Annual Letter to our Partners 2019

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Giverny Capital Collection

Historical Summary

It has been more than 27 years 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; he 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. In 2009, we launched a US office in Princeton, New Jersey. Moreover, in early 2020, we established a partnership with a portfolio manager based in New York City who will head the office of the firm Giverny Capital Asset Management LLC in Manhattan. The directors of the US offices, Patrick Léger and David Poppe, share 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 of 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 2019 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 2013 painting by the Canadian artist, Wanda Koop, entitled "*Ice Shelf*".

For the year ending December 31st 2019, the return for the Rochon Global Portfolio was 25.6% versus 22.3% for our benchmark, which represents a relative outperformance of 3.3%. The return of the Rochon Global Portfolio and the one of our benchmark include a loss of approximately 5% due to fluctuations in the Canadian currency.

Since its inception on July 1st 1993, the compounded annual return of the Rochon Global Portfolio has been 15.4% versus 9.3% for our weighted benchmark, representing an annualized outperformance of 6.2% 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 26 years, the US currency has appreciated by 1.4% relative to the Canadian Dollar, which corresponds to an effect of 0.1% on our annualized returns. Our long-term and 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%
2018	**-0.6%**	-1.4%	**0.8%**	8.7%
2019	**25.6%**	22.3%	**3.3%**	-4.8%
Total	**4391.2%**	**945.8%**	**3445.4%**	**1.4%**
Annualized	**15.4%**	**9.3%**	**6.2%**	**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 adjective "ambitious" in relation to of our performance objectives is chosen with care. A very small number of managers succeed over a very long period (say 20 years) in outperforming the indices. Maintaining such a goal will remain difficult. In Alexandre Dumas' famous novel, *The Count of Monte Cristo*, the author states that the expression that defines him is *cupitor impossibilium*. At Giverny, our ambitions for outperformance are cut from the same cloth: to desire the impossible.

The Rochon US Portfolio

We have been publishing the returns of the Rochon US Portfolio, which is entirely denominated in US dollars, since 2003. The Rochon US Portfolio corresponds to the American portion of the Rochon Global Portfolio. In 2019, it realized a return of 32.1% compared to 31.5% for our benchmark, the S&P 500. The Rochon US Portfolio therefore outperformed the benchmark by 0.6%.

Since its inception in 1993, the Rochon US Portfolio has returned 3631%, or 14.6% on an annualized basis. During this same period, the S&P 500 has returned 1111%, or 9.9% on an annualized basis. Our added value has therefore been 4.8% 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%**
2018	**-8.3%**	-4.4%	**-3.9%**
2019	**32.1%**	31.5%	**0.6%**
Total	**3631.2%**	**1111.0%**	**2520.2%**
Annualized	**14.6%**	**9.9%**	**4.8%**

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

In 2019, the Rochon US portfolio slightly outperformed the S&P 500. This was despite the significant underperformance of our shares in Berkshire Hathaway, the largest weight in our portfolio.

It has been difficult to outperform the S&P 500 in recent years, probably one of the best performing indices in the world over the past five years. The all-stars of the S&P (Apple and Amazon, for example) played a major role in this polarized performance. In addition, the tremendous popularity of index funds also contributed to the outperformance of the S&P 500. Indeed, indices that have performed the best over the short term tend to attract the most capital from passive investors and are further bolstered.

This is the nature of short-term stock market behavior: recent past outperformance propels current outperformance. But, without exception, the stock market always ends up eventually reflecting the intrinsic value of companies.

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 2019, the Rochon Canada Portfolio returned 29.0% versus 22.9% for the S&P/TSX, therefore outperforming its index by 6.1%.

Over 13 years, the Rochon Canada Portfolio has returned 625%, or 16.5% on an annualized basis. During this same period, our benchmark had a gain of 94%, or 5.2% on an annualized basis. Our annual added value was therefore 11.2%.

Year	Rochon Canada	S&P/TSX	+/-
2007	19.7%	9.8%	9.9%
2008	-24.6%	-32.9%	8.3%
2009	28.2%	33.1%	-4.9%
2010	26.7%	17.6%	9.1%
2011	13.5%	-8.7%	22.2%
2012	24.0%	7.2%	16.8%
2013	49.4%	13.0%	36.4%
2014	20.3%	10.6%	9.7%
2015	16.0%	-8.3%	24.3%
2016	11.0%	21.1%	-10.1%
2017	27.4%	9.1%	18.3%
2018	-7.6	-8.9%	1.3%
2019	29.0%	22.9%	6.1%
Total	625.3%	93.8%	531.4%
Annualized	16.5%	5.2%	11.2%

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

Since 2007, the performance of our Canadian securities has been significantly higher than that of the S&P/TSX. We would like to repeat, once again this year, that a concentrated portfolio can drastically exceed the performance of the indices.

However, in our opinion, the risk 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 owning a low enough number of companies to improve the odds of beating the market indices. Since this portfolio represents only a portion (approximately 14%) of the Rochon Global Portfolio, our diversification requirements are met.

2019

Years follow each other but are never alike.

In 2018, American companies had greatly improved their level of profitability (thanks to, among other things, the reduction in corporate tax rates). However, the stock market experienced a decline that year. It was the opposite in 2019: for most compagnies, profits stagnated but the stock market did very well. One could therefore conclude that stock prices in 2019 caught up with the undervaluation created in 2018.

Over the long run, stocks inevitably reflect increased corporate profits. A certain synchronicity between the underlying intrinsic performance of companies and their stock prices therefore always eventually materializes.

The temporality of this stock market justice, on the other hand, is completely unpredictable. Of course, that doesn't stop numerous Wall Street strategists from venturing their predictions, as random as they may be. The reason is simple: their customers keep asking for such predictions despite all the historical data that demonstrate their futility.

Trade disputes

Trade tensions between the United States and China continued to feed the media. We obviously have no idea the outcome or consequences of these tensions, but in general, we are for the free movement of goods and services and a market unshackled from various government interventions. But we also realize that we live in a complex world where there are various parameters which interact on many levels. If it were simple to solve, our civilization would have already found the solution. This line of thinking also applies to many facets of humanity.

Our investment approach is therefore to not try to predict macroeconomics (and the even less predictable political world) but rather to focus on the activity of selecting high quality companies.

The last decade: 2010-2019

10 years ago, we emerged (with a few scars) from the financial crisis of 2008-2009. Few investors liked the idea of investing in stocks and everything seemed like a good reason to stay away from the stock market. Here are some of the geopolitical and macroeconomic events that took place during the last decade:

- The anti-stock-market movement of “Occupy Wall Street” (2011)
- The downgrade of American bonds (2011)
- Financial crisis in Europe, particularly in Greece (2011)
- The debt ceiling crisis with the US government (2012)

- The “fiscal cliff” in the US (2012)
- The start of the conflict between Russia and Ukraine (2013)
- Lawsuits by the US government against large banks (2013)
- Oil price collapse (2014)
- Economic slowdown in China (2015)
- Brexit (2016)
- The trade conflict with China (2018)

If they had known in advance everything that had happened in the past 10 years, many investors would have waited on the sidelines before investing in the stock market... and many did. We can even read everywhere that we had not had a bear market over the decade (another excuse to sell shares!) Strangely, the two bear markets - a 20% drop in the stock market in 2011 and 2018 are often overlooked. I called these “ghost bear markets”.

From 2010 to 2019, the return on the Rochon Global portfolio was 18.2% on an annualized basis, or a total return of 433%. Imagine the opportunity cost if we had let fears of the future hold us back in our business of acquiring high quality companies.

We can break down our annual performance for the decade into three parts:

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

As you can see, most of our performance resulted from the growth in underlying profits from the companies in our portfolio. Over the long term, in our view, owning stocks of above-average companies remains the key to success in the investment world.

What does the next decade hold for us? Obviously, we are not soothsayers. We believe that growth in corporate profits will be weaker in the years to come as we estimate that after-tax profit margins are at a level that will be difficult to improve. For the companies making up the S&P 500, we believe that profit growth will be around 5 to 6% per year in the years to come.

If we continue to own companies that, as a whole, increase earnings per share (EPS) by more than 10% per year on average, over many years, we believe that our overall portfolio will generate an annual return of this magnitude.

In order to reap such return, however, it is essential to remain undistracted by the various headlines of the media. To obtain the strong long-term results of equities, one has to stay invested in equities.

An energy revolution in the United States (part two)

Seven years ago, in the 2012 annual letter, I presented a section on the energy revolution in the United States. I was explaining that new discoveries of shale gas and oil in the western United States (and, most importantly, the technology to extract them) had completely changed the energy balance in the US. I noted that the US appeared poised to dramatically improve the dynamics of its energy trade.

But I took the trouble to add: "despite the optimistic tone of this section, none of this changes the fact that the energy industry is – to us – difficult to predict… this simply means that companies that operate in the energy industry are difficult for us to evaluate."

What has happened since? The energy revolution in the United States continued to the point that in 2019, for the first time in several decades, the United States became a net exporter of oil (see Chart 1).

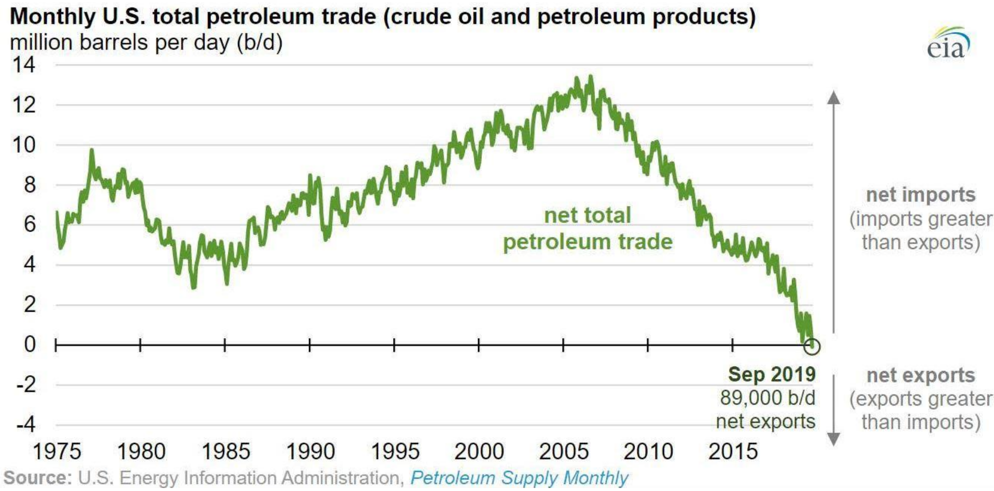

Chart 1: Petroleum trade in the US over the last 45 years.

Oil production in the US increased from 6 million barrels per day in early 2012 to almost 13 million last year. However, this was not necessarily a source of enrichment for the producers. The price of a barrel of oil dropped from $91 in 2012 to $52 recently. The energy sector had a difficult decade (see Chart 2). Few people in 2007 (when oil prices hit $140 a barrel) would have predicted such a thing. There are so many factors that interact, sometimes even in a contradictory manner to each other, that it makes the prediction of the future of this industry very complex.

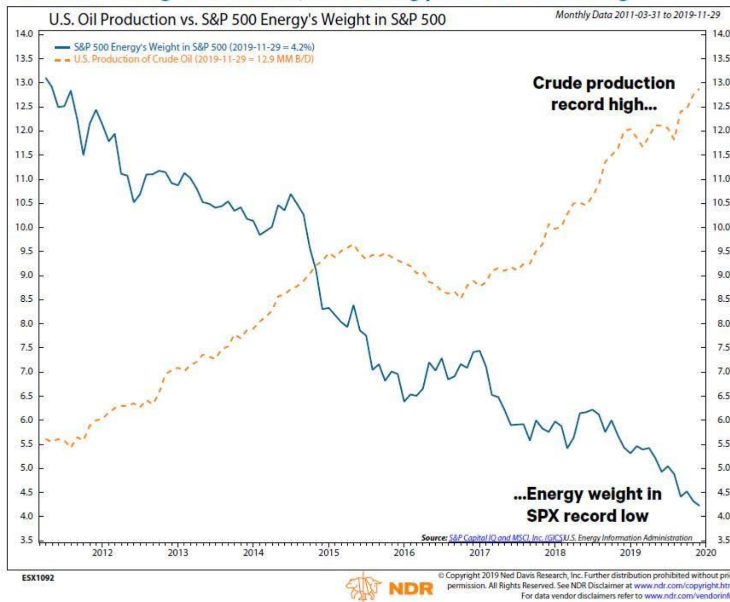

Chart 2: Oil production in the US since 2011 versus the weight of the energy sector within the S&P 500. Source: Ned Davis Research

A first for renewable energy in the United States

Another dimension of the American energy revolution also continued. In 2019, the production of electricity from renewable energy exceeded, for the first time in history, that from coal (Chart 3).

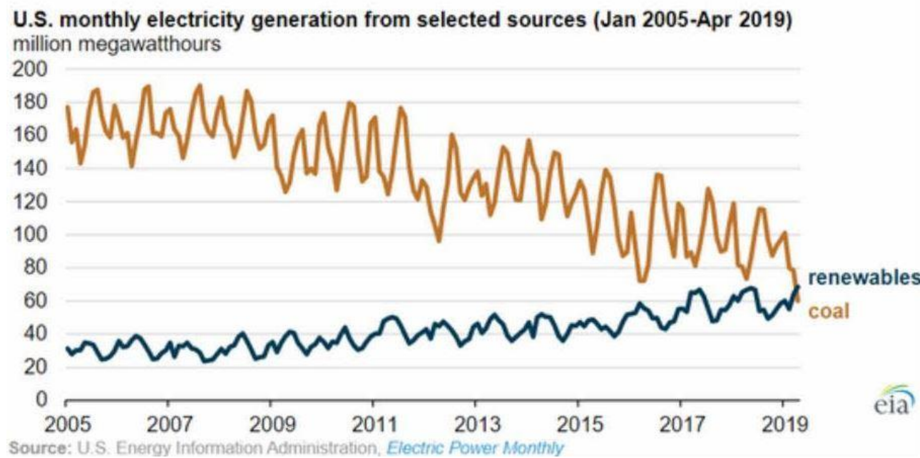

Chart 3: Monthly production of electricity generated from coal versus renewable sources.

This great news for the environment went completely unnoticed on social media. One could argue that a prolonged observation of the media in our society reveals that bad news and prophets of doom have always had excellent press agents...

Conclusion

We continue to avoid the oil sector for several reasons. First, we believe this is an area where competitive advantages are rare and seldom sustainable (excuse the pun). Over the long term, we also believe that humanity will continue to evolve towards more sustainable ways of producing the vast amount of energy we need. We own a few companies in our portfolio that should benefit from the growth of electric car in the years to come.

The flavor of the day

When you consider that a 10-year US government bond (and also that of Canada) carries an interest rate of less than 1%, the alternatives to stocks are clearly unattractive. Such rates are unlikely to be sufficient to cover inflation and it's even worse in Europe where interest rates are often negative. The only guarantee that comes with such low yielding bonds is that of getting poorer. Their popularity is difficult to understand.

The iconic example from this period is the now famous issue by the Austrian government of "century" bonds. These bonds were issued at €100 in 2017 with a 2.1% coupon and maturing on September 20, 2117. This security, in our opinion, already risky at par, rose 55% in less than two years. A second tranche of these bonds was then issued at €154 in June of 2019. At this price, the yield to maturity (in 98 years) was 1.17% annually. But a few months later, in August 2019, the price of these bonds hit a high of €210. The annual yield to maturity was then 0.61%.[1]

[1] Source: Barron's

At the current time, there is $17 trillion (or $17,000 billion) in negative interest bonds worldwide. These negative interest bonds represent, in our opinion, an aberration that is hard to comprehend.

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 inspired 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."

	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%	4%	29%	25%
1999	16%	12%	-4%	12%	21%	9%
2000	19%	10%	-9%	15%	-9%	-24%
2001	-9%	10%	19%	-21%	-12%	9%
2002	19%	-2%	-21%	13%	-22%	-35%
2003	31%	34%	3%	12%	29%	16%
2004	21%	8%	-12%	20%	11%	-10%
2005	14%	15%	0%	15%	5%	-10%
2006	14%	3%	-11%	24%	16%	-8%
2007	10%	0%	-10%	-4%	5%	9%
2008	-3%	-22%	-19%	-31%	-37%	-6%
2009	0%	28%	28%	6%	26%	20%
2010	22%	22%	0%	50%	15%	-35%
2011	17%	6%	-11%	18%	2%	-16%
2012	19%	23%	4%	9%	16%	7%
2013	16%	42%	26%	8%	32%	24%
2014	13%	19%	6%	10%	14%	4%
2015	11%	4%	-7%	1%	1%	0%
2016	9%	10%	1%	4%	12%	8%
2017	14%	20%	7%	14%	22%	11%
2018	20%	-8%	-28%	23%	-4%	-26%
2019	10%	31%	20%	3%	31%	29%
Total	1876%	1889%	13%	608%	720%	111%
Annualized	13.2%	13.3%	0.0%	8.5%	9.2%	0.7%

* 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

Note: The results of the increase in the value of the S&P 500 since 1996 were revised compared to previous letters

This year, the intrinsic value of our companies, as a whole, rose by about 10% (with dividends included). Despite some of the changes to our portfolio during the year, we consider the estimate of the EPS growth at our companies during 2019 to adequately reflect their economic reality. The market performance of our portfolio was a gain of roughly 31% (net of any currency effect). Our stocks therefore realized a price performance that was far greater than their underlying economic performance.

The companies in the S&P 500 also experience weak growth in their corporate earnings, with growth in the order of less than 1% (about 3% when we add dividends). The S&P 500 still had a total performance figure of 31% (in $USD).

Since 1996, our companies have grown their value by about 1876% and their stocks have achieved a total return of approximately 1889%. On an annualized basis, we achieved an intrinsic performance of 13.2% 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 over the long term.

Our stocks have outperformed the S&P 500 by 4.1% annually over the last 24 years for the simple reason that our companies grew their intrinsic values at a rate that was 4.8% greater than that of the companies that make up the S&P 500.

A book on the life of Joseph Rosenfield

Twenty years ago, I read an article that made a significant impression on me: *The Best Investor you've never heard of* by Jason Zweig of the magazine Money. The article painted a fascinating portrait of Joseph Rosenfield. Then aged 96, Mr. Rosenfield had grown the endowment fund of Grinnell University (in Iowa) from $11 million dollars to $1 billion dollars from 1968 to 2000. Warren Buffett was among the members on his investment committee. The latter had nothing but praise for Rosenfield: "A triumph of rationality over conformism". Despite his advanced age, Mr. Rosenfield emphasized the importance of patience in the investment world throughout the interview.

I have reread this article several times since (obviously not often enough as evidenced by my occasional lack of patience). I tried in vain to find a biography of Mr. Rosenfield for years and years.

But my patience was rewarded last year when I came across a new book written by George Drake: *Mentor: Life and Legacy of Joe Rosenfield*. I've never pressed so quickly on Amazon's "Buy Now" button. I wholeheartedly recommend it to you. You will find that Mr. Rosenfield was much more than just a great investor.

Source: grinnel.edu

Five-year Post-mortem: 2014

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 made few changes to the portfolio in 2014, but here are a few remarks from reviewing the annual letter from that year.

- In 2014, we made our first investment in Constellation Software. When I read the company's annual report, I knew instantly that Mark Leonard was our kind of leader. The stock has climbed 500% since our first purchase.
- In 2014, we took a small stake in PRA Group. The company remained in the portfolio for just over a year. The results were disappointing and we sold it in 2015.
- On the other hand, we sold the last shares we owned of Resmed, an Australian company for which we always had great admiration. We found its shares too "expensive" at the time. We will come back to this later on in "error medals" section (and yes, it was a very bad sale).

<u>Our Companies</u>

"… Mr. Morrel was a prudent and rather a timid man, as are all those who have built, slowly and laboriously, a business fortune over many years…".

\- Extract from *The Count of Monte Cristo*

Section for Giverny Capital's partners only

<u>The Podium of Errors</u>

"Misfortune is needed to bring to light the treasures of the human intellect."

\- Extract from *The Count of Monte Cristo*

Following in the "Givernian" tradition, here are our three annual medals for the "best" errors of 2019 (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: Microsoft

We had been shareholders of Microsoft for a few years before selling in 2011 with a very modest gain. But a new CEO, Satya Nadella, arrived in 2014 and completely transformed the culture of Microsoft. He knew how to take the company towards cloud computing and did so brilliantly. We were at the forefront of being able to see this transformation, but were skeptical of the degree level of effect on Microsoft's EPS growth rate.

The stock has multiplied by seven times in eight years.

Silver Medal: Resmed

We invested in Resmed, an Australian company specializing in medical devices to help sleep disorders, in 2003. We were shareholders for about 11 years and sold in early 2014. I then found that the growth of EPS had slowed (we were used to 20% per year) and that the stock seemed too expensive given the circumstances. I did know, however, that sleep apnea was a widespread problem that is still poorly diagnosed and even more poorly treated. Long-term growth prospects were therefore intact.

From 2014 to 2019, EPS increased by about 10% annually and the stock price climbed from $44 to $155. Today's share price reflects better growth prospects expected in the years to come.

We acquired our first shares in 2003 at around $8. We could have achieved a total return of almost 20 times our money if we had been more patient. Peter Lynch liked to say: "you should not pull out the flowers to water the weed". I clearly pulled out a full patch of roses by selling our shares in Resmed.

Gold Medal: Copart

Recently, I ran into a portfolio manager friend I have known for years. We talked about our favorite stocks and she told me she owned shares in Copart. It reopened an old wound—I had almost managed to forget this terrible mistake I made a few years ago.

Copart is a company that sells cars reported by auto insurance companies as total losses. A few years ago, the company started auctioning on the Internet and was able to reach customers worldwide. It is rare to find a company that has a simple business to understand, strong competitive advantages and high returns on equity—all with good prospects for expanding its addressable market.

The management of the company also has a very pro-shareholder approach towards the management of excess capital. In 2011, I not only noticed that the company was doing well but also that the company had gone into debt (modestly) to buy back around 10% of its shares. Copart made $0.63 in EPS in 2011 and the stock was trading at around $11 or 18 times its profits. I loved everything about this company except the valuation. So I decided to wait for a better price.

In 2014, a book was published on the story of Copart founder Willis Johnson entitled *From Junk to Gold*. Again, I found the story fascinating ... without buying the stock.

In 2019, the company made EPS of $2.47. This is the equivalent of an annual growth rate of 19% achieved over eight years. And the stock trades, as of this writing, at $80. That's 27 times the estimated profit for 2020. We could have made about eight times our money in eight and a half years, or an annual return of 26%. And even without the expansion of the P/E ratio, the stock would have done very well.

I have no excuses. The company was in my area of expertise and the value was not at all extravagant. It was a big mistake.

Ah yes, I forgot a little postscript: in early 2016, the stock corrected by 25% and traded for a few weeks at $16. At that time, the stock's P/E was 15 times. So I had the long-awaited opportunity to get a better price!

I think that I will finally give a platinum medal for this error.

<u>Conclusion</u>: the wisdom of Alexandre Dumas

Do you remember the episode of the TV series *Cheers* in which Sam Malone reads the Russian classic *War and Peace* to impress Diane? And at the very end of his long literary journey, he learns to his great despair, that there is a movie!

I experienced the situation in reverse last year. I watched the French mini-TV series on the classic novel by Alexandre Dumas: *The Count of Monte Cristo*. It left me hungry for more so I decided to read the 1,400-page novel. I really loved the book. First, I found in it a vast portrait of the economic world of France from 1815 to 1840. The Stock Exchange already existed at the time (the first exchange was created in Paris in 1639). But most importantly, there are deep reflections on human nature.

Obviously, to highlight just a few sentences does not do justice to this monument of literature. As you can see, I have already used some of them in other sections of this letter. My favorite sentence in the book comes from a lesson by Father Faria to Dantes (the original name of the Count of Monte Cristo):

"To learn it not to know; there are the learners and the learned. Memory makes the one, philosophy the other. But how can someone learn philosophy? Philosophy cannot be taught; it is the application of the science to truth."

Obviously, we can quickly draw a parallel with the world of stock market investment. The knowledgeable are those who assimilate a large amount of information on the economy and companies. But it must be admitted that knowledge and wisdom are two very different things.

Those who are wise (those using philosophy) try to understand the world authentically, beyond the simple accumulation of information. The word philosophy, from the ancient Greek φιλοσοφία (composed of φιλεῖν, philein: "to love"; and of σοφία, sophia: "wisdom" or "to know"), literally means "love of wisdom". It is a process of critical reflection and questioning about the world, knowledge and human existence.

A portfolio manager wanting to achieve long-term success must constantly develop such a critical thinking process.

But any investment philosophy, however thoughtful, is futile without the presence of a human quality which must be paramount: patience.

I leave the final words of this letter to Alexandre Dumas with an extract from his novel *Queen Margot*:

"To wait. All human wisdom is in this single word. The greatest, the strongest, the most skilful is he who knows how to wait."

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 our companies have better growth prospects than average.

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 businesses with solid balance sheets and dominant business models, along with purchasing their shares 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 2020 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 2019, 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 2019 :

    - Giverny Global Portfolio: TSX 16% Russell 2000 41% S&P 500 41% MSCI EAFE 2%
    - 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 and Charles Schwab 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.