# Annual Letter to our Partners 2021

Manuel Mathieu
To begin where I end, 2021
Acrylic, chalk, charcoal, and tape on canvas
Giverny Capital Collection
Photo : Guy L'Heureux

## Historical Summary

It has been nearly 30 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). 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. François Campeau, who joined the Giverny team in 2018, also participates in the investment selection process. In 2009, we launched a US office in Princeton, New Jersey. We also partnered with a manager from New York, David Poppe, in early 2020. He manages Giverny Capital Asset Management, based in Manhattan. Our two directors of our 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 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 the cover of the 2021 Letter

We illustrate the cover page of our annual letters with a reproduction of a work from the Giverny Capital Collection. This year, we have selected a painting by Quebec artist Manuel Mathieu entitled "To begin where I end".

For the year ending December 31st 2021, the return for the Rochon Global Portfolio was 27.0% versus 21.0% for our benchmark, which represents a relative outperformance of 5.9%. The returns of the Rochon Global Portfolio and our benchmark include a loss of approximately 0.4% 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 15.7% versus 9.9% for our weighted benchmark, representing an annualized outperformance of 5.9% over this period of 28 years. 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% |
| **2020** | **12.9%** | 15.1% | **-2.2%** | -2.0% |
| **2021** | **27.0%** | 21.0% | **5.9%** | -0.4% |
| **Total** | **6335.8%** | **1356.4%** | **4979.4%** | **-1.1%** |
| **Annualized** | **15.7%** | **9.9%** | **5.9%** | **0.0%** |

* All returns are adjusted to Canadian dollars
** Index is a hybrid index (S&P/TSX, S&P 500, Russell 2000, MSCI EAFE) which reflects weights of the 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.

## Effect of the Canadian dollar versus the US dollar on our returns

The second question I've heard most often since my start as a portfolio manager concerns the potential effect of fluctuations in the Canadian currency compared to its American counterpart (the first question is, of course, *is it a good time to invest in the stock market*?) It is informative to observe in the table above that the currency fluctuation effect ultimately had virtually no impact on our returns: since 1993, the Canadian dollar has appreciated a total of 1.1% against the US dollar—corresponding to an annualized effect of -0.04% on our returns.

## 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 approximately to the US portion of the Rochon Global Portfolio. In 2021, it realized a return of 27.9% compared to 28.7% for the S&P 500. The Rochon US Portfolio therefore underperformed its benchmark by 0.8%.

Since its inception in 1993, the Rochon US Portfolio has returned 5438%, or 15.1% on an annualized basis. During this same period, the S&P 500 has returned 1746%, or 10.8% on an annualized basis. Our added value has therefore been 4.3% 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%** |
| **2018** | **-8.3%** | -4.4% | **-3.9%** |
| **2019** | **32.1%** | 31.5% | **0.6%** |
| **2020** | **16.0%** | 18.4% | **-2.4%** |
| **2021** | **27.9%** | 28.7% | **-0.8%** |
| **Total** | **5438.1%** | **1745.6%** | **3692.5%** |
| **Annualized** | **15.1%** | **10.8%** | **4.3%** |

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

## 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 2021, the Rochon Canada Portfolio returned 30.9% versus 25.1% for the S&P/TSX, therefore outperforming its index by 5.8%.

Over 15 years, the Rochon Canada Portfolio has returned 964%, or 17.1% on an annualized basis. During this same period, our benchmark had a gain of 156%, or 6.5% on an annualized basis. Our annual added value was therefore 10.6%.

| Year | Rochon Canada | S&P/TSX | +/- |
|---|---|---|---|
| **2007** | **19.7%** | 9.8% | **9.9%** |
| **2008** | **-24.6%** | -32.9% | **8.3%** |
| **2009** | **28.2%** | 33.1% | **-4.9%** |
| **2010** | **26.7%** | 17.6% | **9.1%** |
| **2011** | **13.5%** | -8.7% | **22.2%** |
| **2012** | **24.0%** | 7.2% | **16.8%** |
| **2013** | **49.4%** | 13.0% | **36.4%** |
| **2014** | **20.3%** | 10.6% | **9.7%** |
| **2015** | **16.0%** | -8.3% | **24.3%** |
| **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%** |
| **2020** | **12.1%** | 5.6% | **6.5%** |
| **2021** | **30.9%** | 25.1% | **5.8%** |
| **Total** | **964.3%** | **156.0%** | **808.3%** |
| **Annualized** | **17.1%** | **6.5%** | **10.6%** |

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

Our largest Canadian holding is which rose 42% in 2021—the primary source of the higher returns for our Canadian portfolio (we'll return to this corporation in the "Our Companies" section).

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.

## 2021

> *"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us, we were all going direct to Heaven, we were all going direct the other way--in short, the period was so far like the present period that some of its noisiest authorities insisted on its being received, for good or for evil, in the superlative degree of comparison only."*

You probably recognize the famous first paragraph of *A Tale of Two Cities* by Charles Dickens. Written in 1859, these words still ring true in our world turned upside down by COVID-19 (Dickens' story is set at the time of the French Revolution).

It’s hard not to be pleased with a 27% return this year as an investor. It was the 6th best year out of 28 for our portfolio (excluding the half year for 1993).

The companies that make up the S&P 500, as a whole, reached a record level of profitability (as measured by their profit margins). Dominant companies—like Amazon, Apple, Facebook, Google, Microsoft and Netflix—created revolutionary products and services that transformed our lives. They have economic models with almost unparalleled competitive advantages in the history of our civilization. Other companies—like Pfizer/BioNtech, Moderna and Astra Zeneca—created coronavirus vaccines at lightning speed and helped save millions of lives. The benefits of American-style capitalism are more evident than ever.

On the other hand, however, COVID-19 has greatly affected our lives for two years—first and foremost in terms of the many fatalities it caused.

The pandemic also profoundly affected the nature of what freedom and the entrepreneurial spirit mean to us. While some sectors experienced good growth in spite of the lockdown of citizens, other sectors — such as restaurants, hotels, commercial real estate, the arts, air transportation, everything related to tourism, etc. — suffered greatly. The level of dichotomy between diverse “economic cities” has been unprecedented.

And the magnitude of the challenges that await us does not stop with a pandemic. Global warming continues to be a major issue that we are slow to tackle ardently. In addition, the invasion of Ukraine in early 2022 further increases our concern about the legitimacy of democracies around the world.

Humanity’s search for plenitude has faced challenges for as long humanity has existed. Just over the course of the last century—think of the Spanish flu, Nazi Germany, Soviet totalitarianism, and the proliferation of nuclear weapons—some of these challenges seemed insurmountable at the time.

It is obviously not the role of Giverny Capital to venture into the fragile and slippery terrain of political and social debates. Our mission is to be good stewards of our partners' capital. We have always been capitalists who value integrity, transparency, meritocracy, and entrepreneurial freedom. And it is these values that continue to be our beacons during these cloudy times.

No crises, whether economic, geopolitical, or social, have managed to undermine Benjamin Graham's fundamental investment approach by one iota. Almost a century ago, in 1934, Ben Graham and David Dodd published a book called *Security Analysis*. The authors stipulated that investing in the stock market is first and foremost about acquiring fractional ownership in businesses and that a business’ intrinsic value will eventually be reflected in a company’s stock price over the long term.

I would add that I have always been keen to emphasize the importance of another vital ingredient in the business world: optimism. Over the centuries, nothing has ever been built with pessimism. It is essential to constantly put forward a positive attitude even if, at times, it can become difficult not to succumb to feelings of fatalism.

Large numbers of citizens of London lived in abject poverty at the time of Charles Dickens. The infant mortality rate was 20% and life expectancy was 37 years in impoverished neighborhoods. Tuberculosis, cholera, rickets, scarlet fever, typhoid fever, and smallpox wreaked havoc on an annual basis.

Our capitalist civilization, despite its flaws, has enabled its citizens over the course of two centuries to double their standard of living every 36 years (an annual increase of approximately 2%). Believe it or not, this means that the average standard of living likely increased by a factor of more than 25 times since the publication of *A Tale of Two Cities*.

The percentage of people living in extreme poverty in the world has fallen from 87% in 1850 to less than 10% today. I do not believe that Charles Dickens could have envisioned such a world as we have today back in 1859.

**The market in 2021**

Financial markets did very well in 2021. Once again, the S&P 500, powered by a few dominant companies, outperformed the majority of indices around the world. The companies in our portfolio have also been able to hold their own.

Companies, both those in the S&P 500 and in our portfolio, saw their profits increase substantially. Part of this increase is linked to a rebound in the economy relative to 2020, a year of declining profits, and another part is related to a sharp increase in profit margins.

Inflation has certainly played a role in the rise of corporate profits. It should be noted, however, that the usual side effect of inflation, namely a probable increase in interest rates, has not yet had an effect on the economy and on interest expenses borne by companies.

Inflation is an integral part of our capitalist system. Although the rate varies from one period to another, it has continually been a factor within our system. This is why we have always favored companies that, in our opinion, have significant competitive advantages that allow them to increase the price of their products and/or services.

The Rochon Global portfolio slightly underperformed the S&P 500 in 2021. One of the reasons is that we had a lower weight than the index in technology stocks and this was the source of weaker relative returns. We of course still have investments in technology companies like

But we didn't own some of the big market stars of recent years.

In 2021, of the 27% rise in the S&P 500 (excluding dividends), Microsoft, Nvidia, Apple, Alphabet and Tesla contributed one third of the return. The other two thirds of the increase came from the other 495 companies. Of these five giga-cap stocks, which disproportionately influence the S&P 500, two seem to us to be valued extremely optimistically by the market: Nvidia and Tesla.

Nvidia had a market value of $735 billion dollars at the end of the year. Analysts predict revenues of $35 billion in 2022 and about $14 billion in profits. The estimated price-earnings is therefore more than 50x. As for Tesla, the company's market value was over $1 trillion dollars (1000 billion) at the end of the year. Its estimated revenues in 2022 are $84 billion and its profits estimated at around $11 billion for a price-earnings of around 90x.

For more than 28 years, we have always advocated an approach favoring a selection of exceptional companies with a level of intrinsic risk, both in terms of the business model and the stock market valuation, that we've appraised to be lower than average.

And there are always opportunities to do better than average for investors who have taken a "value" approach. We thus continue to unearth securities for our portfolio which—we believe—should be able to continue generating higher returns than the indices.

**The flavor of the day**

*Each year, this section addresses securities or segments of the investment world that seem dangerously popular to us. The purpose, of course, is not to criticize fellow investors. We are aware that investing wisely is not easy. Our objective is to simply point out valuations levels to our partners that appear to us as reflecting overly optimistic scenarios and therefore present a higher level of risk to investors given an eventual normalization of valuations.*

A strange trend over the last few years is that of stocks that have been called "meme stocks" (the best known being GameStop). Groups of investors believe that they can control the price of a stock without any correlation to its intrinsic value[1]. This strategy is doomed to failure in our opinion because our fundamental principle is that the price of a stock invariably ends up trading at a level close to its intrinsic value over the long term. But this craze is only limited to a few stocks.

Everything related to cryptocurrencies still seems to be the flavor of the day and on a much larger scale. The total value of all these virtual currencies reached $2 trillion (2000 billion) dollars by the end of the year. In our humble opinion, an entire financial sector seems to have been created on an asset whose intrinsic value seems completely arbitrary. Wall Street is obviously on board, sniffing out a whole new source of commissions, and several financial institutions followed for fear of missing the gravy train.

Even a few entities from the art world have joined this universe with the creation of NFTs (non-fungible tokens) which is—to put it simply—a form of digital securitization for works of art. It seems to me that some dangers also exist for this new product which has similarities to cryptocurrencies.

There is a nebulous line between what could be considered an investment and what could be considered speculation. One way to discern them is to ask yourself the following: if the stock market were closed for 10 years, would I be happy owning this security?

An investor believes that if the company in which he is a shareholder increases its intrinsic value by increasing its profits at a rate of (say) 10% per year, in 10 years, his or her investment will have increased its intrinsic value by 160%. Owning a productive asset (and being able to value it) does not require a short-term stock price; in the same way that the value of a dairy farm is measured by the amount of milk it produces. If the only objective, however, is the hope to sell the security to someone else for more in a fairly short period of time, this requires a short-term price and this resembles more a form of speculation.

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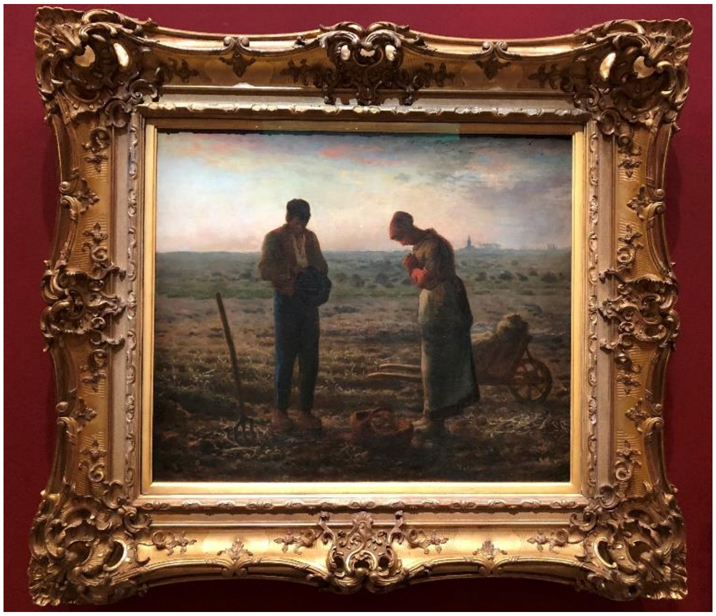
[1] A practice similar to the activity known as "cornering the market".

Speculation is, of course, neither illegal nor immoral. But speculating can be a perilous activity—at any time during human history. This is obviously not the first time that an asset has become dangerously popular. One of the most famous speculative bubbles was that of tulip bulbs in Holland during the 17th century. At its height, in early 1637, the price of a single tulip bulb corresponded to the price of 12 acres of land[2]. The value of the most beautiful tulip bulb at the time has been estimated at more than 5,500 guilders—or the equivalent of approximately $750,000 in today's US dollars.

**The (financial) history of The Angelus by Jean-François Millet**

The Angelus is a painting by the great French painter Jean-François Millet, produced between 1857 and 1859. It is a masterpiece which is exhibited at the Musée d'Orsay in Paris and is also one of my favorite paintings in the history of art.



Jean-François Millet, *L'Angélus,* 1857-1859; Oil on canvas; 56x66 cm
Bequest of Alfred Chauchard, 1909; Paris, Musée d'Orsay; Photo: F.R.

You are probably wondering where I'm going with this at this point—isn't this a letter intended for financial investors? Leaving aside the incredible artistic contribution of this painting, I would like to tell you about the misadventures of one of its owners.

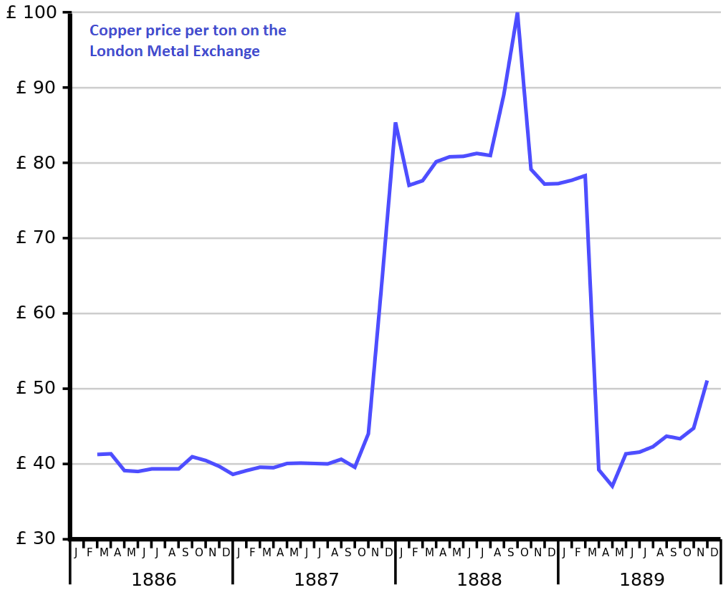
Before ending up at the Louvre (and then eventually at the Musée d'Orsay), the painting had several owners. Although he never took delivery, Thomas Gold Appleton commissioned the work around 1857. The piece was initially acquired in 1860 for 1,800 francs by Alfred Feydeau. The painting then changed hands a few times, eventually to be acquired for 160,000 francs in 1881 by a copper industrialist, Eugène Secrétan.

Of humble origins, Mr. Secrétan was self-taught. Through hard work, he became one of the French specialists in the processing of non-ferrous metals and became head of the *Société industrielle et commerciale des métaux*, a holding company comprised of six companies and more than 3,000 employees. These companies were specialized in the mining of copper, lead and tin. In 1878, he was one of the donors of the copper used to create the Statue of Liberty (300 tons donated) and was named Knight of the Legion of Honor.

[2] According to the book *Extraordinary Popular Delusions and the Madness of Crowds* by Charles Mackay

He then created an exceptional collection of works of art (including The Angelus) with his fortune.

Mr. Secrétan, attracted to speculation, began to acquire tin and lead in the fourth quarter of 1886. He then discovered that the world supply of copper had been reduced to 40,000 tons and that prices fell below 36 pounds sterling per ton. He gathered up around sixty million francs to control the supply of copper with the help of a group of financiers. In three months, prices rose to 84 pounds per ton. In 1888, his company had to raise 37.5 million francs in capital to cope with higher prices and to fund additional mining activities.




Copper prices at the London Metal Exchange, during the cornering of the copper market[3].

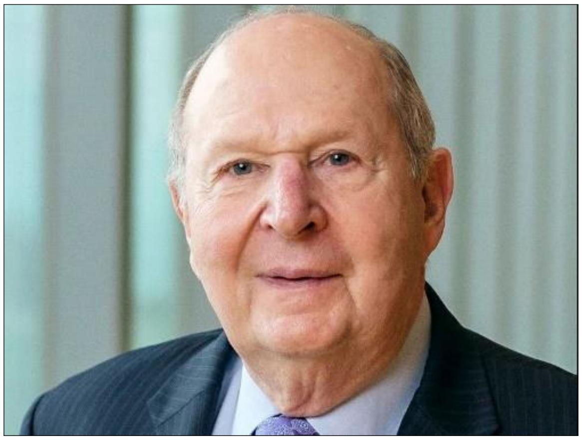
In early March 1889, following the greatest financial speculation in the history of copper production, the price of copper collapsed, and with it the shares of *Société industrielle et commerciale des métaux*. In financial difficulties, Mr. Secrétan had to part ways with his extensive art collection, including The Angelus. The businessman and collector Alfred Chauchard acquired it for the incredible sum of 750,000 francs—a price that held the record for the most expensive modern painting ever purchase for quite some time. Mr. Chauchard bequeathed The Angelus to the Louvre upon his death in 1909.

Mr. Secrétant, however, managed to recover from his losses and began rebuilding his business using a new technology for manufacturing copper tubes by electrolysis. But despite his end-of-life success, copper speculation caused him tremendous troubles, as well as the loss of The Angelus.

It is such a shame to see people who are already rich speculate to the point of endangering their fortunes. As Warren Buffett says, “You just need to be rich once.” Speculation today (with bitcoin or otherwise) is certainly more sophisticated than before, but the very nature of speculation remains just as dangerous.

[3] Source: Wikipedia

## Lou Simpson (1936-2022)



Source: Crain's Chicago Business

It is with great sadness that we learned of the passing of Louis Simpson in January 2022. Lou had a fantastic career in the investment world. He worked as a portfolio manager at GEICO (a subsidiary of Berkshire Hathaway since 1996) for more than 30 years, from 1979 to 2010. He obtained exceptional returns during these four decades.

For several years, Warren Buffett pointed to Lou as his potential successor as fund manager under Berkshire. I invite you to read (or re-read) the excellent book "The Warren Buffett CEO" by Robert Miles in which a chapter is devoted to Lou. Our colleague Allen Benello also devoted a chapter to Lou in the book "Concentrated Investing".

Lou decided to leave Berkshire Hathaway in the early 2010s and founded his own firm with his wife Kimberly: SQ Advisors. Jean-Philippe and I had the good fortune to meet him at his home in 2014. We've had long conversations with Lou and Kimberly about equity investments a few times since then. We also shared other passions with them, such as the arts and wine. In their constant great generosity, Lou and Kimberly shared their best bottles when JP and I went to visit them in Chicago. It's not every day that you get to share a Château Margaux with one of our heroes!

Lou has created a lot of wealth for GEICO shareholders, for Berkshire and for its clients. Lou and Kimberly have also been very generous with their fortune through numerous philanthropic activities. I will miss him very much.

## 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."

| | 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% |
| 2020 | -2% | 15% | 17% | -9% | 18% | 27% |
| 2021 | 32% | 28% | -4% | 48% | 29% | -19% |
| Total | 2474% | 2817% | 343% | 676% | 1152% | 476% |
| Annualized | 13.3% | 13.9% | 0.5% | 8.2% | 10.2% | 2.0% |

* 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

This year, the intrinsic value of our companies, as a whole, increased by about 32% (with dividends included). Despite some of the changes to our portfolio during the year, we consider our estimate of EPS growth at our companies during 2021 to adequately reflect their economic realities. The performance of our portfolio on the stock market was a gain of roughly 28% (net of any currency effect). Our stocks therefore realized a price performance that was less than their underlying economic performance. This corrects, in part, the inverse situation which occurred in 2020.

The companies that make up the S&P 500 index also experienced a sharp increase in their profits this year, rising by around 48%. The index achieved a total performance of 29% (in US dollars).

Since 1996, our companies have grown their value by about 2474% and their stocks have achieved a total return of approximately 2817%. On an annualized basis, we achieved an intrinsic performance of 13.3% versus 13.9% for their stock market performance (dividend included in both cases).

Here are the figures over the course of the last decade, from the end of 2011 to the end of 2021:

| | Rochon Global Portfolio | | | S&P 500 | | |
|---|---|---|---|---|---|---|
| **Annualized** | **Value *** | **Market **** | **Difference** | **Value *** | **Market **** | **Difference** |
| **2011-2021 ***** | **14.0%** | **17.6%** | **3.6%** | **9.8%** | **16.5%** | **6.7%** |

* 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

It is interesting to note that over the last decade our companies have increased their intrinsic value by 14% annually compared to almost 10% annually for the companies in the S&P 500 (roughly in line with our long-term historical figures). Our stocks have done well, increasing by approximately 17.6% per year (net of any currency effect). Thus, our companies on the stock market have done about 3.6% per year better than the intrinsic performance of the underlying companies. This reflects an increase in the price-earnings ratio of our companies during this decade. Indeed, in 2011, equities in general were greatly undervalued and the subsequent revaluation seems justified to us.

However, for the S&P 500, the increase in valuation was much greater (around 6.7% annually). So the stock market revaluation for the index was much more pronounced than for our companies and probably also vis-à-vis most of the other indices in the world. In our opinion, it is very unlikely that this will continue in the future.

We are confident that if our companies continue to grow their intrinsic value at higher-than-average rates, the market performance of their shares will follow suit—in absolute terms and also relative to indices, as it has since 1996.

## Five-year Post-mortem: 2016

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 2016, but here are a few remarks from reviewing the annual letter from that year.

In 2016, we acquired shares in Heico company. This company has two divisions: the manufacturing of parts for the aviation industry and an electronic products division. The first is the one that caught our attention. Heico sells alternative (non-original) aeronautical parts to aviation companies. It is very difficult to obtain Federal Aviation Administration (FAA) approvals to supply aircraft parts. With its vast number of approved products, developed and commercialized over several years, Heico has a very significant competitive advantage.

Of course, Heico has been greatly affected by the major recent issues affecting the airline industry around the world. Despite this, from 2016 to 2021, Heico's EPS grew from $1.39 to $2.51, the equivalent of an annual growth rate of 13%. The stock has done even better in the stock market, climbing more than 200% since our first purchase. One of the reasons for our purchase in 2016 was our admiration for the members of the Mendelson family who run the company—this admiration has only increased since.

## Our Companies

*Note: This section of the annual letter is always long. We want to provide you with an accurate update of the companies in our portfolio companies. In fact, we are trying to present you with the information we would like to know if our roles were reversed.  Prices are as of December 31, 2021.*

# *Section of the letter reserved for Giverny Capital's partners*

## The Podium of Errors

Following in the "Givernian" tradition, here are our three annual medals for the "best" errors of 2021 (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: A2 Milk

We acquired A2 Milk during the summer of 2020. Based in New Zealand, the company manufactures milk and milk products (primarily infant formula) based on a variant of milk that many consumers find easier to digest than conventional milk. The A2 beta casein protein is present in breast milk and some breeds of dairy cows, although most dairy cows produce both A1 and A2 beta casein protein. It is the A1 protein that may cause discomfort in some consumers. The company has become a leader in this niche and had experienced strong growth in recent years. One of the key markets for the company is China.

Some of its sales in China were through independent distributors who traveled to Australia to buy the company's infant formulas and bring them back to China (a distribution method called *daigou*). During the first part of 2020, this mode of distribution continued despite the pandemic and reassured us of the solidity of this business model. But then, the daigou slowed considerably later in 2020. The company had to reduce its sales and profitability forecasts and the stock fell.

We thought at the time that it was a temporary problem that should resolve itself within a few quarters. We realized in 2021 that A2 Milk's challenges were more persistent than anticipated and we decided to sell our shares.

We had invested about 2% of the portfolio in this company and sold at a loss—it was a very disappointing investment.

### Silver Medal: Old Dominion Freight Line

I have always followed the trucking industry since the beginning of my investment career. We once held shares in the Quebec company Groupe Goyette. Subsequently, we had shares in Heartland Express and then Knight Transportation in the early 2000s. It's an industry that, when well managed can have good fundamentals despite its cyclical tendencies and its dependence on various factors such as finding qualified drivers and dealing with the price of fuel.

The stock market experienced (another) correction in 2018 and I had studied Old Dominion Freight Line, based in North Carolina. The company's track record was phenomenal. From 2006 to 2018, EPS had grown from $0.58 to $4.97, or an annual growth rate of nearly 20%. Its net profit margins reached 15% which is a rare level in the industry. The management team seemed to me competent and motivated (management owns 12% of the shares). The stock was trading at around $90, or 18 times the company's profits. This valuation seemed high to me for a trucking company, even for the best, so I decided to wait.

In 2021, the company achieved EPS of $8.86 and the outlook is for over $10 in 2022. EPS will likely have doubled in four years and the stock is currently trading at $288. We could therefore have tripled our money in a little over three years if I had agreed to pay a slightly high evaluation (justified *a posteriori*) for this exceptional company.

**Gold Medal: Fox Factory Holding**

Jean-Philippe and I frequently attended the ICR investment conference in Orlando before the pandemic. Several dozen companies present their outlooks and no one needs to twist our arms to warm up for a few days in early February.

At the 2016 conference, I listened to a presentation from a company I had never heard of: Fox Factory Holding. The company was a leader in a niche product: shock absorbers for mountain bikes. It had also started selling products for utility trucks and the company was very profitable and had good growth prospects. The stock was trading at around $16, which was a reasonable valuation for the expected EPS of $0.96 in 2016. The stock then quickly climbed to $20 and I chose to wait for a *better price*.

I have continued to follow the company closely and its performance has been nothing short of phenomenal. It has developed many new products and new markets and, in only five years, its revenues have more than tripled and its EPS reached $4.50 in 2021—or more than four times the level of 2016. Analysts forecast EPS greater than $5 for 2022.

The stock has soared 500% in six years and reached $100.

**Conclusion: The greatest mistakes by investors (take 4).**

As I stated at the beginning of this letter, the question that comes up most often is always the same: "Is this the right time to invest in the stock market?" It is good to come back to this important question in these (once again) uncertain and worrying times.

Let's first go back to our 2003 letter to partners to answer this question, when I presented an article by André Gosselin on investor results versus the performance of the S&P 500. He explained that there was a huge difference between the results of mutual fund holders in the United States and the leading stock market index.

André was inspired by the results of the research firm Dalbar on the behavior of stock market investors. This firm publishes a fascinating research report annually on the results of all US investors invested in mutual funds compared to indices. We also referred to this data in the 2006 and 2014 annual letters.

The underperformance of investors vis-à-vis the indices over a long period is such that André published a book in 2004 on this subject entitled "An open letter to irresponsible investors". The title is a little harsh, but André nevertheless presents several important points for investors. I am talking again about this book because a second edition has just been published[4]. André hence provides an update on Dalbar's figures.

*"According to the financial information firm Dalbar, the holder of equity funds in the United States achieved an average annual return of 6.24% between 1990 and 2020, while the return of the S&P 500 index has been 10.7%; a shortfall of 4.46% per year in terms of annualized return. .... For the holder of fixed-income mutual funds, the situation is worse. Also between 1990 and 2020, investors who invested in fixed-income funds settled for an annual return of 0.45%, while the benchmark Bloomberg-Barclays Aggregate Bond Index provided an average annual return of 5.86%".*

This 4.5% annual underperformance over three decades for holders of equity mutual funds (and even more so for bond funds) cannot be explained by management fees. The only plausible explanation is that investors, as a whole, consistently buy and sell their funds at inopportune times. In other words, they veer from stocks to bonds and back inappropriately. This underperformance is therefore mainly behavioral in origin.

The only solution for the investor who wants to avoid falling into the trap of this behavioral penalty is not to try to predict the stock market. It is vital to always keep this in mind, especially in periods of declines and/or crises.

From the start, I made the decision to always be 100% invested in the stock market. Rather than futilely attempting to predict the market, I focused my efforts on finding high quality companies for our portfolios. It is the opinion of all of us at Giverny Capital that this remains the strategy with the best probability of success.

## 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 realize that we live in uncertain times, although a wise observer of human history might ask the question: "Were they ever certain?". We want you to know that we are fully aware of and grateful for your vote of confidence. It is imperative for us to not only select outstanding companies for our portfolios, but to also remain outstanding stewards of your capital. We certainly like to achieve good returns (and have taken a liking to it), but it must not come at the cost of taking undue risk. Our philosophy is to favor companies with solid balance sheets and dominant business models, along with purchasing these companies at reasonable valuations.

Thank you from the entire Giverny Capital team and we wish a great 2022 to all our partners.

François Rochon and the Giverny Capital team

[4] André Gosselin – *Lettre ouverte aux investisseurs irresponsables* – 2022 edition – Éditions Guy Saint-Jean.

# APPENDIX A

## Investment philosophy

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

In 2021, 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 2021:
    - Rochon Global Portfolio : S&P/TSX 13% S&P 500 40% Russell 2000 40% MSCI EAFE 7%
    - Rochon US Portfolio : S&P 500 100%
    - Rochon Canada Portfolio : S&P/TSX 100%
- The returns for the S&P 500 (in $USD) are provided by Standard & Poors.
- The returns for the various indices used for comparable purposes are deemed reliable by Giverny Capital.
- It should be noted that currency effects on the returns of the Rochon portfolio and indices are estimated to our best effort.
- The custodian of our client portfolios is National Bank Correspondent Network (NBCN) in Canada and TD Ameritrade Institutional 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.

## Forward-looking information

Some information set forth in this letter constitutes forward-looking information which involves uncertainties and other known and unknown factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information. When used in this letter, words such as "expects", "anticipates", "intends", "may", "believes" and similar expressions generally identify forward-looking information. In developing the forward-looking information contained in this letter, the manager has made assumptions (for ex.: with respect to the outlook for the global economy and publicly traded companies). These assumptions are based on the manager's perception of factors believed to be relevant (for ex.: historical trends, current conditions, expected future developments). Although the manager believes that the assumptions made and the expectations represented by such information are reasonable, there can be no assurance that the forward-looking information will prove to be accurate. Actual results or events may differ materially from those expressed or implied in the forward-looking information. Giverny Capital Inc. undertakes no obligation to publicly update or revise these forward-looking statements.