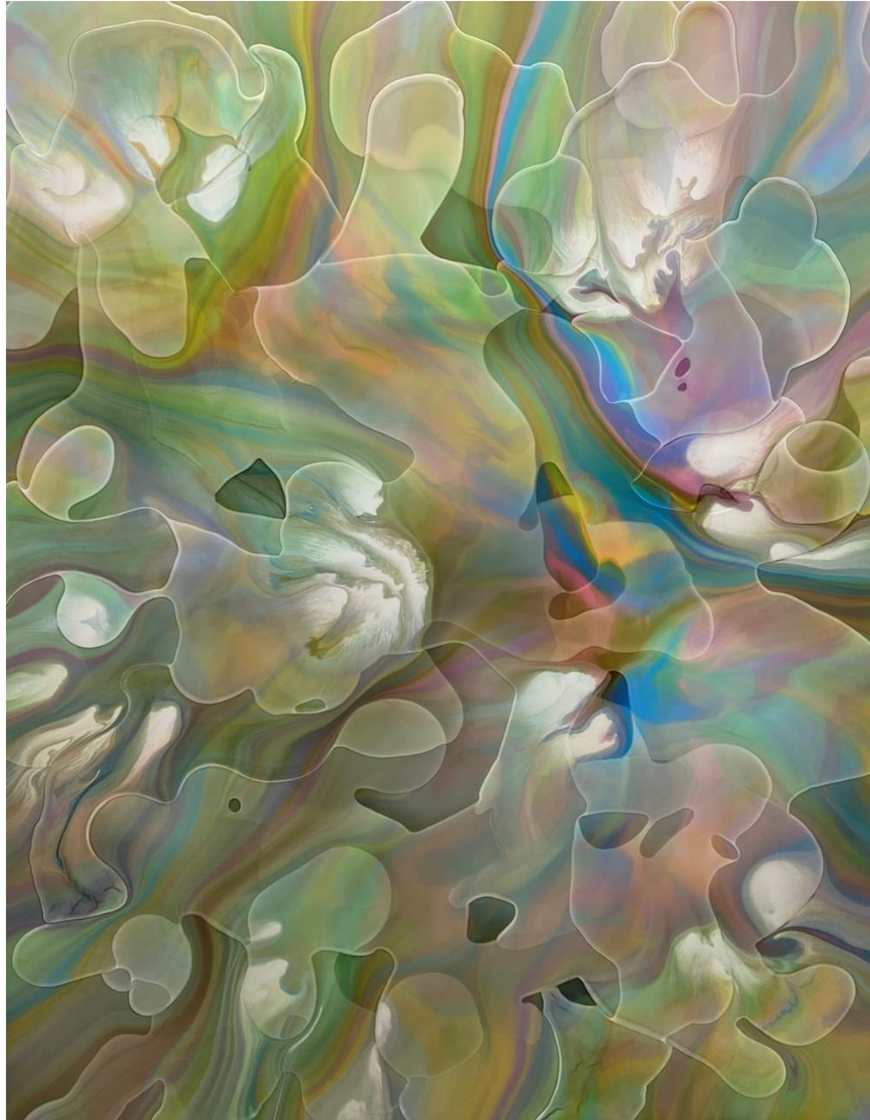
GIVERNY CAPITAL

Annual Letter to our Partners 2022



François Lacasse
Spectre V, 2021
Acrylic on canvas
Giverny Capital Collection

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 people 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. We try to be 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 2022 Letter

Yearly, 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 Québec artist François Lacasse entitled "Spectre V".

For the year ending December 31st 2022, the return for the Rochon Global Portfolio was -15.2% versus -12.3% for our benchmark, which represents a relative performance of -2.9%. The returns of the Rochon Global Portfolio and our benchmark include a gain of approximately 4.6% 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 14.5% versus 9.0% for our weighted benchmark, representing an annualized outperformance of 5.5% over this period of 29 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%
2022	**-15.2%**	-12.3%	**-2.9%**	6.8%
Total	**5355.0%**	**1177.3%**	**4177.7%**	**5.7%**
Annualized	**14.5%**	**9.0%**	**5.5%**	**0.2%**

* 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

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 depreciated a total of 5.7% against the US dollar—corresponding to an annualized positive effect of 0.2% 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 2022, it realized a return of -21.4% compared to -18.1% for the S&P 500. The Rochon US Portfolio therefore underperformed its benchmark by 3.2%.

Since its inception in 1993, the Rochon US Portfolio has returned 4256%, or 13.6% on an annualized basis. During this same period, the S&P 500 has returned 1411%, or 9.6% on an annualized basis. Our added value has therefore been 4.0% 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%**
2022	**-21.4%**	-18.1%	**-3.2%**
Total	**4255.7%**	**1411.3%**	**2844.4%**
Annualized	**13.6%**	**9.6%**	**4.0%**

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 2022, the Rochon Canada Portfolio returned -1.8% versus -5.8% for the S&P/TSX, therefore outperforming its index by 4.0%.

Over 16 years, the Rochon Canada Portfolio has returned 945%, or 15.8% on an annualized basis. During this same period, our benchmark had a gain of 141%, or 5.7% on an annualized basis. Our annual added value was therefore 10.1%.

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%
2022	-1.8%	-5.8%	4.0%
Total	**945.1%**	**141.1%**	**804.1%**
Annualized	**15.8%**	**5.7%**	**10.1%**

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 highly concentrated portfolio can materially exceed the performance of the indices.

2022

The year began with the tragic invasion of Ukraine by Russia. The rise in inflation that started in 2021 continued into 2022. Central banks raised their key interest rates, which had an effect on the market value of the majority of financial assets. These rate hikes could push Western economies into recession if some of them aren't already there as I write this letter.

Inflation is an integral part of our civilization, and the historical inflation rate has been around 3%. Over the past few decades, this rate had dropped slightly and, since I started investing in 1993, the inflation rate has been around 2% on an annualized basis. It was even below 1% for a few years. Now, it looks like we're trending back towards historical norms.

Since inflation is an inherent part of our capitalist system, the best we can do is to own companies which, we believe, will enable us to mitigate its negative effects. We have therefore always favored

businesses with competitive advantages which enable them to increase the price of their products and services in an inflationary environment.

Recessions are just as much an inherent part of our system. In 2008 and 2020, huge sums of capital were invested by central banks to limit the effects of these recessions. This has had benefits and this strategy is certainly based on good intentions. However, the probable side effect of such interventions is greater inflation and above all an increase in the recklessness of many investors, both institutional and individual (believing that their recklessness can be rescued by governments in the event of a financial crisis).

At Giverny Capital, we try to remain apostles of prudence and meritocracy. We believe that financial speculation creates situations of exaggerated valuations which are inevitably rectified by the invisible hand of capitalism. Governments can temporarily obstruct or slow down the movements of this invisible hand—they however cannot fundamentally alter its nature.

The good news is that despite the ups and downs of the economy, our civilization always creates more wealth thanks to a system—even if imperfect—which at its source is the vitality, dynamism and the capacity for progress by workers, business leaders and especially entrepreneurs. Since I started investing 30 years ago, the standard of living for citizens in North America has more than doubled. The stock market (as reflected by our benchmark) has generated total wealth creation equivalent to a more than 12-fold increase or a return of more than 9% annualized since 1993. And our own experience was even better.

<u>The stock market in 2022</u>

Financial markets had a difficult year in 2022. Aside from the energy sector (the S&P 500 energy sub-index climbed 59%) and a few industries considered more stable (but with slower growth rates), most sectors of the stock market experienced sharp declines.

Our performance relative to the indices was disappointing. First, we have always avoided investments directly tied to natural resources such as oil. Secondly, we avoid companies that have a low growth rate of their earnings (and consequently of their intrinsic value). Thirdly, two stocks contributed to our disappointing 2022 returns: Meta Platforms and Carmax. We will come back to these two holdings in more detail in the portion of this letter dedicated to our individual companies.

Our US banks were helped by the rise in interest rates, but less than expected. In return, they have increased their reserve for bad loans in the event of a recession in 2023. We are confident that the situation is cyclical in nature and that their profits will reach new records in the next economic recovery.

To a lesser extent and despite good results, our companies linked to the residential construction sector also experience a drop of their share's market value. The stock market is clearly anticipating a tough year in 2023 for the sector. Already at the end of 2022, due to the rise in interest rates, the economic data for new orders are falling sharply. The medium and long-term outlook, however, remains excellent. For most of the past 15 years, the number of homes built has not kept pace with population growth in the US which created a high level of pent-up demand. We believe that the number of new homes needed to return to equilibrium is over two million annually (compared to an annual construction level of one million).

Even though our performance was disappointing, we did avoid some of the speculative market segments which experienced much more drastic declines, often in the order of 60% to 90%. These declines seem justified to us in many cases and could take several years to recover.

Stock market declines: When a stock turned out to be discounting many years of growth

In 2022, several stocks that floated in the stratosphere of fantastical valuations returned to Earth. It is difficult to assess the intrinsic value of a company when it is not earning a profit and, in a bear market, the realization that there is no floor to a valuation can cause a stock to fall sharply. There are many stock market declines that turn out to be unjustified and temporary, but others are less temporary.

We have always looked for securities whose intrinsic value appears to us to be higher than their market price. So, if a company is likely to be worth—say $100 per share—it is quite possible that in a bear market, its stock price corrects from $70 to $50. What was undervalued just became more undervalued. The best remedy in this case is to remain patient knowing that one day or another the stock market will invariably reflect the intrinsic value of any company.

It's a completely different story for a company whose stock was trading at $100 but whose intrinsic value, as calculated with a reasonable margin of error, seems to hover around $25. If the stock drops 70% to $30 in a bear market, that doesn't automatically make it a bargain.

To illustrate this point, let's take the example of a solid company: Cisco Systems. I know Cisco well since I had acquired shares in 1997. I had sold them a few years later when the valuation had become extremely high.

Chart 1: Cisco Systems stock from 1999 to 2022 (Source: Factset)

As you can see on this graph, the stock had risen from $23 to $80 from January 1999 to March 2000. At its high of $80, the stock was trading at 120 times the earnings per share (EPS) of $0.65 generated in 2000. The stock then corrected sharply from $80 to $10 over the following two years. The stock then traded in a range of $15 to $30 for the next 14 years.

The stock ended 2022 at around $50. During that period, the company itself has performed well: its EPS reached $3.36 for its 2022 fiscal year which represents a compounded annual growth rate of

approximately 8% over 22 years. If we include the dividends of $11.5 received over the course of that period, the stock has generated a negative total return of approximately 20% over the long period since its zenith in 2000. Cisco is indeed an excellent company but its stock was simply way too expensive in early 2000.

In our view, several popular stocks in 2021 that fell sharply in 2022 could follow a similar course in the years to come. At Giverny Capital, we always try to keep in mind the important rule taught by Ben Graham more than 70 years ago: the importance of having a margin of safety when valuing a company.

The real cost of stock options

*** Warning: This section is related to accounting and may cause drowsiness.*
*It can thus be skipped by our partners who are less interested in the subject. ***

We believe it's appropriate to discuss once again this year the subject of stock options (i.e. employee stock options issued by companies which we'll abbreviate as "ESO").

At the end of the 1990s, during the infancy of the so-called "new economy" companies, the level of ESO became very high for many nascent companies. Warren Buffett then campaigned for better accounting of these costs. His argument was simple: "If ESOs are not a form of compensation, what are they? And if compensation is not included as an expense item, in which part of the income statement should they be?" The accounting bodies looked into the matter and came up with a new GAAP (Generally Accepted Accounting Principles) formula for adding an expense for ESO based on the Black-Scholes model. In our opinion, this is an imperfect model but it is better than no model at all! The accounting profits of many companies were then reduced, from modestly to greatly.

But as the stock market rallied sharply after the 2008 financial crisis, ESOs became increasingly important again for many companies, especially in the high-tech industry. Many Wall Street analysts and companies started reporting an additional figure to their results: non-GAAP profits which often exclude the cost of ESOs. Some financial items are non-recurring and deserve to be excluded from recurring expenses. Certain accounting charges (such as the amortization of intangibles following an acquisition) can also be excluded if it is objectively considered that they have no real impact on the underlying earning power of a company.

However, the cost of ESOs is real and sometimes even higher than the expenses calculated in GAAP earnings. There is a pragmatic way to approximate this cost: many companies buy back their shares to compensate for the level of dilution created by ESOs. We can thus estimate the difference between the proceeds of the issues of the ESOs and the cost allocated to the buybacks of the same shares.

Let's go back to the example of Cisco Systems. For the past 21 years, Cisco has aggressively bought back its stock. It made total profits of about $158 billion over those two decades and spent $152 billion on stock buybacks. Out of 7,324 million shares at the beginning of 2002, it repurchased about 5,923 million. On the other hand, it also issued through ESOs more than 2,652 million shares for a net effect of reducing the number of shares by 3,271 million. The buybacks were completed at an average cost of $25.6, which compares favorably with Cisco's current share price of $50. However, equity issues were carried out at an average price of $12.6.

All in all, we calculated that the net cost of buying back all issued shares over 20 years was over $34 billion ($25.6 minus $12.6 multiplied by 2,652 million shares issued). This amount compares to $26 billion in total annual charges that the company expensed over 20 years. Considering that this last amount is before tax deductions, the difference between the net cost of the options and the amount necessary to cancel them was $3.6 billion. Here is a table illustrating this calculation:

Cisco Systems	Number (m)	Amount (m)	Average Cost
Number of shares at beginning of 2022	7,324		
Share repurchases 2002-2022	-5,923	$151,881	$25.60
Issuance of stock 2002-2022	2,652	$33,343	$12.60
Net number of shares for 2022 approx.	4,053		
Cost of option repurchase		-$34,661	
Cumulative amount expensed for stock options		-$25,861	
Income tax deductions (@ 20%)		$5,172	
Difference between repurchases and reported expenses		-$3,628	

The conclusion is that the ESO charges were clearly real expenses. The company had to devote about $34.7 billion of its cash (or $29.5 billion net of taxes recovered) to cancel their effects, which are sums that could have been paid out as dividends.

At Giverny Capital, we always include ESOs in our own profit calculations. ESOs are here to stay without a doubt, but we believe firmly that we have to calculate their real costs as is done for rents, salaries or R&D expenditures.

Outlook for 2023

We remain agnostic, as always, on the economic and stock market outlook for the year ahead. But we still want to provide you with an honest view of how we see things. It is true that the economic situation is challenging these days. Inflation is also a problem that is slow to resolve, and we could fall into a recession in 2023. The situation in Ukraine is also worrisome.

We still believe that owning quality companies, acquired at reasonable prices, and paying little attention to the vicissitudes of the economy, geopolitics and financial markets is a winning long-term strategy. We have repeated it over the years: the number one lesson from my 30 years investing in the stock market is that the worst enemy of investors in the stock market is their propensity to try to predict financial markets. To get rich in the stock market, you first must be invested in the stock market.

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%
2022	5%	-20%	-25%	7%	-18%	-25%
Total	**2591%**	**2234%**	**-357%**	**893%**	**927%**	**34%**
Annualized	**13.0%**	**12.4%**	**-0.6%**	**8.9%**	**9.0%**	**0.1%**

* 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

The intrinsic value of our group of companies increased by around 5% this year (with dividend included). Despite the few changes made to the portfolio, we believe that this estimate of EPS growth for our companies in 2022 is an adequate reflection of their economic realities. For their part, our stocks on the stock market achieved a return of around -20% (estimated without the impact of currency). Our stocks therefore underperformed the underlying performance of our companies.

Three of our companies experienced a significant drop in profits in 2022: Carmax, Ciena and Meta Platforms. If these three companies had made the same profits as in 2021, the level of growth in our owner's earnings would have been approximately 6% higher.

The companies making up the S&P 500 have seen their profits increase this year by around 7% and the index achieved a total performance of -18% (both figures including dividends).

Since 1996, our companies have grown their intrinsic value by approximately 2,591% and their stock prices have achieved a total return of approximately 2,234%. On an annualized basis, our companies achieved an intrinsic performance of 13.0% versus 12.4% for their stock market performance (dividend included in both cases but adjusted net of any currency effect).

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

<u>Five-year Post-mortem: 2017</u>

As 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.

In 2017, we acquired shares in Frutarom, an Israeli fragrance company. It was acquired by International Flavors & Fragrances (IFF) in 2018 at a significant premium. Two other stocks that are still in the portfolio were purchased in 2017: Howden Joinery, a British company that manufactures kitchen cabinetry, and Edwards Lifesciences, an American cardiovascular medical products company. Here is their performance over 5 years:

	EPS 17	EPS 22	Growth	Share Performance
Howden Joinery Group	£0.30	£0.60	100%	30%
Edwards Lifesciences	$1.27	$2.48	95%	110%

Howden and Edwards both roughly doubled their EPS over the last 5 years. However, their respective stocks did not see a similar performance: Howden rose only 30% while Edwards rose around 110% (net of currency effect). Rightly or wrongly (we will see in a few years), analysts who follow Howden believe that the profitability of 2022 is abnormally high and thus the price-earnings is much lower than its historical average. It should be noted that Howden pays a dividend corresponding to a return of more than 2% annually (not included in this analysis).

As for Edwards Lifesciences, although EPS have still grown at high rates over the last five years, the COVID period has delayed many medical procedures and has contributed to reducing the level of its profitability over the past three years. We believe that its long-term prospects remain solid.

We also acquired shares of a new company in 2017: Liberty Formula One, the American company that owns Formula One racing. The company was not yet profitable (a rarity for us) but had a plan to greatly improve its operations. We sold two years later at around $31 with a slight loss. We were disappointed by the fact that profitability was slow to materialize. We could have been more patient because eventually the company managed to improve its operations and its prospects are much better today. The stock is currently trading at over $70.

A look back at the Austrian 100-year bond issued in 2017

In 2019, we highlighted in the “flavor of the day” section the danger of the hundred-year bond issued in 2017 by the Austrian government. We wrote at the time:

> *“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%.”*

Here are the 5-year prices of this bond since its issuance:

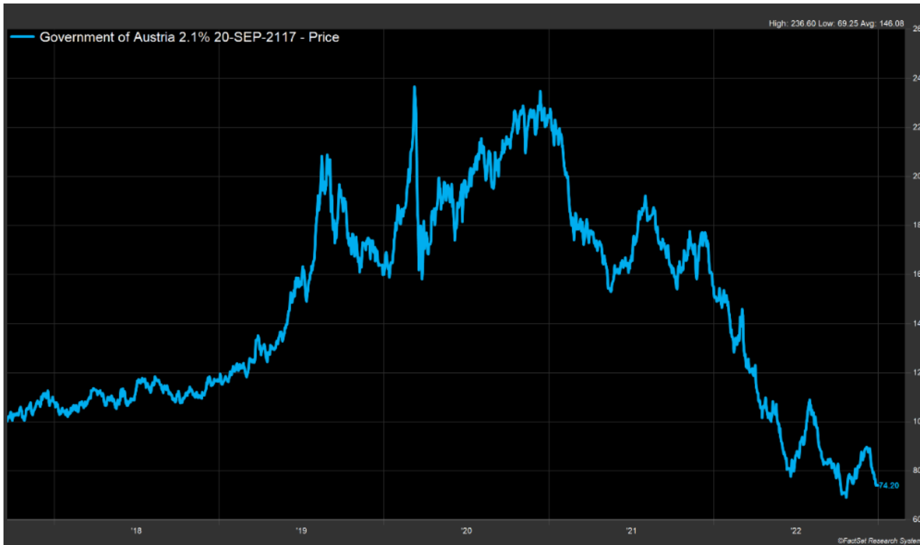


Chart 2: Austria 100-year government bond ratings from 2017 to 2022 (Source: Factset)

The bond has fallen to less than €75 from its peak of €230—a drop of 67%. Investors who bought at par at issuance still have a negative return of around 14% considering the interest received during the period. But that's only half the story—over the past five years, inflation in Austria has been 16%. Thus, the initial investors have experienced a loss of nearly 30% of their purchasing power over the last 5 years (and we are not talking about those who bought between 2019 and 2021).

The flavor of the day

2022 was a tough year for bitcoin (our flavor of the day last year). It fell 64%. The debacle was even more dramatic for FTX Trading Ltd, a cryptocurrency trading platform. At its July 2021 high, the company's market value was pegged at $18 billion. The company filed for bankruptcy protection in November 2022.

The value of all cryptocurrencies combined fell from $3 trillion in November 2021 to around $800 billion by the end of 2022, a 73% decline. Despite this, we still believe that this is a segment of the financial world that still seems to be very risky. In our humble opinion, the intrinsic value of these objects of speculation appears to be totally arbitrary; so we continue to stay away from them.

Our Companies

Section of the letter reserved for Giverny Capital's partners

The Podium of Errors

Following in the Giverny 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: Texas Roadhouse

I know the restaurant industry in North America well! I acquired shares in the Outback Steakhouse chain twenty-five years ago and we have been shareholders of MTY Food Group since 2007. We were also shareholders of Buffalo Wild Wings for a few years.

I make it a point—during my many trips to the US—to always try new restaurant chains with the noble aim of finding new potential investments for our portfolios. It must be said that you don't have to twist my arm to try the wonderful cakes at Cheesecake Factory, the fabulous burgers at Shake Shack or the divine chicken burgers at Chick-fil-A (the latter is unfortunately not a public company but I'm ready for the day it will be!)

Sadly, I have never tried a meal at Texas Roadhouse, a steakhouse chain. It's a solid company which has experienced exceptional growth. I should have tried harder to find one during my travels because it could have been a rewarding meal, on more than one level.

I had looked at the finances of the stock in more detail in 2017. The stock had corrected at the start of the year to $40 and was trading at around 20 times earnings. It maintained a growth rate of 15% year after year and its EPS of $1.97 had almost quadrupled since 2007. Texas Roadhouse also has a sound balance sheet and achieves excellent returns on its equity.

In 2022, the company earned $4.11 in EPS and the stock ended the year at $100. We would have achieved a return of 150% over 5 years.

Silver Medal: O'Reilly Auto Parts

In February 2020, I made the decision to sell our last shares of O'Reilly Auto Parts. We had been shareholders for 16 years and I believed the company had reached a level of maturity that would make future EPS growth less impressive than in the past. We thus sold our last shares at just under $400 as the company had earned around $18 of EPS in 2019. This level of profits was up 11% compared to 2018 and I believed that the slower growth rate was going to continue.

It was a major mistake. During the pandemic, the company achieved an outstanding performance. O'Reilly's replacement auto parts were in great demand. Then its ability to raise prices was beneficial during the rise in inflation in 2021 and 2022. It achieved EPS of just over $33 in 2022 and the stock ended the year at $844, or more than twice the level at which I sold it 3 years ago.

If we had kept the shares acquired in 2004, we would have achieved a total return of 4100% or 22% on an annualized basis.

Gold medal: LVMH

LVMH is a French company that I have followed for a long time. It is the parent company of the famous brand Louis Vuitton but also of many other exceptional companies (personally, my favorite is the famous Cheval Blanc vineyard). I have always admired the many competitive advantages of the company and the management of its president Bernard Arnault.

During the euro crisis in the summer of 2011, LVHM stock fell to less than €100 and was trading at around 16 times earnings. To be able to acquire one of the best companies in the world at an attractive valuation is an opportunity that I should have known to seize. I seriously considered it but preferred to wait for an even more attractive evaluation. And I had several chances: the stock remained at a reasonable valuation for more than three years!

Since 2011, EPS has grown from €6.2 to €29.6 in 2022, i.e. a compound annual growth rate of 15%: a phenomenal performance for a company of this size. The stock reached €800 at the start of 2023 for an annual return of more than 20% over these eleven years (and that's not counting dividends). I am still looking for an excuse to explain this indecision.

Conclusion: a book about my career and a vital quality

Saint-Jean Éditeur published a book in February of 2023 by author André Gosselin on my career entitled: *François Rochon: le parcours singulier d'un investisseur d'exception* (this would translate to *François Rochon: the unique journey of an exceptional investor*).

Obviously, it is a great honor to have a book published on my 30 years in the investment world. André was greatly inspired by my annual letters and the interviews we had together. He also knew how to maintain a captivating tone throughout the book while dealing with sometimes dry subjects. He presents in detail the concept of "self-determined" companies to qualify the type of companies in which we like to invest at Giverny Capital. I like to think that our partners who read it will become even better acquainted with our investment philosophy and the intellectual journey that led to it.

I hesitated before participating in André's book project (but not too long). I've often discussed in my writings, conferences and meetings with clients the vital importance of humility. Clearly, a biography does nothing to improve this character trait in me. Nevertheless, I always keep in mind the importance of cultivating humility.

Why is humility so important in life and even more so in the stock market? Managing portfolios is a hyper-competitive activity and many managers (and their sales representatives) naturally tend to highlight their successes in order to attract new customers or simply retain those they already have. Wall Street and fund management companies are generally not well known for having humble people. Through a somewhat Darwinian process, people who survive in these industries often have a high level of confidence in their judgment.

Paradoxically, confidence in one's judgment is really necessary to succeed on the stock market. The best investments are those made when the majority of other investors are bearish (on the stock market as a whole or on a particular security). To capitalize on great opportunities, confidence in one's ability to assess the fundamentals of an investment is required. But you also must know how to achieve a delicate balance between confidence in your judgment and humility.

Here is what the great philosopher Erich Fromm wrote about humility: "The most important quality to develop is objectivity: the ability to see things as they are. The faculty to think objectively is *reason*; the emotional attitude behind reason is that of *humility*. To be objective, to use one's reason, is possible only if one has achieved an attitude of humility, if one has emerged from the dreams of omniscience and omnipotence which one has as a child."

To be able to analyze financial markets and the various companies with circumspection and objectivity is certainly essential. Humility is therefore at the source of this objectivity. In addition, humility is necessary to recognize that the stock market and the economy cannot be predicted in the short term. This avoids the biggest mistake investors make, which is to try to predict financial markets.

Humility is also necessary to accept that we cannot have an informed opinion on the thousands of companies listed on the stock exchange and that we must therefore be able to draw a "circle of competence" around companies that we can understand. Humility is just as necessary to recognize our mistakes (inevitable in the investment world). From this perspective, humility becomes the catalyst that allows one to become a better investor by constantly trying to learn from one's mistakes.

Charlie Munger once said that Warren Buffett's greatest quality is his humility and his ability to always want to learn, even after eight decades of successfully investing in the stock market.

My collaboration with André made it possible to identify together some very pertinent notions. These are, in my opinion, the important conclusions of his book:

- Investing in the stock market in a group of solid companies is a winning strategy over the long term. However, few investors manage to achieve good results because they lack patience and behave willy-nilly with the stock market.
- The key to doing better than average is owning superior than average companies. These companies have "self-determination" characteristics in their business model allowing them to control their destiny better than average.
- We must accept that capitalism is a complex system that is always evolving. It is difficult to predict the future and to find companies that remain dominant for several decades. André takes the example of companies like Sears and Kodak, which were once titans of American capitalism and have now almost disappeared.

I fervently hope that I have many years left for further volumes in the future (note the use of the plural!). I aspire to nothing less than the longevity of Roy Neuberger and Philip Carret who left us at the age of 107 and 101, respectively.

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 2023 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.

We saw a large increase in the number of Giverny Capital partners (the term we use for our clients) in 2022. 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 2022:
    - Rochon Global Portfolio: S&P/TSX 15% S&P 500 40% Russell 2000 40% MSCI EAFE 5%
    - 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.