GIVERNY CAPITAL
ASSET MANAGEMENT LLC

October 15, 2021

To Our Clients & Friends:

For the third quarter ended September 30, 2021, our Giverny Capital Asset Management model portfolio, which is a Poppe family account, returned 0.53%, net of fees,[1] vs. a 0.58% return for the Standard & Poor's 500 Index.[2] For the first nine months of the year, the GCAM model has returned 16.93%, net of fees, vs. 15.92% for the Index. And since our inception 18 months ago, our model portfolio has generated an annualized return of 43.48%, net of fees, vs. 42.83% for the Index.

The market was on its way to another nice quarterly gain through the end of August, but cooled off with the temperatures, dropping 4.65% in September. Our GCAM model portfolio was ahead of the market for the quarter when, on September 30th, our second-largest holding Carmax dropped 12% after it reported earnings. We remain enthusiastic about Carmax's long-term prospects but would have appreciated an October 1 earnings report. Portfolio-manager humor.

Over our first 18 months in business, we are slightly ahead of the S&P 500 Index, net of fees. Obviously, I would prefer more separation, but I am satisfied with the performance of our underlying businesses. Using Factset Research consensus earnings estimates for 2021 and 2022, we calculate that our portfolio trades for a higher PE than the S&P Index, but for that premium we receive a higher return on equity and faster growth rate for earnings. We include a small chart at the end of this letter that documents these figures.

We are bottoms-up stock pickers, aiming to curate a portfolio of about two dozen high quality businesses that we purchase at reasonable prices and then hold for years, letting talented management teams create value on our behalf. But the top-down math on our portfolio is encouraging.

During the quarter we trimmed two positions, Alphabet and Eurofins, after significant run-ups. Alphabet remains our largest holding at a 9% weight. When it rose above a 10% weight in late July, we brought it down a bit. I won't automatically trim a position when it reaches the 10% threshold, but Alphabet nearly doubled from the summer of 2020 to 2021 and it felt responsible to take some gains.

[1] The family account does not pay a management fee. The returns presented herein assume the deduction of an annual management fee of 1% to show what a client's account performance would have been if it had been invested the same as the family account during the period. Past performance is not necessarily indicative of future results.
[2] The S&P 500 Index returns include the reinvestment of dividends and other earnings. The Index is an unmanaged, capitalization-weighted index of the common stocks of 500 major US corporations. The index does not incur expenses and is not available for investment.

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Similarly, Eurofins is a world-class scientific testing company led by a brilliant founder, Gilles Martin, and we expect to hold shares for a long time. But the stock is up substantially this year, partly because the market for Covid-19 tests has been so strong , and it felt prudent to trim it. Alphabet and Eurofins each rose more than 50% for the first nine months of the year.

We exited our holding in Jacobs Engineering during the quarter. Jacobs is a terrific company and I have no doubt it will continue to perform well under the leadership of CEO Steve Demetriou. Over the last few years, Demetriou has repositioned Jacobs out of petrochemical engineering, which is prone to boom-and-bust cycles, and into more steadily growing sectors like environmental, infrastructure and life sciences. If the US actually embarks on a badly-needed infrastructure investment program, Jacobs should receive a lot of new work.

That said, civil engineering is a good-not-great business. Even a best-of-breed firm like Jacobs earns relatively low returns on capital and modest profit margins. Jacobs essentially sells the labor hours of engineers to clients who generally are putting work out for bid. Demand for engineering projects ebbs and flows, but because engineers have specialized skill sets, it is not so easy to hire and fire talent to adjust to demand. In slow periods margins often contract as Jacobs pays skilled people who are working below capacity.

Jacobs' current financial returns are at historically high levels. As Jacobs rose to roughly 19x next year's earnings, or $135 against a consensus estimate of $7.00, I decided to rotate our capital into a business that trades for a lower PE multiple and has, in my opinion, a better growth trajectory.

That company is II-VI Inc., a technology company that holds leading supplier positions in various optoelectronic components and lasers used in communications equipment, aerospace and defense, semiconductor capital equipment, electric vehicles and other products. The company's name is pronounced Two-Six and signifies the element groups on the periodic table with which it works. We believe II-VI is differentiated three ways: by its expertise in engineering complicated materials, its manufacturing capability and its vertical integration.

To cite one fast-growing area where we believe II-VI has advantages: the company is a leader in working with silicon carbide, or SiC, which is an extremely efficient conductor of electricity. This segment represents about 5% of revenue today but should grow rapidly this decade.

In computer science, Moore's Law predicted that engineers would double the number of transistors on a silicon chip roughly every eighteen months. Gordon Moore made this forecast in 1965 and it has proved out over a half-century. But we may be coming to the end of the line with silicon; packing more transistors onto a chip is getting harder to do, which means it is harder to increase the amount of power flowing through a circuit.

Silicon carbide is difficult to work with, but when properly engineered the resulting material can conduct roughly 10 times higher voltage than a silicon chip. In an industrial setting this might mean you could sustain more voltage with fewer switches, less heat (or higher breakdown temperatures) and smaller system size. In an electric car, SiC chips might allow for more power density from a lighter motor. In a solar installation, SiC chips could capture more energy from a smaller grid.

It caught my eye when a leading market research firm predicted that the market for SiC chips would grow from $500 million in 2020 to $30 billion in 2030, a 60-fold increase. Today, II-VI is a leading player in SiC materials, although there are other strong competitors, including Wolfspeed (formerly known as Cree). II-VI plans to invest $1 billion this decade on SiC production capacity and research. This will be a competitive industry, but materials and manufacturing expertise form a significant barrier to entry.

Even if the pace of growth in SiC technology lags expectations, II-VI participates in a diversified photonics industry that should grow by double digits for several years. In its investor materials, the company cites eight distinct customer groups that it supplies. All eight should grow by at least 5% per year for the next five years, with three segments growing more than 20% annually.

On top of this, II-VI is in the process of closing its acquisition of Coherent, which itself is a leading producer of laser technology. II-VI is paying a high price for Coherent and taking on a lot of debt to fund the purchase. The market is leery. Since announcing the acquisition, II-VI shares have lost about a third of their value, dropping from $90 to below $60.

But II-VI has a strong track record integrating acquisitions. We see a business that is firmly focused on a once-in-a-generation opportunity to establish leading positions in several megatrends. In a meeting with management over the summer, CEO Chuck Mattera, Jr. responded to our questions about heavy investments in future growth by saying that when an investor has a choice between owning a good company participating in a great market or a great company participating in a good market, he should choose the great market.

I thought about that a lot in the weeks after the meeting and decided that I'd like the exposure to great markets. GCAM bought a small position in II-VI in the low-$60s per share in August and then added to the position in September at roughly the same price. The consensus of Wall Street analysts is that II-VI should earn about $4.15 per share in calendar 2022. That puts the forward PE at less than 15x.

I'll close with a few high-level details about the portfolio. We finished the quarter with a 5.6% allocation to cash. Our portfolio turnover continues to be very low, about 8% annualized. It probably won't stay this low forever, but we are long-term business owners. Our results have been similar to the market's recently and some clients ask about our "active share," or the extent to which our performance comes from mimicking the Index. Our active share at quarter end was 90%, meaning we do not look like the Index. Over time, this means that our results may deviate significantly from the Index.

Our business grew quite a bit this quarter as we added a number of clients. I remain very mindful of the trust our clients have placed in GCAM and I love coming to work every day knowing that I am in business with like-minded investors.

Sincerely,

David M. Poppe

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Portfolio characteristics	GCAM	iShares S&P 500
PE on 2021 estimates	26.0x	21.9x
PE on 2022 estimates	22.9x	20.0x
Estimated 2022 earnings growth	13.2%	9.6%
Return on Equity 2021	24.6%	20.4%

Source: Factset Research

Giverny Capital Asset Management, LLC	*Top 10 holdings*
September 30, 2021	
Alphabet A&C	*9.0%*
Carmax	*7.2%*
Charles Schwab	*5.5%*
Constellation Software	*5.5%*
Progressive Corp.	*4.8%*
Facebook	*4.8%*
Credit Acceptance	*4.7%*
Arista Networks	*4.6%*
Heico Class A	*4.5%*
SS&C	*4.4%*
Total	***55.0%***

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