ACADEMY
CAPITAL MANAGEMENT

January 31, 2023

Enclosed is your statement for the fourth quarter of 2022.

Our focus continues to be a diligent search for the best companies and the patience to wait for attractive prices. In the larger context, we view the current inflation fight to be one with four phases. Phase one is the Fed raising rates. Phase two is the Fed holding rates constant. Phase three is a system-threatening financial breakdown. Phase four is the Fed dropping rates. While the future is a closed book, we believe that the conversations during 2023 are likely to gyrate between "soft landing" and "hard landing" scenarios. At this point, we are ending phase one and entering phase two with some decent investing opportunities, a portfolio of high-quality durable companies and adequate cash for the superior buying opportunities of phase three.

Our fourth quarter letter highlights companies that we have sold during the past year. Our preferred stock holding period is "forever"- or for as long as the underlying company is preserving or increasing its competitive advantage. Low turnover is a hallmark of our portfolios. Last year we sold an atypically high number of six companies. As we have discussed before, we have been reshaping our portfolios with more "irreplaceables" – those companies with enduring dominance. We look forward to a year in which *no* companies are sold.

In January, we sold our position in Leverkusen, Germany-based Bayer AG (BAYRY). BAYRY has diversity in pharmaceuticals, crop science and healthcare. Using a sum-of-the-parts approach, we saw a deep discount to our summed valuation. Headlines for huge jury awards due to glyphosate (the active ingredient in the herbicide Roundup) damage created this discount. We have had prior success in the pharma sector as the legal issues were resolved and the discount closed. However, unlike US-based companies, BAYRY seems to lack the ability to resolve their legal issues. As debt continued to increase, we determined that time was no longer on our side and sold our shares. Due to a sizeable dividend, we were able to roughly break even after nearly three years and move on to better opportunities.

In April, we sold our position in Greenfield, IN-based Elanco Animal Health (ELAN), a pharma company for companion and food animals. Since the animal healthcare sector lacks third party payers (such as insurance or Medicare), there is little generic price pressure. A few years ago, we realized a nearly 300% return on our investment in Zoetis – a similar company. But unlike Zoetis, ELAN's revenues are driven more by food animals than by companion animals. As we deepened our understanding of these lines of business, we redirected more towards companion animal investing. We were pleased to realize a profit of over 20% after two years while reallocating the proceeds to another companion animal investment (more on that in next quarter's letter).

In April, we sold our position in New Brunswick, NJ-based Johnson and Johnson (JNJ), a diversified healthcare company that requires little introduction to our clients since this is our third roundtrip. JNJ is what we term an "equity bond" – meaning a company with high consistency of earnings at slow growth. This is not our preferred category but remains an excellent way to create yield and some capital gains. Given its high price and our view that rising bond yields might be at the expense of "equity bonds," we took our profits. In a brief eighteen months, we were pleased to book a return of over 25%.

In May, we sold our position in Lausanne, Switzerland-based Philip Morris International (PM), the world's largest cigarette manufacturer, concluding a second successful roundtrip in their shares. PM is also an "equity bond" due to the high degree of stability that PM's famous Marlboro brand drives. Despite our admiration for its management as well as their commitment to a "smokeless" future, PM's pricing became expensive. After 8 years of ownership during which we received a nearly 6% dividend yield annually, we are happy to report a capital gain of over 25% as well.

In September, we sold a small position (less than 1%) in Hamilton, Bermuda-based Liberty Latin America (LILAK), a cable-centric provider of communication and entertainment services in Central and South America. LILAK was a spin-off from our Liberty Global holding (sold last year). As with any John Malone-led company, we were pleased with the execution, the strategy as well as the management. Because LILAK focuses on the purchase of cheap assets to sell opportunely, the earnings profile is erratic. This increasingly does not fit well with our focus on "compounders" and "equity bonds." So, we sold our position during a year that would benefit from a realized tax loss. Disappointingly after four years, we realized a nearly 50% loss.

In October, we sold our position in Hershey, PA-based Hershey (HSY), the US's largest producer of chocolate products, concluding our second roundtrip. HSY is another "equity bond" – and operates within an industry that is extremely slow to change. It is remarkable how little change has occurred in the top 10 candies over the past eighty years. With HSY's price high and volumes declining, we took our profits to allocate elsewhere. In a four-year period, we enjoyed a tasty profit of roughly 150%.

Academy Capital Management