	**9.2%**	**6.5%**	**-0.1%**

* All returns are adjusted to Canadian dollars
** Index is a hybrid index (S&P/TSX, S&P 500, Russell 2000) which reflects the weight of the underlying assets at the beginning of the year.
*** 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

We have been publishing the returns of the Rochon US Portfolio, which is denominated in US dollars, since 2003. The Rochon US Portfolio corresponds to the American portion of the Rochon Global Portfolio. In 2017, it realized a return of 19.7% compared to 21.8% for our benchmark, the S&P 500. The Rochon US Portfolio therefore underperformed our benchmark by 2.1%.

Since its inception in 1993, the Rochon US Portfolio has returned 2980%, or 15.0% on an annualized basis. During this same period, the S&P 500 has returned 863%, or 9.7% on an annualized basis. Our added value has therefore been 5.3% 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%**
2017	**19.7%**	21.8%	**-2.1%**
Total	**2979.8%**	**863.2%**	**2116.7%**
Annualized	**15.0%**	**9.7%**	**5.3%**

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

No individual holding contributed significantly to this underperformance. Many stocks that were all-stars within the S&P 500 in 2017 were not in our portfolio and the slight relative underperformance of the Rochon US Portfolio this year can be primarily explained by this factor.

You will note that the Rochon US Portfolio underperformed the S&P 500 on eight occasions (or roughly 33% of the time) over 24 years. 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. 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 and not-so-good times.

Rochon Canada Portfolio

We introduced a portfolio that is 100% focused on Canadian equities in 2007. This corresponds approximately to the Canadian portion of the Rochon Global Portfolio. In 2017, the Rochon Canada Portfolio returned 27.4% versus 9.1% for the S&P/TSX, therefore overperforming its index by 18.3%.

Since 2007, the Rochon Canada Portfolio has returned 509%, or 17.8% on an annualized basis. During this same period, our benchmark had a gain of 73%, or 5.1% on an annualized basis. Our annual added value was therefore 12.7%.

Year	Giverny Canada	S&P/TSX	+/-
2007	19.7%	9.8%	9.9%
2008	-24.6%	-32.9%	8.3%
2009	28.2%	33.1%	-4.9%
2010	26.7%	17.6%	9.1%
2011	13.5%	-8.7%	22.2%
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%
2017	27.4%	9.1%	18.3%
Total	**508.8%**	**73.1%**	**435.7%**
Annualized	**17.8%**	**5.1%**	**12.7%**

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

Over 11 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 three most important 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.

2017

2017 was a year of strong economic growth, with profits for the companies making up the S&P 500 rising by nearly 12%.

The American tech giants (Apple, Facebook, Amazon, etc.) continued to carry the US stock market in 2017. The five stocks in the table below rose by 47% during the year, or more than twice the return of the S&P 500. Furthermore, these five stocks are the five most important weights within the S&P 500. So it was hard to beat the S&P 500 in 2017 without these stocks in a portfolio (Alphabet is the only one in ours).

Stock	2017 Gain
Apple	48%
Microsoft	40%
Amazon.com	56%
Facebook	53%
Alphabet	36%
Average	**47%**

Tax Reform in the US

The American president managed to pass his tax reforms at the end of the year. So in addition to benefiting from an environment of GDP growth, US companies will see their tax rates drop substantially in 2018. We believe that the estimates for profit growth for companies in the S&P 500, which are in the neighborhood of 15% to 18%, could even be conservative given these reforms.

Roughly 80% of our portfolio is invested in the United States. Additionally, our US companies will likely see their corporate tax rates drop in a manner that is even greater than the average company in the S&P 500. Indeed, we have always been wary of investing in companies with low tax rates for the simple reason that we have always feared that governments could change the rules. Our past conservatism will be rewarded in 2018: the majority of our American companies pay significant taxes and will be greatly favored by the lower corporate rate. Considering all factors, we estimate that the profit growth prospects for our companies are above the 20% mark for 2018. The tax reform will even help our Canadian companies, such as , which generate a large share of their profits from the United States.

Meanwhile in Canada

It was a quiet year in Canada. The Canadian stock market did well with the S&P/TSX posting gains of 9%, though below the US stock market. The price of oil dropped from $56 a barrel early in the year to a low of $44, ending the year at $60. This price is still below the total cost of production for several Canadian oil companies, especially those operating in the oil sands. The growing popularity of electric cars is also not a good omen for the oil industry in general.

Canadian residential real estate continued to hold up despite various new and more restrictive rules put in place by governments. The average price of a house in Canada is roughly $500,000, or about 5% more than in 2016. This level seems unsustainable, in our opinion, compared to the current GDP per capita of Canadian households. The level of indebtedness of Canadian has become the highest of the

OECD countries (101% of GDP per capita compared to the average of 80%). When this returns to normal ("when" and not "if" in our opinion) it will likely be difficult for the Canadian economy to absorb without creating additional aftershocks to various segments of the economy.

As a result of US tax reforms, Canadian corporations may well become less competitive relative to their American counterparts. Regardless of what politicians say, a high level of taxation has the same effect on investors as the cold on the geese: they fly off towards more favorable climate.

New segments of the Canadian industry have done particularly well in 2017: artificial intelligence and cannabis agriculture. It seems early to assess the business model and the long-term financial potential of AI-related companies. As for the cannabis industry, it is quickly becoming a major business. Of course, speculators have already taken notice (we can smell it!) and companies in this sector are trading at high valuations which seem to have already discounted many years of future growth.

You likely concluded, if you're reading between the lines, that our philosophy of selecting companies with a strong track record of high profitability and a reasonable stock market valuation keeps us away from these types of industries.

A Few Words on the United Kingdom

As for the United Kingdom in 2017, predictions of economic apocalypses following Brexit did not materialize. GDP growth was close to 1.5% for the year, which is lower than the European average (around 2.4%) but still acceptable given the circumstances. We took advantage of the stock market gloominess that prevailed to buy two British companies for our portfolio.

The Flavor of the Day for 2017: Bitcoin

Every year, we present to you what we consider the "flavor of the day" from the financial world. In our opinion, the top prize for 2017 goes to bitcoin.

Several people asked us throughout the year what we thought about bitcoin, the most popular cryptocurrency. We recognize that this new way of transmitting money is difficult to fully understand. We quote Warren Buffett, who explained that bitcoin is "*…a very effective way of transmitting money and you can do it anonymously and all that. A check is a way of transmitting money too. Are checks worth a whole lot of money?*"

Such a rational statement does not hinder the innate nature of the human being from being seduced by speculative activities. Things ends badly whenever a speculative fever sets in, with those who are burnt by it swearing to never get caught again.

But mix a new generation of humans with a new form of speculation and you get a brand new explosive cocktail. The bitcoin cocktail is spiced with brilliant marketing: it is aimed at those who want to rebel against the system (oh so seductive is this idea!) while also using their intelligence to understand a complex cyber currency concocted by other people just as smart. But intelligence and rationality are two different qualities.

In our opinion, reason and experience dictate avoiding this trend.

Robert Wilmers (1934-2017)

We unfortunately lost Robert Wilmers, CEO of M&T Bank, in December. He had been head of this Buffalo-based bank since 1983, and we have been shareholders M&T for more than 18 years.

I have in my archives the 1993 annual report for the First Empire State Bank (before the name of the bank was changed to M&T). It was the first of many annual reports written by Bob that I read over the years. I became a great admirer of not only of Bob as a banker but also as an incredibly generous human being.

We bought our first shares in M&T in 1998. Then we added to our position at the beginning of the 2000, while Wall Street seemed only interested in tech stocks. M&T's stock did very well during the 2000-2002 market correction and it became our biggest holding. Bob always managed the company extremely cautiously while maintaining a high rate of growth in the company's intrinsic value. We slept peacefully with Bob at the helm.

In 2007, at the age of 73, Bob decided to retire. We met with the company and weren't as comfortable with the bank's new management team and we sold our shares (at around $100).

Then came the great crisis of 2008 and Bob decided to return to run M&T. JP and I met him in August 2008 and bought shares again a few months later, in February 2009, for about $36 a share. The stock is currently trading at $190. There is no doubt whatsoever that Giverny's partners owe Bob a huge debt of gratitude. We are all richer because of his boundless devotion to M&T's customers, employees and shareholders.

I would like to add a personal note about another form of enrichment that Bob indirectly gave me, which is a cultural enrichment. It was a Monday when we travelled to Buffalo in 2008 and the famous Albright-Knox museum was closed. I asked Bob if he knew anyone at the museum who could open its doors. When we arrived at Bob's office, his assistant said: "After the meeting, the museum director

will be waiting for you to take a guided tour." I then met Louis Grachos, the then director of the Albright-Knox, who gave us a very memorable visit. When I told him about my passion for collecting contemporary art, Louis confided in me his admiration for an Italian collector, Count Giuseppe Panza di Biumo.

The first thing I did after the meeting was order Count Panza's autobiography on Amazon and I devoured it in a few days. In my opinion, Count Panza was the greatest collector of contemporary art in history. He quickly became a mentor for me through his writings. Louis then put me in touch with the count and a few months later, in November 2009, I went to meet him at his home in Varese, in northern Italy. It was a wonderful meeting. Six months later, Count Panza died.

I saw Louis a few times afterwards. He also introduced me to some people of the Albright-Knox Museum Board of Directors. Without the great generosity of Bob Wilmers, I would have never met Count Panza or known several very warm people in Buffalo who have become good friends.

I owe a lot of marvelous things in my life to Bob and I will miss him very much.

Five-year Post-mortem: 2012

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 wrote in our 2012 annual letter: "*We believe that equities will be the best asset class in the coming years for the simple reason that it seems to be the most undervalued.*" Over five years, the S&P 500 has risen more than 87% (it has doubled if we include dividends).

In 2012, we acquired shares in LKQ and Union Pacific (UP). We still hold these two companies in our portfolio. To assess these investments, here is a table measuring their performance, in absolute terms, relative to the S&P 500.

Stock	Date of 1st Purchase	2012 EPS	2017 EPS	Growth Rate	Price at 1st Purchase	Price at end of 2017	Avg. Div.	Annualized Return	S&P 500 Annualized	+/-
LKQ	Apr-12	0.87 $	1.88 $	17%	15.0 $	40.7 $	0%	19%	15%	4%
UP	Jul-12	4.13 $	5.79 $	7%	60.0 $	134.1 $	2%	18%	14%	3%
S&P 500		104	133	5%	-	2674	2%			

Both stocks did very well, with LKQ and UP generating annualized returns of 19% and 18%, respectively, or about 3 to 4% better than the S&P 500 during the same period. LKQ grew its EPS by 17% from 2012 to 2017 and the stock has broadly followed the growth in its intrinsic value. Although we believe that the company will have difficulty maintaining this rate of growth in the future, we are of course satisfied with this investment so far.

On the other hand, UP has grown its EPS by only 7% per year, a rate that is slightly higher than that of the companies in the S&P 500. The strong performance of the stock therefore originates from a significant increase in its P/E multiple over the last five years (just like the S&P 500, by the way). We believe that UP's valuation premium is justified by its excellent long-term fundamentals (it must also be taken into account that EPS will likely increase sharply in 2018). Our opinion, however, is that we will no longer count on such a stock market revaluation in the years to come.

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 equity investing, 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 14% (13% from the growth in earnings and around 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 2017 to adequately reflect their economic reality. The performance of our portfolio in terms of market value was a gain of roughly 20% (net of any currency effect).

The companies in the S&P 500 also saw strong growth, with growth in the order of 12% (about 14% when we add the dividend). The S&P 500 had a total performance figure of 22% (in $USD).

	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%
2017	14%	20%	7%	14%	22%	8%
Total	1391%	1544%	153%	365%	552%	188%
Annualized	13.1%	13.6%	0.5%	7.2%	8.9%	1.7%

* 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

Over 22 years, we believe our companies have grown their intrinsic value by about 1391%; and their stocks have achieved a total return of approximately 1544%. On an annualized basis, we achieved an intrinsic performance of 13.1% versus 13.6% 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 over the long term.

Our stocks have outperformed the S&P 500 by 4.7% annually over the last 22 years for the simple reason that our companies grew their intrinsic values at a rate that was 5% greater than that of the companies that make up the S&P 500.

Our Companies

"It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent."

- Charlie Munger (Vice Chairman of Berkshire Hathaway)

Section for Giverny Capital's partners only

The Podium of Errors

"The man who does things makes many mistakes, but he never makes the biggest mistake of all—doing nothing."

- Benjamin Franklin

Following in the "Givernian" tradition, here are our three annual medals for the "best" errors of 2014 (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: Knight Transportation

Our older partners will remember that we were shareholders of Knight Transportation for several years, from 2003 to 2011. Knight Transport is a large truck transportation company located in Phoenix, Arizona. We sold our shares in 2011 to buy another stock that seemed more undervalued.

In early 2015, the company appointed a new CEO, David A. Jackson, and we met with him. Mr. Jackson was previously CFO of the company and reinvigorated Knight's growth plans. We were very impressed by this young leader (40 years old at that time) and decided to become shareholders again. Then in March of 2017, after holding the stock for about two years, we sold our shares for about $33, netting a small gain. Once again, I preferred to invest our capital in another stock that seemed more interesting.

It seems like it was a mistake. Shortly after our sale, David Jackson led the company in its acquisition of Swift Transportation which, at first glance, seems very promising. The growth outlook for 2018 is excellent and we expect a 58% increase in EPS. The stock did well on the stock market, climbing nearly 50% after we sold it. It looks like I lacked patience.

Silver Medal: Intuit

I discovered Intuit and its Quicken software about 25 years ago. I found the product excellent and very practical. I knew that the company was listed on the stock market but found the stock too expensive. In October 1994, Microsoft announced a takeover bid for Intuit for $1.5 billion. From memory, it was the equivalent of around 30 times the profits of that time—a level that I found exorbitant (I was still quite inexperienced). In April 1995, the US Department of Justice opposed the transaction for antitrust reasons and Intuit's stock dropped to less than $5 (adjusted for subsequent splits).

I decided to follow Intuit more closely after this failed acquisition. I liked the product and I thought that if Microsoft saw so much value in it that the company certainly deserved my attention. Obviously, I always found the stock too expensive because I never bought any shares of the company. I only admired the company from the bleachers.

A few years later, the company launched a second flagship product: Quickbook (bookkeeping software). We even started using this product a few years ago at Giverny. I could not be more in the front row! Today, the stock is trading at $164. Yes, you calculated correctly: the stock has risen 3200% since 1995, or the equivalent of an annualized return of 17%.

Gold Medal: FactSet Research Systems

This year's gold medal is one of high caliber and one that was many years in the making. It is necessary to return to 1998 to find the origin of this error. In early 1998 (a few months before founding Giverny Capital), I went to a high-tech conference in San Francisco. No need to tell you that the word on everyone's lips was: "Internet". The young business leaders were daring, flashy and excellent presenters with beautiful computer presentations. The sole exception to this was the president of FactSet Research.

I had never heard of this company but I looked at its numbers in the documents provided to conference attendees. The company was very profitable (one of the few in the group) and I went to the company's presentation. The president and co-founder was the speaker and he must have been about 70 years old and had no computer or projector. Near the end of his presentation, he pulled out sheets of paper taped together (yes, I was wondering "what are these strange things?"). In this stack of unfolded sheets, one could see the sales and profit growth of the company over 20 years (the company was founded in 1978). Of course, from my seat in the audience, I couldn’t really see anything. But I liked the old fashioned manner of the president and took the time to study the company in detail upon my return to Montreal.

FactSet sells financial information software and competes with giants like Bloomberg and Thomson Reuters. The company has a successful product, a loyal customer base and is continually gaining market share. It has exceptional profitability and an exemplary balance sheet.

After following the company a few years, we bought shares of FactSet in 2003. Then we sold them after a slight increase. We briefly rode on the same carousel in 2006. The reason that made me sell was always the same: after a small rise, I found the stock's valuations too expensive. In fact, the market valuation, without being exaggerated, always seemed too high and that is the main reason we did not have this company in the portfolio for longer periods of time. Yet the company continued to generate exceptional results and the company continued to grow its profits even during the great recession of 2008-2009.

At the beginning of 1998, the stock traded at less than $8. The stock hit the $200 level twenty years later. We could have made more than 25 times our money over two decades (an annual return of 18%).

What makes me to blame even more is that we are loyal customers of FactSet Research at Giverny Capital. I love to use this product! Our familiarity with the product and our loyalty to the company should have turned the light on in my brain!

<u>Conclusion:</u> it was 10 years ago

A decade ago, in 2007, Giverny Capital had a difficult year. The only sectors that were "working" were those related to natural resources (with oil leading the way). As you know, we avoid this universe because, in our opinion, it is extremely difficult to have a competitive advantage. In addition, the sharp rise in the Canadian dollar at that time also decreased our short-term results. The Canadian stock market (especially the sectors linked to natural resources) was then at its peak of popularity.

We stayed the course on our stock selection process as we knew that our philosophy of selecting high quality companies was sound. We also believed that the level of the Canadian dollar, at par with its American counterpart at the time, did not make sense. We wrote at the time: "Patience is in order."

This patience was rewarding for us and our partners. The following is a chart of the performance of the Rochon Global Portfolio (in Canadian dollars and without currency effect) compared to our benchmark, the S&P 500 and the S&P/TSX (in Canadian dollars and without currency effect) for the 10-year period, beginning January 1, 2008.

2008-2017 Period	In $CAD		Estimated w/o currency	
Return	Total	Annualized	Total	Annualized
Rochon Global	351.0%	16.3%	271.6%	14.0%
Index **	159.4%	10.0%	111.0%	7.8%
S&P 500	186.1%	11.1%	126.0%	8.5%
S&P/TSX	58.1%	4.7%	58.1%	4.7%

** "Index" is a hybrid index (S&P/TSX, S&P 500, Russell 2000) which reflects the weight of the underlying assets at the beginning of the year.

<u>Refer to Appendix B for disclosure statements on the Rochon portfolios</u>.

The Rochon Global portfolio thus achieved a total return of 351% (16.3% on an annualized basis) compared to 186% for the S&P 500 in Canadian dollars (11.1% annualized). The S&P/TSX Canadian Index returned 58% over 10 years (4.7% annualized). The Canadian dollar lost 21% of its value over the decade and returned to a level we consider normal. Without currency effect, we estimate the total return of the Rochon Global portfolio at 272% (14.0% annualized) and 126% (8.5% annualized) for the S&P 500.

It should be noted that these returns were obtained by starting the clock at the BEGINNING of 2008, so BEFORE the big fall of the stock market that followed. Our companies are not immune to recessions but have had the strength to go through hard times.

Two ingredients are therefore necessary to succeed on the stock market: a rational stock selection process and patience (often, a good dose of it).

I would add that the first ingredient is futile without the second.

To Our Partners

We believe 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 we believe 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 2018 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 2017, 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 2017 :

    - 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 Independent Network (NBIN) 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 (NBIN). The auditor's annual reports are available upon request.
- For more information, please see the "returns" section of our website.