Giverny Capital Inc.

QUARTERLY LETTER TO OUR PARTNERS

3RD QUARTER 2011

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Our companies: an excellent third quarter

Our companies, as a whole, had a terrific third quarter. Many of them even surpassed our high expectations.

After the first three quarters of the year, our companies are on track to increase their earnings by more than 18% relative to last year. This exceeds our goal of 12-14% for the long-term earnings growth of the companies we select.

O'Reilly Automotive announced an 8% increase in sales, with 4.8% of this increase from same-store sales. Profits rose 27% and earnings per share (EPS) climbed 34%. The company purchased $502 million of its own shares during the quarter.

Wells Fargo continued to improve its profitability. EPS rose 20% during the last quarter. Higher profits resulted primarily from lower losses on its loan portfolio: the bank's level of write-offs for bad loans effectively dropped from 2.1% in 2010 to 1.4% in 2011.

As far as **M&T Bank**, profits declined 1% during the third quarter. The integration of the loans and deposits from Wilmington Trust (M&T's latest acquisition) had a negative impact on profits. The Buffalo bank is confident that the temporary expenses linked to Wilmington Trust have passed.

Revenues at **Buffalo Wild Wings** grew by 31% during the quarter, with 4% of that growth from same-store sales. The company opened 44 new restaurants over the last year and the company expects to grow its restaurant footprint by approximately 12% during 2012.

Google had a phenomenal quarter. Revenues reached $9.7 billion—a 33% increase from last year. EPS rose by 27%. It is also worth noting that international revenue now represent 55% of the company's overall sales.

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Warren Buffett announces a share buyback

Warren Buffett is taking advantage of the bargains currently offered by the market.

The most famous investor of our era has made a historic move: he not only announced a share buyback for his company, Berkshire Hathaway, but he also went ahead and began buying back shares in Berkshire.

On an interview with CNBC, Mr. Buffett explained "*In my opinion, the only time a stock buyback makes sense is when the stock trades at a significant discount to its intrinsic value. We've talk about this throughout the years in our annual reports but never had the occasion to do it...until today*."

Over the course of the third quarter, Berkshire bought $7 billion in the stocks of public companies and made a $5 billion preferred stock investment in Bank of America.

"*It's simple: the relationship between price and value is the only thing that guides our decisions. The cheaper stocks get, the better I like to buy them, whether it is our stock or somebody else's.*"

WE REITERATE TO OUR PARTNERS THAT WE CONTINUE TO SEE A STRONG OUTLOOK FOR INVESTING. WE BELIEVE THAT THE COMPANIES IN OUR PORTFOLIO ARE TRADING AT COMPELLING VALUATIONS AND OFFER OPPORTUNITY TO ADD CAPITAL FOR LONG TERM INVESTING.

Market myths. Myth #1: "Buy and hold is over"

I HELD A CONFERENCE ABOUT MARKET MYTHS ON NOVEMBER 1ST. HERE ARE A FEW EXCERPTS.

At the end of the 90s, investors were willing to pay any price-to-earnings ratio (P/E ratio) for their favorite stocks. Companies such as Coca-Cola were trading at 50 times earnings, while companies such as Cisco and Nortel, perceived as companies which would grow for decades, were trading at more than 100 times their profits. Since this strategy didn't work out too well (yes, I'm being sarcastic), investors have now come to believe that "buy and hold" is over. An argument we hear repeatedly is that the market hasn't done anything in ten years. The ones who say this seem to forget that over the course of the last 50 years (since 1961), the total return for the market has been 10,000%. Let's see what happened since the end of 1999. The Dow Jones rose from about 10,500 then to 12,000 currently. During this same period, the profits of the companies the comprise the Dow Jones rose from $455 to $950—an annual growth rate of 6.7% which is in line with historical averages (see Figure 1). We can therefore deduct that the lackluster performance of the Dow Jones during this period was the result of a compression in the P/E multiple of the index, which decreased from 23 times earnings to 13 times (see Figure 2). It's not that companies are not growing as fast as they were before, but rather a change in investor perception. At the current level of 13 times earnings, stocks in the Dow Jones are significantly undervalued. We therefore believe that the next years will be far different from recent ones.

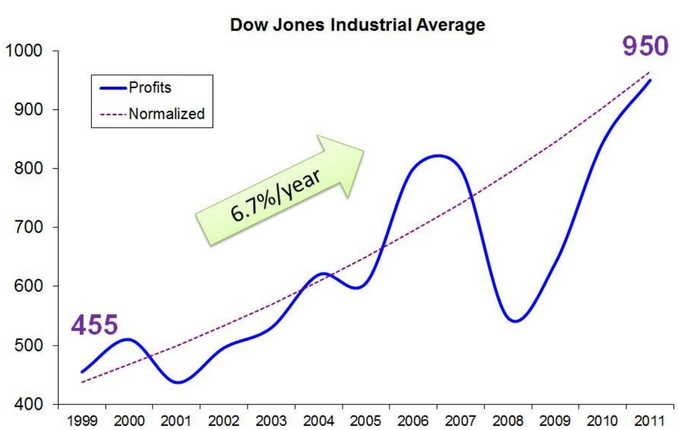


Figure 1: Profit growth for the Dow Jones since 1999

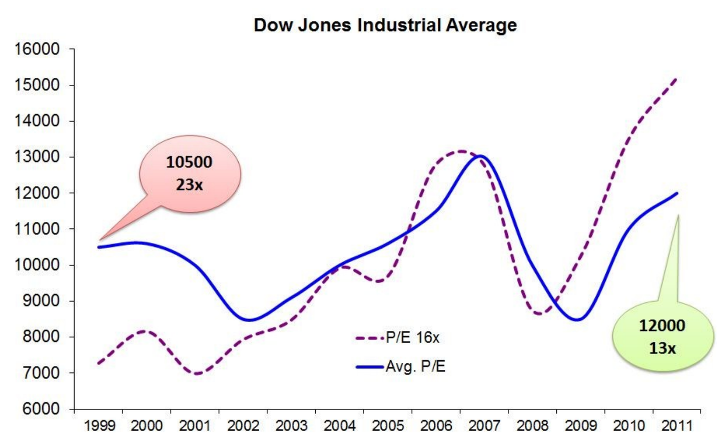


Figure 2: P/E multiple of Dow Jones since 1999 relative to average P/E of 16

Our companies: an excellent third quarter (cont.)

Fastenal remains a well-oiled machine, with a 22% increase in sales and a 35% rise in EPS.

Disney's revenues rose by 7% while its EPS climbed 31% during the third quarter. Disney's cable networks (including ESPN) remain as great sources of profits for shareholders. The company's theme parks had a solid quarter, while its film division has been having a more difficult year. This division's Cars 2 and Thor were not as successful as last year's Toy Story 3 and Iron Man 2.

At **Carmax**, revenues rose 11% but same-store sales decreased 2%. EPS rose by only 2%. The company continues its expansion and is planning on opening 8 "big box" stores during the next year.

Following its sizable acquisition of MCP Group, **5N Plus** saw its revenues increase by 507% during the last quarter. EPS rose by 89%. While it's too early to celebrate, this acquisition seems to be a big success.

Fastenal: An 1100% return since our initial purchase in 1998

Figure 3: Stock price of Fastenal since 1998 relative to its earnings-per-share during the same period

The importance of patience

The myth about the end of "buy and hold" may make some investors forget about the virtues of patience in the market (and in other aspects of life). An example we have lived through is the exceptional performance of **Fastenal** since our first purchase in 1998. We initially bought shares during the height of the Asian crisis of 1997-1998. At the time, Hong Kong and South Korea were in the news just as much as Greece and Italy are today. Although Fastenal was hardly affected by what was happening in Asia, its stock price still dropped by over 50%. We have made about 1100% since then (or about 21% on annualized basis). As you can see in Figure 3, the stock price has approximately followed the company's growth in earnings which have risen from $.18 per share in 1998 to an estimated $1.21 per share for the current year. So this reward in the stock price didn't fall from the skies, but it require a healthy dose of patience. In fact, there were two periods of 3 and 4 years, respectively, where the stock price treaded water. Sitting still for three years is a long time (more than 1000 days).

Reaping the fruits of this investment required arming ourselves with patience. And on top of the periods of the stock standing still, there were also drops of more than 20% on 12 different occasions over 13 years. I consider patience to be the most important ingredient for success in the market.

Myth #2: "Buy low, sell high"

Buying low and selling is the dream of all market speculators. It is, however, not an easy thing to do with any degree of success. Most importantly, investors overall have demonstrated on numerous occasions that they are incapable of doing so.

Each year, the behavioral research firm Dalbar publishes the results of US investors versus the S&P 500. For 20 years, from 1990 to 2010, the S&P 500 had an annualized return of 9.1% (see myth #1 for anyone who believes that "buy and hold" no longer works). Mutual fund holders, however, only generated an annualized return of 3.8% over the course of the same period. This difference of 5.3% cannot be explained by management fees or transaction fees—so the only explanation is that the average investor buys and sells at the wrong times (they buy high and sell low). The fact that they investors own their shares for an average of only three years provides us a hint at the origin of their difficulties with investing.

In theory, it is of course ideal to buy low and sell high. This is, however, very difficult to do and the vast majority of investors are incapable of doing so. It is more constructive to select outstanding companies and to hold them for the long term.

Surplus High	S&P 500 3 years later
Q3 1947	28.8%
Q4 1950	21.6%
Q4 1955	21.4%
Q4 1959	5.4%
Q4 1968	-1.7%
Q3 1973	-2.9%
Q1 1979	10.2%
Q4 1988	50.2%
Q4 1999	-40.1%
Q3 2003	-20.9%
Average	**7.2%**

Deficit Bottom	S&P 500 3 years later
Q4 1949	58.6%
Q4 1953	88.1%
Q1 1958	54.5%
Q1 1967	-0.6%
Q1 1971	-6.3%
Q1 1975	7.0%
Q3 1982	51.2%
Q2 1992	33.5%
Q2 2003	30.3%
Q3 2009	?
Average	**35.1%**

Figure 4: Returns of the S&P 500 versus the cycle of governmental deficits in the US.

Source :"Debunkery" from Ken Fisher.

Myth #3: We should wait until the economy improves

Another myth I hear regularly is that "we should wait until the economy improves before investing." This "improvement" includes not only economic growth but also governmental deficits and unemployment rates.

Yet, it is when these economic indicators are the worse that the prospects for market returns are the brightest. For example, if you had invested at the top of the governmental economic cycle (when budget deficits are low or even at a surplus), you would have realized a 7% return over the next three years. If you had, on the other hand, invested at the lows of the cycle (when deficits were the highest), you would have realized a 35% return over the course of the following three years (see Figure 4).

In fact, after the recession of 1981-82, the deficit was at its high. In March 1984, Time Magazine published the cover include in Figure 5. The market, over the course of the following ten years (from 1984 to 1994) rose by 300% or 15% on an annualized basis.

As far as unemployment, if you had invested at its historical high, you would have realized a 15% return during the following twelve months.

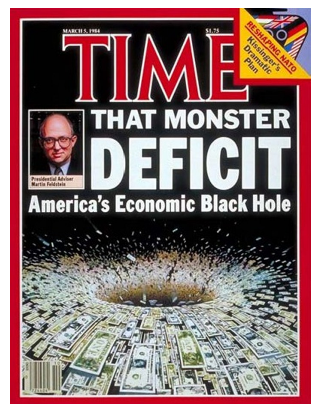


Figure 5: Time, March 1984

Myth #4: We should wait for "better" times

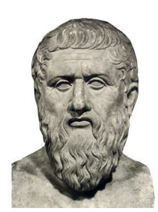
If we had to nominate a single phrase to the Market Myth Hall of Fame, it would be: "we need to wait for better times to invest…" What are "better times"? Is this the moment when there will be no more problems on the planet? When economic cycles have disappeared? When human beings will have become rational and wise?

If we look to consumer confidence, for example, the lower it is the higher the potential for the performance of stocks. Since 1967 (the year the consumer confidence index was created), when American consumers were the most confident (when the index was higher than 110), the market return over the next five years was 17%. But when consumer confidence is low (when the level of the index is below 70), the market return for the next five years was 116%. At this moment, the consumer confidence index is below 40—the lowest level in the history of the index aside from March 2009.

And, of course, the majority of people are reticent to invest in the market. At the euphoric high of 1999, the consumer confidence index was at 140…

The best time to invest is when we can find outstanding businesses that are trading at compelling valuations.

Philosopher's corner



It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so.

- Mark Twain