Interview With François Rochon

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Years ago, my friend John Zemanovich spoke to me about his friend and colleague François Rochon of Giverny Capital. I did a little research on François and found his website, where I read his annual report. His results were impressive, but his thought process was even more compelling.

It's absolutely amazing how a "deep discount, margin of safety" investment philosophy transcends various backgrounds. A true student of Buffett and Graham, François has converted himself from an engineer by trade, into an exceptional investment manager with few equals. Since July 1st 1993, he has averaged 19.97% compounded annually, ending December 31, 2004.

François graciously agreed to participate in an interview, and it's my pleasure to present it to the MSN Berkshire Hathaway Shareholder's Board for your enjoyment.

Q&A Period With François Rochon

When and how did you learn about Buffett and Ben Graham? Was it at Montrusco or earlier?

Oh it was in my early beginning around the end of 1992 or so. I read about them in articles. My good friend Bernard Mooney is the one that introduced me to Buffett's annual reports in 1993 which was the real turning point.

Charlie Munger often mentions that the best businessmen and investors tend to come from backgrounds with a diverse base of knowledge. Like many other great investors, you originally did not come from a financial background. How has this affected your thought process?

I do think that my engineering background had a good impact (as Peter Lynch would say: "Imagine everything I did not have to unlearn"). I believe that a science education gives you a more analytical and rational mindset. I probably think more about how to understand the true nature of investing, how can you really over perform others over the long run, etc.

When you know about science, you become very skeptical of modern portfolio methodology (beta, standard deviation, etc.) and of the so-called neural and automatic ways to build portfolios. Because it's so obvious to me that you can't judge portfolio's results over a few years, considering how irrational and unpredictable market quotations are in the short run. How can you be not amused by people that judge their quarterly results by measuring stock market returns at the nearest 0.1% ?

What is your favorite investment book that most of us have never heard of?

Well that's a tough one since you guys have read so much. I would choose the book written by the founder of Value Line, Arnold Bernhard, in 1959 called "The *evaluation of common stocks". I found it at a used book store in New York City and paid $1 for it. There's also a very good chapter on investing in the stock market in J. Paul Getty's book: "How to be rich".*

Hypothetical Question: Let's say that you knew you were going to lose all your memory the next morning. Briefly, what would you write in a letter to yourself, so that you could begin relearning everything the next day?

"Read Warren Buffett's annual reports on www.berkshirehathaway.com". It would then lead me to Fisher, Graham, Munger and lots of other great teachers.

How do you determine when you've found a good investment? Which factors have the most weighting: management, numbers, price/value, general economic performance, etc.?

I always start with the numbers: last 10 years' revenues, profits, ROE's, margins, etc. I compare with similar players in the industry. Sometimes, a company stands out.

I then try to find out why. What do they do that is better than the others (do they have a "moat" or not)? I read the message of the CEO and interviews with him. I then try to figure out what the next 5 years (or 10 if I can) will look like. I want companies that can grow the EPS going forward at twice the average growth rate or better (12% and more).

I look at how much management have invested in the company, how much they get in salaries and the level of stock options.

In the end, investing in a company is all about becoming partners with its top management. I have to believe that these are outstanding people. They care about building something that will last not for their own good but because they get fulfillment in the art of building itself. And they care about treating everyone involved (clients, suppliers, employees, shareholders) fairly.

Good businessmen (or businesswomen) are like artists: they have to do something with passion, something innovative and unique, that will last and that will eventually inspire others.

In the final process, I try to figure out how much this marvelous company should be worth, and try to buy it in the market at half of what I believe it should trade in 5 years if everything goes somehow as planned (so to make 15% a year).

How do you determine when to exit from a position? Is it more art or science?

We sell for one of those 4 reasons:

- *I've made a mistake*
- *The fundamental of the business has deteriorated or I don't agree with a management decision (which could be a prelude to deterioration).*
- *The stock looks to me way too pricey in the market.*
- *I've found a better opportunity. It then makes sense to sell A stock to purchase shares of B stock*

I would add that the science part of it is to be disciplined: not to sell for irrational (read emotional) reasons. In the end, we have to sell when basically the reasons for purchasing a company in the first place are not valid anymore.

The art part of it is to be able to feel that there is something wrong with the company. We have to be able to read between lines to detect that things are not adding out right.

How do you reconcile buying technology companies based on value and business durability?

Basically, I have the same approach. I ask myself: Can I understand the business? Where will it be in 5 years or so? Do I trust the people *managing the company? Does valuation make sense?*

You have to accept – if you do decide to invest in such an area of the economy – that the rate of change is rapid. So, do not succumb to denial, as for the ever changing nature of the industry is more important than ever.

We did very badly with some high-tech securities (Vitesse Semiconductor) but very well with others. I bought shares of Intel and Sun Microsystems in 1994 and they turned out well for the years we owned them. But – for Sun Micro for example – you had to be ready to sell at some point when you felt the company could be left behind. Which I did in 1997, when I started to fear for Unix-based server's future.

As for Intel, it got quite pricey in 2000 (P/E in the 40's), so I then sold most of my shares. But I still believe that Intel – in the CPU market – has a solid and durable moat. It's not quite as large and deep a moat as Coke's moat, but it's a moat. And Microsoft has a very good moat in the operating system market.

So it is possible to find business durability in that industry. But you have to know history and realize that Burroughs, IBM, NCR, Remington Rand, Digital, etc. all missed a crossroad and never got back to their level of dominance afterward.

How much in assets do you now have under administration? How many people comprise Giverny Capital's investment team and staff?

We have $104 million under management. We're 5 people.

What is the best piece of advice you could give someone thinking of entering the investment management business?

Think for yourself (as Graham would say : "You're neither right nor wrong because people agree with you. You're right because your data and reasoning are right."). Be active (as a great painter paints, a great investor invests). And most important of all, be patient (good things do take time).

You've met many managers of great companies. Other than Buffett and Munger, which ones have impressed you the most and why?

They're so many of them. I like Robert Shillman at Cognex (Dr. Bob). His annual reports are so good. I met him 3 times and he behaved as such a great person each time. He genuinely loves his employees and he is a marvelous leader.

I really admire the founder of Fastenal, Robert Kierlin. He was a great example of integrity and an incredible businessman.

Peter Lewis at Progressive and Robert Wilmers at M&T Bank have created lots of wealth for their stockholders (moreover, M. Lewis and I share a passion for contemporary art).

I love reading Peter Rose's letters to shareholders (Expeditors Intl.) and his answers to questions (8-K).

In Québec, I admire Yves Des Groseillers, the CEO of BMTC Group, a great furniture retail chain. He's a master in capital allocation. In the same industry, I had the chance to meet Bill Child (R.C. Willey) twice. He's an inspiration to me. He's the kind of person, I'd like to become.

And finally, I would like to recommend reading "Plain Talk" by Ken Iverson, the great CEO of Nucor for 30 years, who sadly passed away in 2002.

Is Quebec sovereignty an issue in your investment decisions? What about any other prominent geopolitical situations?

Not at all. In general, to some degree, I don't care much about the political landscape. Good capitalists *adapt. If I'm right on that, a good businessman (businesswoman) should do well whatever the environment.*

I like reading about history, so I know that there always has been something to worry about (and always will be). In the case of Québec, it would not become a communist state, so business should not change that much. And its most important commercial partner is the U.S. and I don't see why this would change. But I like pessimism, for political reasons or whatever. I love it when other people sell their stocks to me for non-intrinsic value-related reasons.

In fact, I made my best investment in my career (so far) the day of the 1995 referendum (for some reason Québec's stocks were not popular that day): I bought shares of BMTC at $0.88 which compares to $13.50 today.

John Zemanovich would like to know why you bought Krispy Kreme? Was it business, or simply the doughnuts had blinded your decision-making? (John and François are the best of friends).

You can tell John I was not blinded; I was bewitched by their doughnuts. I liked the product, I liked the stores, I thought the brand was strong and obviously the company was doing well at the time I purchased some shares. I started with a small weight (1%).

In fact, most of the time, I start a new investment with a small weight. I believe that you should live a few months with your girlfriend before getting married! And I never increased the weight and did eventually sell after a few months of holding (at least I did that right).

Basically, I believe that the product is still good and that the Krispy Kreme brand should survive this crisis. But it seems to me now that the top management wanted to grow the business too rapidly. I should have thought twice about Peter Lynch's wise words: "More companies die of indigestion than of starvation" (pun intended!).

What do you do when great companies start to have significant problems? How do you decide which situations are recoverable, and which have become irreparable?

I go there and fix everything. No no, I'm joking. I try to see objectively if I would buy it today, if I did not own it already. If not, I just sell and do a postmortem to understand what went wrong. If I realized I made a mistake, it becomes eligible for my yearly medals in my annual report.

Which other investment managers (other than Buffett and Munger) do you hold in high esteem?

I admire Bill Ruane and Bob Goldfarb (Sequoia Fund) a lot. I love to sit down in the first row each year at Sequoia's meeting and hear every word that they have to say about investments. They have such clear minds and they lead a very impressive team of analysts.

I also like Eric Ende (Source Capital). I believe he invests wisely and with a very long term horizon.

Although I would not always buy the same securities as him, I admire Bill Miller tremendously. His quarterly writings are pure treasures.

Finally, I like the managers at Wasatch (a firm in Utah). They truly can dig up young and dynamic enterprises.

You have written for "Les Affaires" and "Webfin." You also write wonderful annual reports. Any future plans for an investment book?

I'd like to some day. Although, since I'm only 36, I do hope that I'm still in the first chapters of my life.

Finally, if you could only choose one, which would it be? A dilly bar, See's candy or a Krispy Kreme doughnut?

It’s so hot these days, I would go for a dilly bar. In fact, my favorite Berkshire dessert is an Oreo Blizzard at Dairy Queen.

Thank you very much François for taking the time to do this interview. Our boardmembers will continue to follow your success, and we look forward to your wonderful annual reports.