ACADEMY
CAPITAL MANAGEMENT

January 14, 2015

Enclosed is your statement for the fourth quarter of 2014.

Because our portfolios are managed individually, if you have been an equity investor with us since at least 2009, you are nearly fully invested in companies with low cost bases. The Great Recession of 2009 provided great purchasing opportunities. However, if you joined us recently or added significant funds, you hold a portfolio which is heavily invested in cash, awaiting opportune investments which lately have occurred less frequently. The result is that as long as this market continues its upward ascent, the more likely it is that there will be a disparity of results between the S&P 500, long term clients and those joining us more recently.

Our long-standing fourth quarter tradition had been to discuss the investments which generated the best and worst results for the year. Over time, we came to believe that this exercise had a fundamental flaw – the time horizon was much too short. More often than not, we simply ended up discussing our most volatile positions, not those with the most impact. Instead, we instituted the practice of discussing stocks we have sold as a means of understanding the investment principles we employ. We discuss these in chronological order.

In March, we sold our position in Leucadia National Corporation (LUK), a diversified holding company. We had followed LUK closely for over ten years and studied the outstanding investment decisions under the combined leadership of Ian Cumming and Joseph Steinberg. In their annual report, they reviewed their process with admirable clarity and honesty. Best of all, from 1979 – 2011, they grew shareholder equity and share price at 19% per year as compared to the S&P 500's growth of 8% per year.

In early 2013, we saw what we believed to be an outstanding opportunity. Chairman Cumming and President Steinberg announced that they were purchasing the remaining shares of Jefferies & Co., an investment banking firm. They had already accumulated a sizeable position and in their reports, had thoroughly discussed how capably Jefferies had navigated the Great Recession under the leadership of Richard Handler. We thought the share purchase was a good deal and were pleased at the prospect that Richard Handler would succeed Cumming and Steinberg as CEO of the combined firm. When the first annual report for the combined firm came out, however, we were very disappointed to find little of the clarity and candor we had come to expect and that we require, particularly in the case of an investment banking firm. Without them we concluded we had no choice but to sell LUK, which we did at a slight profit, even though we still believe it to be a good firm.

In July, we sold our position in Cisco Systems Inc. (CSCO), often referred to as the "plumbing company of the Internet." CSCO is the dominant provider in its space with nearly $50 billion of revenues, an outstanding operating profit margin of 33% and excellent returns on capital of nearly 15%. Compounding these advantages is the presence of $50 billion in cash and a very long-term CEO. So, despite not knowing what Internet 'plumbing' would look like if it showed up in our offices, we believed ourselves well protected by these factors in combination with a low price in early 2013.

As we reviewed quarterly statements, annual reports and investor presentations, we continued to be impressed with CSCO. The company even has a remarkable insight into the direction of economies, serving as an early warning indicator. However, we became troubled by the appearance elsewhere in the industry of a low-cost alternative to CSCO's core products called "software-defined networking." Given that CSCO relies on higher margined products, it risks being on the wrong side of the kind of "innovator's dilemma" described by Clayton Christensen in a famous book of that name. That book provides enough examples of high cost technology being replaced by low cost technology, causing seemingly invincible firms to fall aside, to give any money manager nightmares. Undoubtedly, CSCO will respond to these competitive pressures, but may be forced into narrowing margins. Lacking the ability to forecast the resolution of this issue, we sold our position in CSCO for a profit of about 20% in eighteen months despite our conviction that CSCO is a fine firm.

Starting in October and continuing through the first trading day of January 2015, we sold our position in Becton, Dickson and Co. (BDX), a healthcare company focused on parenteral drug delivery. "Parenteral" comes from two Greek words meaning "outside" and "intestines," that is drug delivery outside the mouth. BDX has the characteristics we seek in a company. The earnings history is consistent and growing. The operating margins and returns on capital are high. Shareholder rewards with dividends and share repurchases are ample. However, the phrase "price is what you pay and value is what you get" connects price and value. BDX's rising price simply outran its growth in value. So, we sold our position for a profit of nearly 100% in about five years.

Our selling strategy in BDX deserves a little more discussion. Just as we tend to gradually purchase a position on declines in stock prices, so, too, we tend to trim out of our stock positions on a rise in stock prices. In October, BDX's stock price had moved up to where we sold half of our position. Then the stock continued to rise rapidly, hitting our final sell price in December. We sold all of our non-taxable shares, i.e. those not generating capital gains, in December, holding the remaining taxable shares to be sold on the first day of January. This split of taxable versus non-taxable would have been impossible ten years ago. But our firm has grown an ability to move deftly through the obstacles involved in this process. We can thank Joyce Bell, Derek Richards and Robert Stovall for that.

We hope this rather lengthy letter deepens your understanding of our process. We want you to stay informed and feel comfortable about our investing discipline. In communicating, we try to “do unto others as we would want done unto us.” If you’re new to Academy, past quarterly letters may be useful and may be obtained through your financial advisor or Margie Shelton at our office. In addition, our website (at www.academycapitalmgmt.com) has our investment reports on the individual holdings in your portfolio.

Government regulations also require us to send the enclosed copy of Academy's Privacy Notice and to make available a copy of our updated Form ADV - Part II (our regulatory filing with the SEC). If you would like one, please contact Robert Stovall at our office.

As always, we appreciate the stewardship responsibilities you entrust to us and your patience with our investment process.

Academy Capital Management