ACADEMY
CAPITAL MANAGEMENT

January 29, 2018

Enclosed is your statement for the fourth quarter of 2017.

In the fourth quarter of 2014 we stated, “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.” Our preferred stock holding period is “forever”- as long as the underlying company is preserving or increasing its competitive advantage. We prefer extremely low turnover in our portfolios. However, rapid advances in technology combined with high prices to cause the sale of several portfolio companies during the past year.

In March, we sold our final position in Walmart (WMT), the world’s largest retailer by sales. We started buying WMT in 2005 when a pushback against their expansion into urban areas gained traction, causing their stock price to drop by almost one-third. We had long admired their low-cost, high integrity business culture financed by a business model of increasing volume while decreasing prices. We term this a “virtuous cycle.” As a result, we assigned WMT our highest rating – Tier I – something we never give retailers. When the stock price hit our “margin of safety” price level, we pounced and happily planned to own it “forever.”

Then the disruption of internet retailing increased and WMT was not adjusting. Over time, WMT’s ability to change seems impaired due to a structural reliance on a narrow range of large scale manufacturers. Internet retailing, properly executed, drives a better “value” proposition through an increased variety of goods and increased convenience. Walmart’s “virtuous cycle” started to sputter with flat or declining same store sales. That can become a “vicious cycle.” We dropped WMT to a Tier II and began trimming in 2016 and completed our sales in 2017. Our investment results were satisfactory, but did not have the holding period we had hoped for.

Also, in March, we sold our final position in International Business Machines (IBM). For years, we had passed over IBM due to its complexity, but were impressed with its business results and extensive share repurchasing. After Warren Buffett purchased a huge position in IBM, we dug deeper, including a study of former IBM CEO Louis Gerstner’s “Who Says Elephants Can’t Dance?” In it, he detailed how the company’s complexity was built around a simple idea – consultative-based selling that could drive multiple sales in multiple areas. These diverse, low margin activities hid the real gem of IBM -

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"middleware," a custom-tailored way to tie it all together with 85% profit margins. Given the scale of its business and the profitability of "middleware," we assigned it a Tier II and when the stock dropped to our "margin of safety" price in 2013, we purchased it.

The following year IBM delivered poor results in its hardware division. The price of the stock again dropped. We purchased more stock because we did not view hardware sales as vital to profitability. No matter whose hardware was purchased, IBM would still consult and provide "middleware." But the following year we did become concerned. Advances in "cloud" computing increased the ability to standardize systems and reduce the need for "middleware" – driving a stake through the heart of IBM's profitability. As a result, we reduced IBM to a Tier III and committed to exit the stock. We began a process of buying the stock on major drops and trimming on strength. Due to our abilities here, we were able to make a slight overall gain despite a 20% drop in stock price from our initial purchase while also collecting a large dividend payment. Our thoughts are reflected in the country song, "It's not love, but it's not bad."

In April, we sold our position in Franklin Resources (BEN), a global investment management company. We had followed BEN for years and were impressed with the conservative, family-led company culture. The Johnson family continues to own more than 20% of the shares and, despite low interest rates, has held a huge net cash position of over $8 billion. When emerging markets, commodities and oil and gas prices dropped in 2015, we were finally able to purchase BEN at our "margin of safety" and looked forward to a long-term relationship. However, technology disrupted again.

In the investment management business, exchange-traded funds (ETFs) emerged as an increasingly popular choice. Due to the length of the current bull market expansion, automatic investing seems to work. Similar to flying an airplane, autopilot functions are difficult to beat in fair weather. As these passive strategies became more attractive, ETFs emerged as a popular solution and assets began to flow out of BEN's active fund management. Initially, BEN held firm to its approach, but then changed to meet the demands of its retail distribution. We viewed that unfavorably. Given that we had profited from our purchases on bad news, we decided to exit our position with gains, nevertheless doing so much earlier than we had hoped.

By August, we sold our position in British Petroleum (BP), a major integrated oil company. Purchasing commodity stocks do not meet our "forever" investment criteria, but if the price is compelling, we are tempted. When it comes to commodities, we remind ourselves of the definition of a miner - a liar next to a hole in the ground. This joke is not so much about the moral failings of a miner, but rather about the limited ability to accurately assess hidden assets. Despite our misgivings, the lingering effects of the horrible Deepwater Horizon oil spill seemed to misprice the stock and in 2013 we purchased it. Management was narrowly focusing its asset base while tempering the aggressiveness responsible for the disaster. On these counts, our investment thesis worked, despite challenges of "lower for longer" oil prices. BP's large dividend and our willingness to buy BP during times of $20 oil allowed us to generate a positive investment result.

In July, we sold our position in Abbott Laboratories (ABT), a global medical supplies company concentrated on emerging markets. In 2010, the stock price of ABT dropped due to concern over a large percentage of earnings coming from one key drug (Humira). We believed the concerns were overstated and could be resolved. In addition, we were impressed with the CEO, Miles White. Our thesis was rewarded as ABT delivered high quality results as well as spinning off its key drug into a new standalone company. In 2014, however, emerging market growth sagged due to a strong US dollar. ABT responded by making a large acquisition, creating high debt levels as well as a reduced focus on emerging markets. This new direction combined with a high stock price caused us to sell our position. Other than not holding ABT "forever", we were extremely pleased with our investment results in ABT.

In November, we sold our position in Core Laboratories (CLB), a global oilfield services company with a focus on reservoir description. In 2015, we took advantage of the "lower for longer" issue in oil prices to purchase shares of CLB. CLB has a long history of the best financial characteristics within the oilfield services area. These financials reflected the superiority of an "information" business with low capital requirements and high value-added. Due to these strengths, we "paid up" for the stock with the conviction that a prolonged oil price downturn would not prove highly cyclical for CLB. In this thesis, we were wrong. CLB's results were cyclical. However, our attention to "margin of safety" pricing allowed us to profitably exit the stock when we reevaluated its cyclicality.

From these discussions, we hope to provide you a deeper look at our investment process. It is worth pointing out that critical to the execution of these ideas is our excellent operations department, led by Robert Stovall and supported by the careful work of Joyce Bell, Derek Richards and Margie Shelton. On a sad note, Margie is taking "early retirement" this March to enjoy her seventies, despite our protests. Please wish her well and welcome Sara Johnson who will be joining us.

If you're new to Academy, past quarterly letters may be useful and may be obtained through your financial advisor or Sara Johnson at our office. Government regulations also require us to send the enclosed copy of Academy's Privacy Notice and to make available to you 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