Annual Letter to our Partners 2024

Marlon Kroll
Echoes, 2024
Colored pencil and acrylic on muslin mounted on wood
Giverny Capital Collection
Photo: Courtesy of the artist and Eli Kerr Gallery

Historical Summary

It has been more than 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. Both 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's 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 2024 Letter

We illustrate the cover page of our annual letters with a reproduction of a work from the Giverny Capital Collection each year. This year, we have selected a painting by Québec artist Marlon Kroll entitled "Echoes".

For the year ending December 31st 2024, the return for the Rochon Global Portfolio was 24.9% versus 26.8% for our benchmark, which represents a relative underperformance of 2.0%. The returns of the Rochon Global Portfolio and our benchmark include a gain of approximately 8.5% due to fluctuations in the Canadian currency.

Since its inception on July 1st 1993, the compounded annual return of the Rochon Global Portfolio has been 15.1% versus 9.8% for our weighted benchmark, representing an annualized outperformance of 5.3% over this period of 30 years. Our long-term and ambitious objective is to maintain an annual return 5% higher than our benchmark.

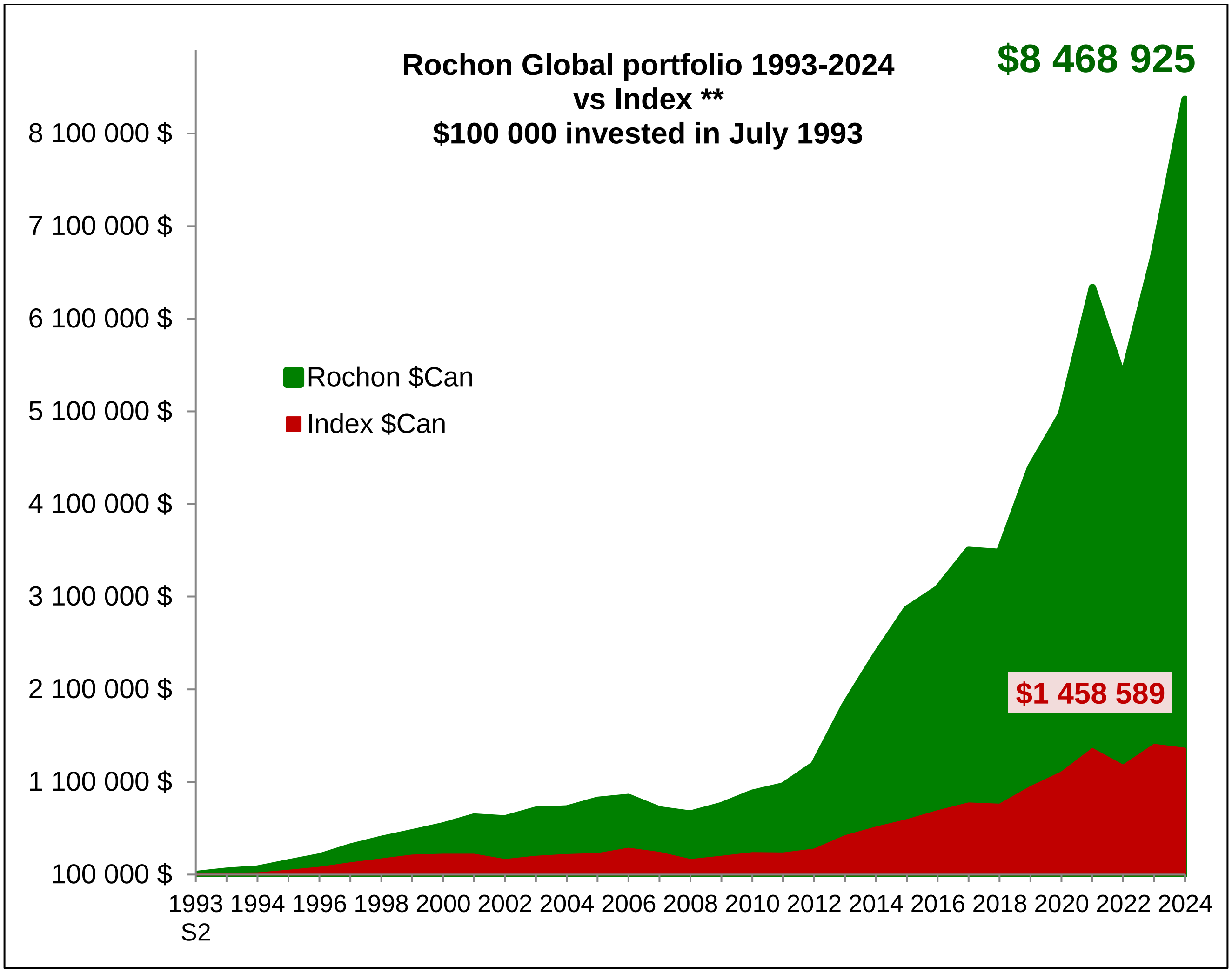
The Rochon Global Portfolio: Returns since July 1st 1993

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%
2023	**24.3%**	17.5%	**6.8%**	-2.3%
2024	**24.9%**	26.8%	**-2.0%**	8.8%
Total	**8368.9%**	**1803.8%**	**6565.1%**	**12.3%**
Annualized	**15.1%**	**9.8%**	**5.3%**	**0.4%**

* 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.

Here are the same results of the Rochon Global portfolio in graphical form:



** Index is a hybrid index (S&P/TSX, S&P 500, Russell 2000, MSCI EAFE) established at the beginning of the year reflecting the portfolio composition.

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Just looking at this chart, one might think that this was a period of strong growth that unfolded almost in a straight line without any major crisis. This was not the case. This graph reflects increases on a year-over-year basis. If we were to use a larger X-axis, for example on a weekly basis, we would see the many and sometimes enormous fluctuations in financial markets since 1993. There has been no shortage of crises: the stock market has fallen by 50% twice and by more than 20% seven times over the past three decades.

More than anything, the chart above illustrates an important lesson in equity investing: the benefits of having a long-term horizon. Perseverance, through thick and thin, along with the rigorous adherence to our investment principles and a good dose of patience, has made it possible to weather the storms and obtain satisfactory results. Fashions come and go but good principles endure.

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 2024, it realized a return of 17.0% compared to 25.0% for the S&P 500. The Rochon US Portfolio therefore underperformed its benchmark by 8.0%. Since its inception in 1993, the Rochon US Portfolio has returned 6349%, or 14.1% on an annualized basis. During this same period, the S&P 500 returned 2286%, or 10.6% on an annualized basis. Our added value has therefore been 3.5% 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%
2023	26.5%	26.3%	0.2%
2024	17.0%	25.0%	-8.0%
Total	**6349.3%**	**2286.1%**	**4063.2%**
Annualized	**14.1%**	**10.6%**	**3.5%**

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 2024, the Rochon Canada Portfolio returned 22.7% versus 21.7% for the S&P/TSX, therefore outperforming its index by 1.0%.

Over 18 years, the Rochon Canada Portfolio has returned 1595%, or 17.0% on an annualized basis. During this same period, our benchmark had a gain of 228%, or 6.8% on an annualized basis. Our annual added value was therefore 10.2%.

Year	Rochon Canada	S&P/TSX	+/-
2007	**19.7%**	9.8%	**9.9%**
2008	**-24.6%**	-32.9%	**8.3%**
2009	**28.2%**	33.1%	**-4.9%**
2010	**26.7%**	17.6%	**9.1%**
2011	**13.5%**	-8.7%	**22.2%**
2012	**24.0%**	7.2%	**16.8%**
2013	**49.4%**	13.0%	**36.4%**
2014	**20.3%**	10.6%	**9.7%**
2015	**16.0%**	-8.3%	**24.3%**
2016	**11.0%**	21.1%	**-10.1%**
2017	**27.4%**	9.1%	**18.3%**
2018	**-7.6**	-8.9%	**1.3%**
2019	**29.0%**	22.9%	**6.1%**
2020	**12.1%**	5.6%	**6.5%**
2021	**30.9%**	25.1%	**5.8%**
2022	**-1.8%**	-5.8%	**4.0%**
2023	**32.2%**	11.8%	**20.5%**
2024	**22.7%**	21.7%	**1.0%**
Total	**1594.9%**	**227.7%**	**1367.2%**
Annualized	**17.0%**	**6.8%**	**10.2%**

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

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

2024

International equity markets generally had a good year. To measure the performance of the world's stock markets excluding the United States, the MSCI ACWI ex USA Index can be used. It covers approximately 85% of global equities excluding those of the United States and its return was 5.5% in 2024 in US dollar terms (i.e. 13.0% without the 7.1% gain from the average appreciation of the US dollar against other currencies).

As for the S&P 500, the large-cap index in the US achieved one of the highest returns in the world at 25.0%. It was once again the year of the S&P 500's mega caps: the so-called "Magnificent 7" returned 48% and now represent more than a third of the index. These seven companies contributed half of the S&P 500's gain in 2024. In fact, all S&P 500 stocks on an equal weight basis (not weighed by market capitalization of each company) generated 13.0% in 2024.

We would like to emphasize that this concentration of the S&P 500 in only a few stocks is unmatched in history. Of course, it must also be taken into consideration that market capitalization is partly linked to market valuation. For example, if Apple were to trade at 16.5 times earnings instead of 33 times, its weight in the S&P 500 index would be half as much.

Popularity often means high valuations. Hence the appeal of this small group of companies to investors translates into high market valuation for their stock. The top 4 companies in the S&P 500 (Apple, Microsoft, NVIDIA, and Amazon) trade at an average of 33 times expected earnings for 2025 compared to an average price-earnings ratio of 19 times for all of the other 496 companies in the index. These high stock market valuations are discounting very strong growth to continue for years into the future. For example, if the four companies at the top of the S&P 500 doubled their earnings per share (EPS) by 2030 – a 15% annual growth – but the average price-earnings fell to 20 times in 2030, the return of these four stocks would be 4% annually.

A new president in the United States

Last year also marked the election of a new President of the United States, Donald John Trump. We have always refrained from making comments that are political in nature since the founding of Giverny. We've discussed this many times in the past, but it's worth repeating: we believe it is a mistake for an investor to be distracted by what's going on in politics. Our job is to judiciously select companies with the aim of being shareholders over the very long term; and if these companies increase their intrinsic value at above-average rates, their stock prices should eventually follow the same trajectory (provided they have been acquired at reasonable prices, of course). We have often held securities for more than 10 years, which is a period longer than the majority of political mandates in various Western governments. It's vital to always keep this in mind.

It is understandably very difficult at this stage to measure the future impact of various foreign trade policies and tariffs that the new US administration has put in place. We are confident that the businesses we own will not be substantially affected and, if necessary, we will find alternatives to meet that challenge.

Our portfolio companies in 2024

Although the portfolio underperformed its benchmark, it is difficult to be disappointed with a return of more than 16% (without currency effect) for our securities. Still, it was a challenging year for some of our companies, especially those in the retail world.

Section of the letter reserved for Giverny Capital's partners

We will provide more detail on these and all our holdings in the "Our Companies" section of this letter.

The growth in profit for our portfolio's group of companies in aggregate was approximately 12.1%, representing a growth in total intrinsic value of approximately 12.7% when including the average dividend (see the "Owner Earnings" section of this letter). This remains a level of growth in intrinsic value for our companies that is very good and in line with our historical average (around 13% annually). Still, in the coming months, we intend to make changes to the portfolio mix to improve the combined long-term growth rate of our businesses.

2025 outlook

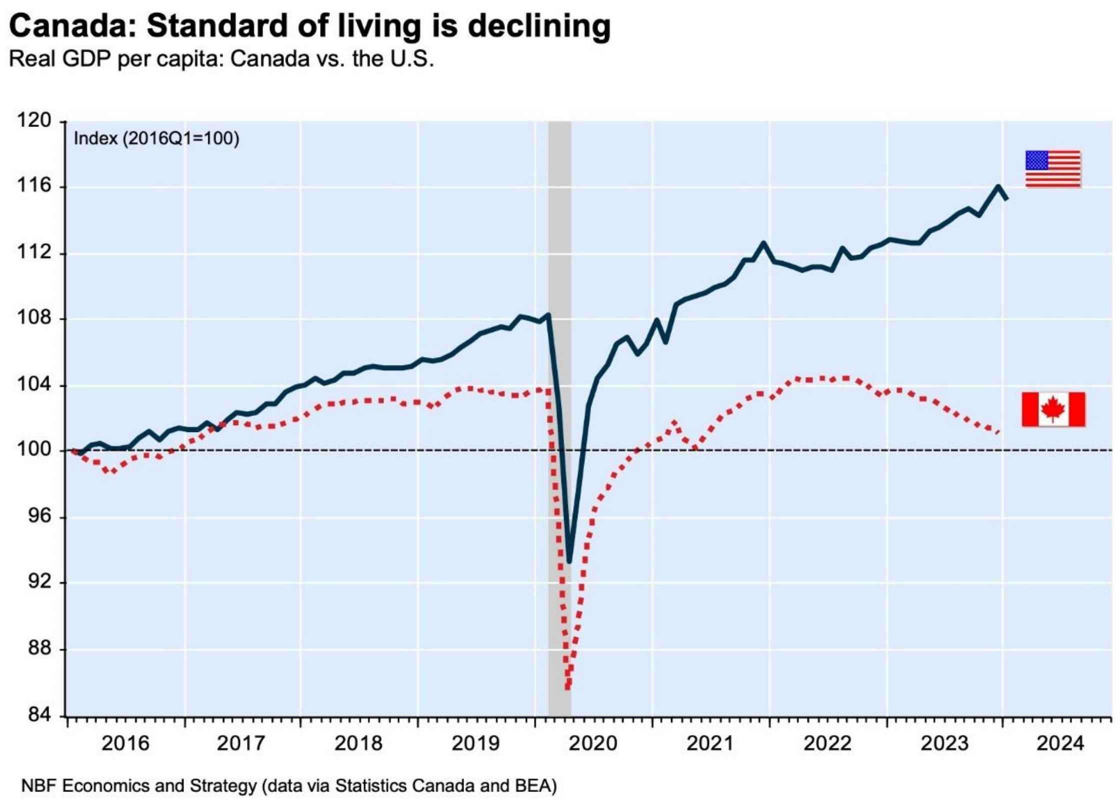
We remain agnostic regarding the economic and stock market outlook for the coming year. As always, there are sources of concern, whether in terms of particularly tense trade relations between Western countries, the dramatic conflicts in Ukraine and the Middle East, or the various technological and climatic upheavals that are transforming our lives. As the writer Sydney J. Harris said, "When I hear someone sigh that life is difficult, I am tempted to ask: Compared to what?"

The current year will most likely see its share of uncertainties and worries of a geopolitical nature. We are confident, however, that our companies, as a whole, will achieve record profits in 2025.

****DISCLAIMER: The following section is macroeconomic in nature (don't adjust your screen) and is intended primarily for citizens of Canada. We prefer to warn you about it. ****

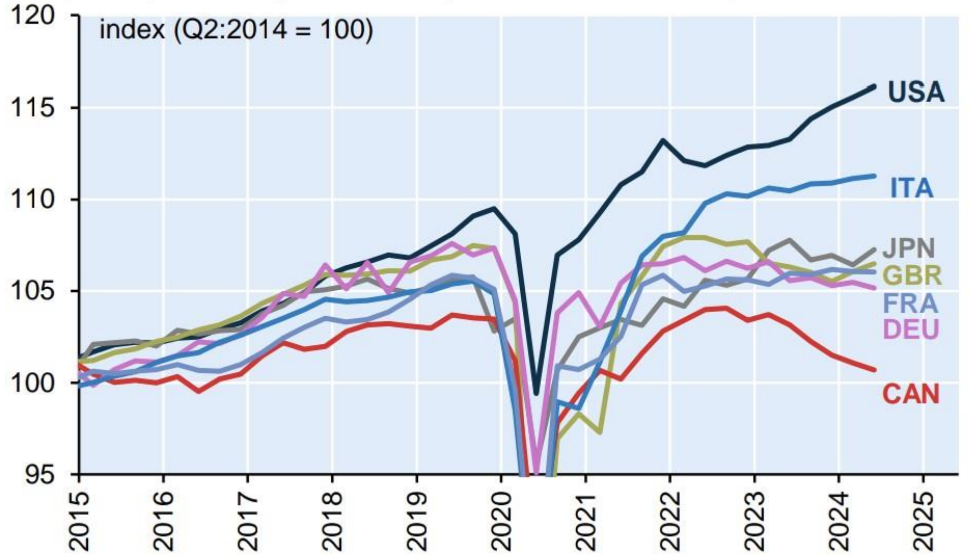
A difficult time for Canada's economy

Although few Canadian media outlets have been reporting on it, a major problem has affected Canada's economy: the very low productivity growth of Canadians.



As the chart above indicates, the United States has increased its Gross Domestic Product (GDP) per capita by at least 14% more than Canada since the beginning of 2015. And it's not just relative to the U.S. that our productivity has stagnated, as this next chart of GDP per capita growth for G7 countries illustrates. Canada is dead last.

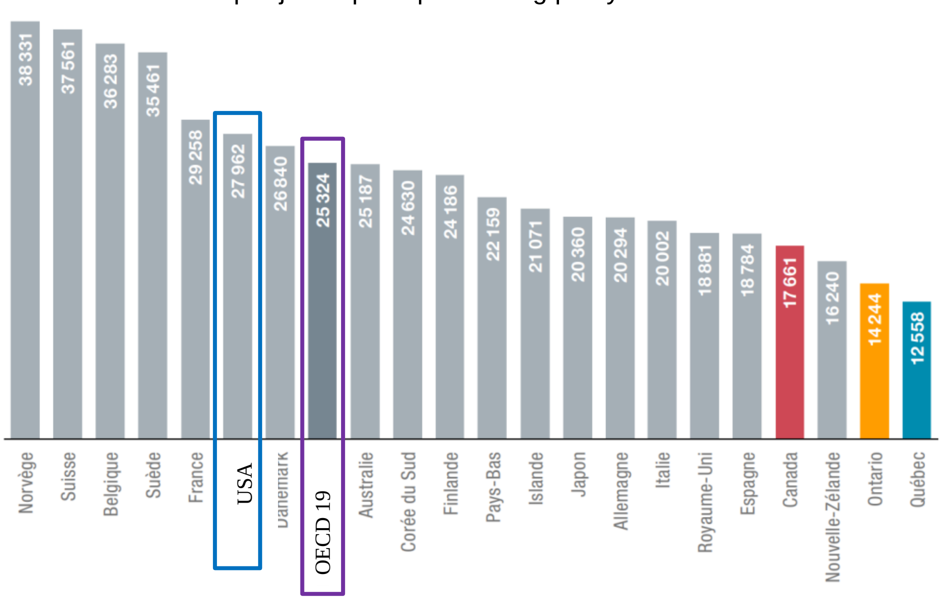
Real per capita GDP growth among G7 countries: Last 10 years



Source: NBF, OECD, Bloomberg | Note: GDP per capita based on working age population

There has been a significant increase to immigration programs to Canada in recent years. With the ensuing increase in population, absolute GDP increased but not GDP per capita. What continues to rise are the costs of the various social programs per capita.

Private non-residential investment per job, 2019
In Canadian dollars per job at price purchasing parity



Source: Centre for Productivity and Prosperity, Walter J. Somers Foundation, HEC Montreal

There are several causes for our low productivity. For example, taking into account the corporate tax rate and the corporate dividend tax applied to personal income, the OECD estimates that the total tax on profits distributed by Canadian companies is the highest among G7 countries[1]. There is also the low level of private sector investments. As the graph above shows, private companies in Canada invest only

[1] Source : *RBC Economics (June 4th 2024)*

$17,661 annually per job, compared to $25,234 in OECD countries and $27,962 in the United States. That's more than $10,000 less per Canadian job, or 37% less than in the United States.

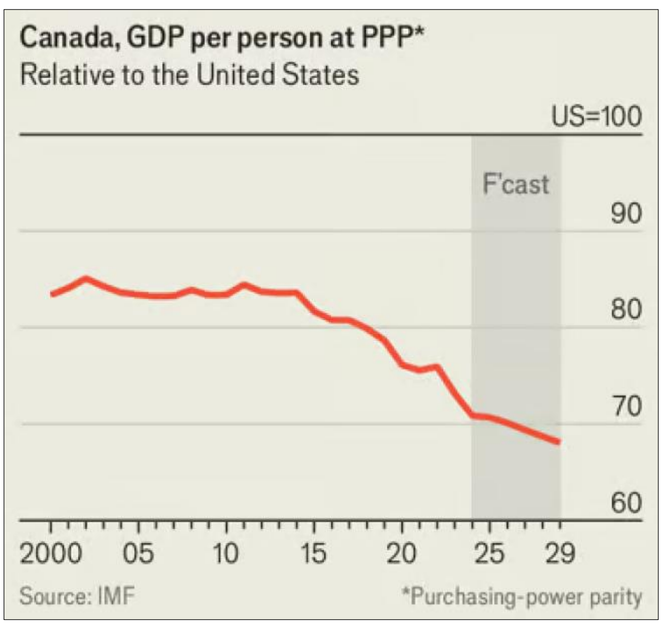
This 14% decline in the relative level of productivity in the United States in nine years is enormous and will be difficult to make up going forward. According to my estimates, this is a relative loss of about US$7,400 annually (Canada's GDP per capita in purchasing power parity being US$53,300) or about CAD$10,000 per year. We multiply this $10,000 in lost productivity by 41 million Canadians, resulting in a figure of more than $400 billion less in GDP each year.

The solution for Canada lies, in our view, in a change of vision: we need to encourage much more entrepreneurship and private investment.

The Decline in the Canadian Dollar

As we stated at the beginning of this letter, the Canadian dollar has fallen in 2024 by about 9% against the US dollar. One factor influencing the level of the Canadian dollar relative to the US dollar over the long term is the relative level of GDP per capita on a PPP (Purchasing Price Parity) basis. The decline in productivity described above has had major consequences for this variable.

For three decades, the level of GDP per capita in Canada relative to the United States has been around 0.83x (see chart below from The Economist). The situation deteriorated from 2015 onwards and the level of relative GDP per capita fell to around 0.71x.



Source: The Economist

<u>Owner's Earnings</u>

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 <u>owners</u> 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%
2023	11%	27%	16%	2%	26%	24%
2024	13%	16%	4%	10%	25%	15%
Total	**3266%**	**3344%**	**78%**	**1023%**	**1517%**	**495%**
Annualized	**12.9%**	**13.0%**	**0.1%**	**8.7%**	**10.1%**	**1.4%**

* 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 13% this year (dividend included). Despite the few changes made to the portfolio, we believe that this estimate of EPS growth for our companies in 2024 is an adequate reflection of their economic realities.

The stocks in our portfolio achieved a market return of around 16% (estimated without the impact of currency). Our securities thus performed better than their underlying companies.

The companies making up the S&P 500 have seen their profits increase this year by around 8.7% (about 10.4% when dividends of about 1.7% are included) and the index achieved a total performance of 25% (including dividends).

Since 1996, our companies have grown their intrinsic value by approximately 3266% and their stock prices have achieved a total return of approximately 3344%. On an annualized basis, our companies achieved an intrinsic performance of 12.9% versus 13.0% for their stock market performance (dividend included in both cases but adjusted net of any currency effect). The undeniable similarity – over a long period – between these two figures is not a coincidence. This is in line with the fundamental principle that, in the long term, securities on the stock market end up reflecting the intrinsic value of the underlying companies.

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.

Five-year Post-mortem: 2019

We purchased shares in Progressive, the Ohio-based auto insurer, in 2019. We had actually already been shareholders from 1999 to 2007. In 2019, the company's prospects seemed solid and we bought back shares. EPS increased from $5.65 to $14.04 and the stock climbed from $75 to $240 during the following five years. So far, it's been a good investment.

Another purchase in 2019 was Bank of America. At that time, we already held shares in JP Morgan Chase in our portfolio. Both banks were solid and managed by high-caliber CEOs. We subsequently sold JP Morgan but kept Bank of America—a mistake since JP Morgan did much better than Bank of America. Over 5 years, Bank of America has only modestly increased its EPS and its share price has risen from $29 to $44, an increase of nearly 50%. During the same period, JP Morgan increased its EPS by 60% and its stock rose from $139 to $240, an increase of 73%.

Finally, we acquired shares in Keysight Technologies in 2019. After a few years of good growth, it was a challenging year in 2024 for Keysight. The stock still ended the year at a 92% higher level than when we first bought shares in this company in 2019.

The flavor of the day

We highlight to our partners what we think is popular in the investment world in this section. It is rare that buying what is immensely popular yields good results over the long run. We often see several companies on the stock market trading at lofty prices relative to their earnings, leaving little margin of safety, to use the famous expression of Ben Graham, the father of value investing.

Even more dangerous is when an asset is valued solely on the hope of selling it at a higher price to another trader rather than on the basis of tangible economic results. Warren Buffett describes such an asset as "non-productive" (relative to a productive asset such as a business, farm or revenue-generating real estate). In the vast world of "non-productive" assets, nothing seems riskier to us than cryptocurrencies. After a 77% decline from the high of 2021 to the low of 2022, Bitcoin has rebounded strongly over the past two years. There is nothing tangible, in our view, to justify even a fraction of its current price.

I know that crypto enthusiasts won't agree. And that's the beauty of the free market: everyone has the right to their opinion and is free to buy what they want at the price they want—I am a fan of this free market and respect it. But the purpose of this section is to highlight to our partners what seems risky to us and bitcoin and other cryptocurrencies are in our opinion.

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 2024 (or from past years).

It is with a constructive attitude, 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: Apollo Hospitals

Here's a stock off the beaten track: Apollo Hospitals—a hospital management company based in Chennai, India. I had seen a report on television, probably in 2007, about Quebecers who were going to India for treatment in one of Apollo's hospitals. It highlighted a medical care company that was clearly at the forefront and had gone digital in all its activities. Additionally, its costs were much lower than in North America. Of course, my first reaction was to see if the company was listed on the stock exchange—it was.

It's not an easy task to invest in a country that is so far away, both in terms of geography and culture. Buying a stock that trades in a weak currency such as the Indian Rupee creates an additional barrier for a potential investor. Yet I continued to follow the company from afar but without ever investing.

From 2007 to 2024, Apollo's revenues increased by a factor of twenty and the stock has risen from about 250 rupees to 6267 rupees. It should be considered that the Rupee has depreciated by about 40% against the Canadian dollar; but we could have achieved a total return of around 1400% in 17 years despite this.

Silver Medal: Ameriprise Financial

We were shareholders of American Express for several years. In 2005, Amex spun off its investment advisory division, renamed Ameriprise Financial. We received shares in the new entity with an approximate cost per share of $34. We kept them for a few years and eventually sold them because of a lack of enthusiasm for the new company's long-term prospects. I had a hard time believing that the company had a strong competitive advantage. I continued to follow the company since.

In 2005, the company generated approximately $2.80 in EPS. In 2024, it achieved more than $35 in EPS, an annual increase of 14%. Except during the 2008-2009 financial crisis, EPS has grown almost every year and the stock is trading today for $563. We could have achieved a return of more than 1500% over 19 years.

I repeated this mistake often: for example, I looked at the stock in depth again in 2019. The company was then generating $14 in EPS and the stock had corrected to $125 by mid-year, a level equivalent to 9 times its earnings. It seemed attractive to me but I passed again.

The stock then quadrupled in 5 years.

Gold Medal: Cintas

Cintas is a company whose primary activity is the rental of uniforms for a million different companies. It's a business that fits exactly my style: not very exciting, hyper stable and recurrent… and also highly profitable.

And I know this industry well, having spent an afternoon in Cincinnati 22 years ago with Brad Kinstler, the CEO of Fechheimer Brothers, a company in the same sector that is owned by Berkshire Hathaway. Mr. Kinstler was extremely generous with his time and took the time to speak to me at length about his company and the industry.

I've always followed Cintas (which is also based in Cincinnati) and have done so since I started investing. In the summer of 2016, Cintas announced the acquisition of a major competitor: G&K Services for $2.2 billion. Cintas' stock was trading at $26 at the time, which was about 26 times its profits of $1.02 in 2016. Despite this rather high valuation, I believed that there was a lot of potential synergies with G&K and that possibly EPS could grow at a higher rate than revenues in the years to come. Though the level of Cintas' debt had increased, it seemed to be at an acceptable level.

For fiscal year 2025 (ending next May), EPS is expected to reach $4.35, which is an increase of 326% in nine years, or an annual growth of more than 17%. Revenues increased from $4.9 billion to $10.3 billion—my scenario of improving profit margins has clearly materialized.

What unfortunately did not materialize was to become a shareholder. I found the stock a bit expensive and decided to wait for a better price.

The stock is trading at $204 at the time of this writing, a 700% increase since 2016, or 25% on an annualized basis. It's true that the stock has a high PE ratio (in the 40x range) but even if the stock had only followed EPS growth without an expansion in its multiple, we could have almost quintupled our money in nine years.

This is a worse mistake than Apollo or Ameriprise. Because in the case of Cintas, I understood the company and its competitive advantages perfectly. To use a baseball analogy: it was a pitch right in the middle of my strike zone.

<u>Conclusion</u>: risk management in equity investing

If there is a complex topic, with a large spectrum of various opinions, it is the level of risk of an equity portfolio. More than 30 years ago, I read everything I could of Warren Buffett's writings. What was most fascinating about my readings was the combination of high returns achieved while maintaining a very low level of risk. This challenged a stereotype that higher returns are necessarily accompanied by higher risk.

Since then, with my now three decades of investing, I have come to the conclusion that the link between returns and risk in the stock market must be carefully considered and nuanced. One thing that's certain is that it's not in mathematics that you will find the answers (nor with the Greek letters used in some finance courses). Judgment and experience can contribute more to an informed analysis of risk than a panoply of algorithms.

In my view, an investor's stock portfolio has four distinct levels of risk: portfolio diversification, the quality of the companies held, the stock market valuations paid, and lastly the investor's own behavior.

1) <u>Portfolio diversification</u>. Our experience and analysis show that a portfolio of twenty or so securities considerably reduces the risk of having too much concentration in a few securities. This is a figure that represents a good balance between having enough securities to obtain a greater probability of doing better than the average while having a reduction in the risk associated with too much concentration. Obviously, some of the greatest investors in history have often owned only five or six stocks and have been very successful. However, in these cases, the selected securities had a very low level of risk with respect to the other parameters below. On the other hand, having five or six stocks all in the same sector (e.g., high-tech) does not, in our opinion, represent adequate diversification.

2) <u>The quality of businesses</u>. This is the most important parameter for reducing the risk of an equity portfolio. There are several characteristics that are hallmarks of a high-quality company. First, the company achieves strong returns on equity while maintaining a low level of debt and using conservative accounting. A high level of debt and/or aggressive accounting increases a company's inherent level of risk, especially during more difficult economic times. A quality company also has a sustainable competitive advantage that allows it to maintain better returns on its capital over the long term when compared to its competitors. In addition, its business model is durable and will therefore prove to be more immune to the various transformations, technological or otherwise, inherent to our capitalist world. The faster the pace of change in an industry, the greater the risk that a company will miss a critical inflection point.

3) <u>Stock market valuations</u>. It is normal for a quality company to trade at a premium to the average company as measured by its price-earnings ratio. However, the higher the premium, the greater the risk. A security that trades at 40 times earnings – all other factors being equal – is necessarily riskier than another similar security that trades at 20 times earnings. The greater the number of securities in the portfolio that trade at high ratios, the greater the risk of the portfolio. Ben Graham stated that the key to intelligent investing is the "margin of safety." Being conservative in our analysis of a company's future potential (and therefore its estimated value) is therefore an important ingredient in reducing risk.

4) <u>The investor's own behaviour</u>. I have written this many times, but it is vital: the best investment strategy is futile if one tries to predict the stock market. The level of risk of a portfolio is thus linked to the period of holding of its securities. The longer the holding period, the greater the

probability that there will be a correlation between the stock market performance and the intrinsic performance of the companies held. Conversely, the more an investor trades, the more the risk of the portfolio increases. In the 1950s, the average holding period for a stock on the New York Stock Exchange was 8 years. It is 8 months today (note: our average holding period at Giverny is 8 years). It's even worse with ETFs, a security which mimic index investing. The ease of trading ETFs for today's investors often negates all the benefits of passive management. In 2023, the average holding period for the S&P 500-based ETF (SPY) was 17 days! The very low holding period of ETF's holders led John Bogle (the inventor of index funds) to say that concocting ETFs is the equivalent of giving matches to arsonists. Thus, in the quest to reduce the risk of an equity portfolio, the worst enemy for many investors is often themselves!

The analysis of a portfolio's past and potential performance must therefore be taken in the context of the risk involved, at these four levels.

At Giverny Capital, from day one, I've always focused on the pursuit of superior long-term returns while maintaining sound risk management. Investing in the stock market is like running a marathon. And to win a marathon, the first rule is to run in a way that will allow you to finish it.

To Our Partners

We believe that the companies we own are exceptional, led by top-notch people, and destined for a great future.

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.

We also want to offer you a service that always meets your expectations. Please do not hesitate to contact us with any questions you may have about your account.

Thank you from the entire Giverny Capital team and we wish a great 2025 to all our partners.

François Rochon

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 2024. 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.
- We avoid risky companies: non-profitable businesses, with too much debt, with a lot of cyclicality and/or run by people motivated by ego instead of genuine stewardship.
- 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.
- Returns for the three portfolios include transaction fees, dividends (including foreign withholding taxes) and other investment income, but do not include management fees.
- 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. 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. In addition, depending on when they arrive at Giverny Capital, returns may vary from one client to another.
- Past results do not guarantee future results.
- 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 2024:
  - Rochon Global Portfolio: S&P/TSX 17% S&P 500 39.5% Russell 2000 39.5% MSCI EAFE 4%
  - Rochon US Portfolio: S&P 500 100%
  - Rochon Canada Portfolio: S&P/TSX 100%
- 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 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.