Marshfield Associates

Letter to Clients
May 2024

Punk'd

"I've got the skills to pay the bills"
Beastie Boys[1]

In writing about company and industry quality and the kinds of signifiers of durable value creation we seek, we never want to lose sight of the importance of price. Our price discipline, which encompasses the valuation of a company and the setting of a per share price we're willing to pay (based on conservative assumptions as well as the addition of a margin of safety), is an integral part of our investment philosophy. But price also matters in another way: as operating businesses, the companies we analyze pay for many things, including the inputs to the goods and services they produce; the labor needed to run things; the research and development they have to conduct to adapt to or promote changes in demand; and the marketing, advertising, and partnerships they require to support the sales and distribution of what they create. While all of those decisions about how much to pay and for what affect a company's profitability, we're not always in a position to peer as deeply into a firm's spending proclivities as we might like. Instead, as proxies for those considerations, we pay attention to industry structure (are those in the industry forced to purchase from just one seller and are therefore beholden to its whims? do they have a diversity of customers of varying sizes, allowing them pricing flexibility? are they on a treadmill of continuous innovation and R & D spending in order to stay ahead of the pack?) and work to maintain a good understanding of the company's financial return profile. But there are in fact direct behaviors that we can look to that tell us about how much price discipline a company exercises and what kinds of things it splashes out on and what kinds of things it chooses to economize on. Each category of discretionary expenditure tells a story—often a compelling one. Specifically, are they flashy spenders of their shareholders' money, inclined to overpay or take on excessive debt to fund their binges? Do they pay themselves out of proportion to what others do and to the value they create? Are they opportunistic in their capital allocation or wedded to a formulaic set of expenditures that fail to flex as circumstances may warrant? It's a no-brainer that financial matters are material to an investment analysis (duh); but in our view, how and how much a company spends its discretionary dollars provides insight into the culture of a company and especially its attitude towards shareholders that might not be as visible viewed through another lens.

To buy shares in a company without a sense of its spending priorities—especially those that are not integral to its baseline operations—is to allow for the possibility that you will have been "punked" by the corporate equivalent of a mullet: all business in the front, a lavish party in the back. We find four categories of pricing behavior to be especially illuminating in evaluating a company's price discipline as well as its attitude towards shareholders: decisions around share repurchases; acquisition strategy and price-tags; the magnitude and structure of executive compensation; and expenditures on headquarters and facilities. What a company is prepared to shell out on a discretionary basis for acquisitions, share buybacks, headquarters, and CEO compensation tells you a lot about the culture of the company and the

[1] Beastie Boys, Check Your Head, 1992

mindset of management, though not always in a straightforward tale of miserliness versus profligacy. As is often the case in our business, hard-and-fast rules quickly fall prey to a raft of exceptions that are impossible to enumerate in advance. On the other hand, approaching each situation without an analytical template forces one into a Potter Stewart cul-de-sac of “we know it when we see it” ambiguity. Instead, we’ve developed a series of rules of thumb (i.e., heuristics) that nod to our preferences without foreclosing the possibility that an expenditure that might look like a spree is actually a savvy strategic investment in the future.

There’s another thing that ties these particular categories of expenditure together: they are highly visible and can be used as window-dressing to lull the gullible investor into a sense of complacency. What may look to some as charging full-throttle into the future—look! they have a CEO with a GE pedigree; they buy back shares regularly; they have a glamorous glass tower; they buy up all the competition!—might well appear to us as showboating and a lack of seriousness of purpose. Erecting a fancy new headquarters, eschewing fusty old dividends in favor of the practice du jour of buying back shares, showing that you can afford a big-ticket CEO, and the conspicuous consumption of acquisitions can be the financial counterpart of rocking a Rolex Daytona. Obviously, this is not always the case, and sometimes signaling something about your robustness and durability to the public has its advantages. But in our world, things need to make sense, they need to be proportionate to the value they produce, and money spent for no purpose other than showmanship or because everyone else is doing it raises our hackles.

Free Money[2]

The popular trope about stock buybacks (when they’re not being derided as instruments of manipulation or other manner of social devilment) is that—presto chango!—they magically increase the value of your shares, with no tax consequence to boot![3] The truth, however, is more complicated. While buybacks do reduce the share count of a company, thereby concentrating the benefits of ownership among a smaller base, they are not uniformly good for incumbent shareholders. A reduction in share count does mean that each shareholder owns a bigger portion of the earnings pie, sure, but it also can mean that if an excessive price is paid to expand that piece, it diminishes the overall value of the pie, making it one very pricey slice. Thus, if the price/earnings multiple is, say, 50 (as it is for random stock Netflix)[4], it’s reasonable to question whether the money it spent on buybacks last year (totaling nearly $6 billion) might have been better spent elsewhere. Tech companies are notorious for bounteous buybacks; both Apple and Alphabet pay billions each quarter to buy back their own shares (albeit at lower multiples than Netflix). For many companies, especially those in the tech industry, such purchases are more or less required so that grants of shares and options to purchase them for employees are not dilutive to existing shareholders, options being the honey with which these companies (especially those with earnings yet to make an appearance) attract and retain their worker bees. Accordingly, some companies have an outstanding Board authorization to repurchase a chunk of shares and they do so in a mechanized way, irrespective of the price of such shares. Ironically, though, so-called sanitization of options may keep the share count steady, but at the price of a series of trades at an inflated—and value destructive—price.

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[2] Patti Smith, Horses, 1975

[3] The recent change in the tax law to include a corporate excise tax on share repurchases likely changes that formulation a bit.

[4] As of the end of the first quarter 2024. Note that we only pay attention to a company’s p/e as a ballpark stat; our valuation methodology is, for a number of reasons, a measure in which we have far greater confidence.

Here's how overpaying for buybacks can destroy value: suppose a company has $100 in cash on its balance sheet and a share of its stock is worth $100. If it buys that share at that price, there's an equal exchange of value, resulting in no change in the value of the firm and no change in what non-financial types would call reality. Suppose instead, however, that the share price is $100 but that the actual value of that share is $50. The transaction looks the same as in the first example once the purchase is made. But reality begs to differ: the opportunity to use that cash for higher return purposes has been foregone.[5] Had, for example, the company paid out as a dividend that same $100 (let's agree to forget about taxes on those dividends for the moment), investors would receive in cash the same amount in value as the amount by which the value of the firm declined. Or the company could reinvest in expanding or upgrading its own operations, which could yield a more attractive return on the $100 than the dissipation of half its value. To be sure, the shareholder will own a greater percentage of the company's future earnings, but the cost of that increase in ownership is hard to justify; the earnings, a larger share of which the stockholder owns, will have been reduced by the company's failure to realize the full potential of what that $100 could generate or even simply to obtain through holding it as cash and getting a modest return while awaiting a better use for it.

And yet, companies, at times even ones we like, do this all the time. While some corporations whose shares we own—**Arch Capital** comes to mind—buy back stock with meticulous opportunism, others are less particular about when they buy back and what they pay for shares. It's nevertheless worth paying attention to the level of overpricing, whether there is nuance with respect to how much is bought at higher versus lower prices, and whether there are other uses of capital in the organization (or outside it, as is the case with dividends) that could reasonably make better use of that capital. One of the many reasons we like Arch is that their stated mantra of "cycle management"[6] extends not just to how they allocate capital among their lines of business but also to how they conduct themselves in general and how they approach buy-backs in particular. Their financial discipline is all-encompassing and reinforces their culture of painstaking attention to where the best returns lie for them and their shareholders. In contrast to Arch, however, **NVR** buys back shares with abandon, rarely pausing in its program. They have, however, what we deem to be an acceptable reason for doing so: while they buy back shares to a steady drumbeat, they go high volume and hardcore when their shares get cheap. Because their asset-light operating model generates a lot of cash, they have both the firepower and the business model that allow them to spend on stock, not land, at the bottom of the cycle. And while they are expanding their footprint and market share, they're doing so in a measured and deliberate way that doesn't require masses of capital or the purchase of someone else's operations to achieve those goals. In contrast, their competitors in the homebuilding industry tend to buy shares only when they're flying high, flush with cash and, not co-incidentally, enjoying a rich share price.[7] Basically, NVR can afford to repurchase shares regularly given that they're willing to back up a truck when their peers are focusing their energies on loading up on land instead.

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[5] As, of course, it has been in the first case, but the set of better opportunities there is much smaller.

[6] This refers to the company's willingness to pull back when pricing in an insurance market is soft and to go full-throttle when it hardens. Embedded in that concept is one of capital allocation among their businesses according to the relative opportunities provided by the property and casualty insurance/reinsurance/mortgage insurance markets.

[7] In the wake of the great financial crisis, in 2010, when home builder stocks were quite out of favor, NVR bought back 4.9% of its shares (net of issuance) and bought back a further 12.1% in 2011. By contrast, Toll Brothers, a reasonably well-managed home builder we once owned, was a net issuer of shares in 2010 (+1%) and bought back only a small amount in 2011 (-0.5%).

Bulls on Parade[8]

Acquisitions, of course, are another use of capital that help shine a light on a company's spending philosophy, and a showy one at that. They also provide information about the strategic goals of the company and what it's willing to pay to purchase rather than build for themselves the components management deems important for the firm's success. The types of acquisitions companies make are myriad but can loosely be categorized along a series of continua: modest tuck-ins versus large and transformative purchases, offensive and intended to expand the business versus defensive and intended to foreclose an opportunity for a competitor, and accretive to growth and margins versus decremental or neutral to them. Acquisitions, along with the prices paid for them, are rich in information for the curious investor.

All companies are confronted with the "make or buy" decision on a frequent basis; even questions whether to outsource the development of information technology or build it internally invoke the need to understand what is core to a business and what is not and what skill sets they "own" and which they don't. But particularly in the case of a company moving into new areas, whether geographic or of the product or service sort, the question of whether to "greenfield" through their own internal R & D and repurposing of managerial resources or whether to find an acquisition target that fits the bill well enough is key. In addition, there are companies whose sole purpose (and here, we're not just talking about SPACs and rollups) is to acquire a portfolio of operating companies that are aggregated under a single holding company. But what we'd like to discuss here are companies that elect to purchase the know-how, customers, and management teams of other firms in furtherance of their core operating business(es).

We often run into whole industries where acquisitions are simply a part of the culture. Once upon a time, way back in the 1990's, pharmaceutical companies relied on in-house labs for most of their drug development. More recently, though, companies like Johnson & Johnson have come to rely more on acquisitions of new pharmaceuticals once it becomes clear that there is a "there" there after the startups have borne the risks of clinical trials. Of course, waiting for greater certainty of the efficacy of a new drug makes such acquisitions costly. This is typically a safer but more expensive way to grow while minimizing the risks entailed in creative failures.[9]

Of course, the cost of the acquisition matters, whether it saves you theoretical "build" dollars or not. Many elements contribute to the cost of an acquisition, including the number and kind of competitors for it (which, in many industries include private equity, which may be willing to pay up via the use of leverage), the perceived necessity of making it (a sense of urgency can breed inattention to price), the level of hype around the target, and the return requirements set by the various bidders, which can vary from one to

[8] Rage Against the Machine, Evil Empire, 1996

[9] The declining returns in big pharma suggest R & D might well have been better off had it remained within the companies, though the move was probably inevitable. The abundance of venture funding created a raft of new centers of innovation to compete with them and they had to choose between competing with them or joining forces.

another, based on their own cost of capital or other parameters. But from our perspective, paying too much for an acquisition is really no different from paying too much for buybacks; it redirects the cash and/or other assets of a company used for payment from potentially higher return uses. Our yardstick to determine overpayment is crude but, we think, provides us with a simple heuristic: if a company pays in excess of what we believe the target's intrinsic value should look like based on its growth trajectory, margins, and reinvestment requirements, we think that, probabilistically speaking, it's likely to be too rich a price. And if we see that company doing this multiple times, we take particular note.[10]

Recently, we completed the sale of our long-held position in Goldman Sachs. As is often the case with such things, a series of concerns had begun to stack up, including long-held reservations about the sharp-elbowed culture, questions about whether CEO David Solomon was really the right guy at the right time, and ongoing mutinous attitudes among the rank-and-file. But what finally lit the fuse on that pile of kindling was strategic disarray in the company's retail banking efforts. While the company has enjoyed relative success with respect to its online savings vehicle Marcus, it bombed out resoundingly when it sought ham-handedly to expand Marcus into "the banking platform of the future".[11] Not only did it prove unable to crack the code of online checking, it made an ill-fated acquisition at what proved to be a fatally rich price. In diving head first into checking and consumer lending, it chose as its launchpad GreenSky, a specialty lender focused on "buy now pay later" in the home improvement sector. When Goldman agreed to pay $2.24 billion in 2021, it looked like a bargain entry point into BNPL, given that GreenSky went into its IPO with a $4 billion valuation. What Goldman failed to anticipate, however, was that GreenSky's valuation was inflated even at that lower price, given that it had been temporarily boosted by spending on home improvements during the pandemic. What, perhaps, it could not have predicted (but still arguably should have understood via scenario testing) was that an increase in interest rates would dim the shine on BNPL for consumers, while also elevating default rates. As a direct result, Goldman soon reported sizeable losses for the platform solutions unit, the consumer vertical whose crown jewel was meant to be GreenSky. Finally, with GreenSky languishing on the auction block, Goldman was able to sell its deadwood for the mid-hundreds of millions, no b-handle in sight.

Moody's has proved to be a far better judge of the value that acquisitions can bring to the table. Following the financial crisis, Moody's had insights about two things: its ratings business was robust but subject to legislative and regulatory tampering (though the industry handily defeated the more intrusive proposals made at the time); and its somewhat sleepy analytics business could be transformed into a powerhouse utility for other regulated entities such as banks that had new and more burdensome statutory and regulatory obligations imposed on them by the Dodd-Frank legislation that was passed in the wake of the crisis. It understood that growing a different—but conceptually related—part of its business made sense. While it built much of this now $3.1 billion annual revenue[12] business via acquisitions, its core analytical

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[10] Lots of companies express their return requirements on a purchase in terms of it being accretive to earnings within a specified timeframe. We call bull on that; if a company is earning 3% on cash and it buys something that returns 4%, that's accretive, but hardly an adequate return for an equity investment.

[11] Per David Solomon when he announced the acquisition of GreenSky.

[12] As compared to the ratings business, which generated $2.9 billion in revenue in 2023. Note, however, that while the ratings business, as a member of a quite resilient oligopoly, is higher margin, analytics is nonetheless no slouch in that department; indeed, it has been improving margins markedly over time.

skills underpinning its ratings business were both transferrable to the broader analytics space and part of a brand that could easily extend to non-ratings analytics. Moody's went on an acquisition hunt that persists to this day, building and then reinforcing and then expanding its analytics business to encompass the information tools required by an array of businesses.[13]

Just as with share buybacks, however, there are caveats to our antipathy toward unnecessary or pricey acquisitions. Both **Visa** and **Mastercard** are serial acquirers—mostly of tech start-ups within the payments ecosystem—and often at prices that seem out of line with the apparent benefit. But by the same token, both companies, as measured by their operating margins, are among the real stars in our portfolio. Some of the companies they acquire are purchased for defensive reasons; that is, they want to ensure that rivals do not have access to the technologies they own. Some are a means to enter into adjacent areas of business with which they want assistance. And some are simply ways of acquiring talent that they can repurpose to other endeavors within their organizations. They have not paid enough for acquisitions to dent their margins over time, and their capital expenditures on top of depreciation and amortization remain within reasonable bounds. And certainly, with margins in the mid-50% to mid-60% range, respectively, Mastercard and Visa can afford to spend a little mad money. But perhaps most pertinently, the theater they create via these acquisitions is intended to ward off new entrants into a business that is mind-blowingly attractive. And that is a worthwhile use of their capital. Fittingly, their cultures, as far as we can tell, are prudent and cautious, and while such spending might suggest otherwise (and we keep our eye trained on that ball), our assessment is that as a total package, it actually makes sense. It helps them with hiring in a very competitive space, it allows them to fund innovation without having to produce it entirely on their own, it signals to competitors that they're not asleep at the wheel, and it gives them visibility into competition they might not otherwise be aware of when they're playing the role of potential acquirers/funders. We're not arguing that the exception proves the rule here exactly, but we are saying that if the scale players in an industry believe it's in their interest to absorb nascent competition, their culture is otherwise appropriate and supportive of their business and strategy, and they do so without dampening returns,[14] who are we to complain?

Cashing In[15]

It's difficult to draw conclusions about the absolute level of executive pay in an era where the post-WW II unwritten compact between workers and management has been all but obliterated. Maintaining some kind of rational relationship between the two seems quaint, the momentary outgrowth of a more communitarian time. Starting in the 1970s, management compensation has risen like helium almost across the board. We don't have professional opinions about that development other than to retain a

[13] Although we're not focusing in this letter on such fripperies as corporate jets and the like, it was just announced that Moody's has agreed to be the "Official Cornerstone Partner" of the New York Jets and Giants at MetLife Stadium in New York. In contrast to the wisdom that is apparent to us in the company's acquisition strategy, we're scratching our heads pondering what synergies a business-to-business provider like Moody's sees in partnering with a ballpark, however corporatized football may have become. Needless to say, our questions for them are already written.

[14] Of course, it's always possible that paying a bigger dividend, for example, and permitting shareholders to reinvest that capital as they see fit would be a superior use of the companies' capital, but that possibility seems remote given these companies' returns on capital.

[15] Minor Threat, Out of Step, 1983

skeptical view of the incentives surrounding pay and the company's (and more to the point, the Board's) practices with regard to carrots and sticks. Accordingly, here are certain things we can and should evaluate with regard to CEO pay in particular: whether it is higher than the norm in the industry; whether options and other incentives that accompany the salary are aligned with the generation of shareholder value; and whether it fluctuates with the fortunes of the firm, especially when those fortunes have diminished.

It's hard to resist taking a whack at America's favorite corporate punching bag du jour, Boeing.[16] Its CEO during the company's most recent spate of mishaps, ex-GE exec Dave Calhoun (where "lean manufacturing" and "Six Sigma" have been a religion), had been drafted in early 2020 as a way to signal the company intended to improve its game following deadly crashes of its 737 Max 8 jets in 2018 and 2019. Apparently, though, Calhoun failed to get the message. As Calhoun presided over the company and its supposed revamping,[17] the manufacturer nevertheless continued to produce jets that almost cartoonishly defied safety regulations.[18] As a result, door plugs blew off mid-air, poorly made rivets were painted over rather than replaced, flawed fuselages were accepted from Spirit AeroSystems, their epically shoddy supplier, and most recently, critical engine parts went walkabout during takeoff. This Wylie Coyote-like saga has made it clear that the company was willing to sacrifice safety and quality along the production line in exchange for speed and profitability, without stopping to incorporate the improvement part of "continuous improvement". And while the company has not paid a dividend to shareholders since March 2020 nor repurchased shares since 2019 (okay fine, whatever), it certainly did not skimp on executive pay. Calhoun's tenure has been marked by rich—and accelerating—compensation; he was paid $22.5 million in 2022, with a 45% bump up to $32.8 million in 2023.[19] Our beef is less with the absolute level of his comp than with the Board's failure to flex it downward in response to readily detectable signs of the failure to fix the company's problems.[20] Though earnings continued to look good for the company through 2023, the metrics for the guy coming in sworn to repair things should have been whether they've been fixed on the inside, not whether earnings are temporarily pretty on the outside. It's probably safe to say that quality was not job 1[21] for Boeing, notwithstanding the boilerplate lip service paid to it. But even that boilerplate reads as false on its face, with pay benchmarked against peers as the starting point, with financial metrics the most prominent among the factors considered for awarding bonuses and options, and things like safety and quality simply listed as among other core values to be considered[22]. This was recently acknowledged in a back-handed way; in an attempt to address the failure to prioritize safety, the company announced plans to tie incentive comp for all non-union employees of the commercial unit more tightly to safety, with 60% of the annual bonus dependent upon safety and quality metrics.[23] While also

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[16] We highlighted Boeing's lousy culture before in Game of Thrones, Letter to Clients, December 2021.
[17] Prior to his resignation announcement in March of this year.
[18] We would not normally turn to words like "game" and "cartoonish" in describing safety incidents that claimed lives, but the lack of corporate seriousness in addressing these issues almost begs for their use here.
[19] To be fair, much of that bump was an acceleration of stock options in anticipation of his separation from the firm.
[20] On audit, the FAA found an array of issues, with the company failing 1/3 of the production audits the agency conducted. Of 13 product audits conducted, the company failed 7. Shockingly, in one instance, agency observers saw mechanics using a hotel key card to check a door seal and in another, saw them using Dawn soap "as a lubricant in the fit-up process". See New York Times, "F.A.A. Audit of Boeing's 737 Max Production Found Dozens of Issues", March 11, 2024.
[21] Apologies to Ford Motors.
[22] In fairness, though, the proxy statement does allow for claw backs in the event of "certain types of misconduct or negligent conduct, particularly where such behavior compromises the safety of our product or services". To date, we are not aware of any attempt to claw back Calhoun's pay, however, misconduct and negligence likely being difficult to document with respect to a CEO.
[23] Financial incentives had represented the bulk of the award, with only a quarter of it reflecting operational objectives, among which were quality and safety goals.

applicable to the company's C-Suite, the sword of Damocles poised to slice bonuses by almost two-thirds is blunted for the top execs since they also get bonuses for the financial performance of the other two units.[24]

In describing how we define appropriate CEO pay practices, we're tempted by the Sherlock Holmes trope of the dog that didn't bark in the night[25]: it's what's not there that's important. Along these lines, **Fastenal** provides an interesting contrast to Boeing. CEO Dan Florness earned $750,000 in cash compensation each of the last two years, was paid less than $1 million in option awards, and maxed out at $4 million a year in non-equity incentive compensation. The company's stated compensation philosophy is to pay annual base salaries that are "generally below" the market median and are meant to remain unchanged from year-to-year unless there is good reason to change them, the idea being to emphasize incentive comp as much as possible. The cash incentives are based on growth in pre-tax or net earnings and are intended to be above the market median, as an added incentive. Longer term carrots are provided in the form of stock options, but no re-pricing or reloading of them is permitted. In our lengthy tenure as shareholders under several different management teams, we have never seen this formula abused, nor have we felt that rewards for service have been misplaced.

Expeditors is also an exemplar of what we like to see in the way of executive comp. CEO Jeff Musser makes $100,000 in annual salary, with an annual award of $2.9 million in company stock, along with additional cash incentive/performance bonuses. The net result has been a range of comp totaling between $7.5 million and $13 million over the last three years. He, too, has had a steady hand in guiding the company through rough times and flush times, without drama.

And then, once again, there's NVR. NVR pays its CEO a lot. Between 2006 and 2023—years encompassing the housing meltdown and financial crisis—the company's CEO earned $156 million in total compensation (with some extra added in over the last few years for his role as Chairman). And yet during that time, NVR has grown its book value per share by 577% (14.6% annually), bought back shares robustly and at breakneck pace when its stock price moderated (see above), and has delivered us long-term performance well ahead of the S&P 500. For what it's worth, a rich CEO pay package seems to be the ethos of the industry, with the CEO of Toll Brothers, for example, netting $15 million last year and that of Lennar receiving total comp in 2023 of over $34 million. It's also worth remembering that during the housing downturn, NVR experienced only one quarter in which it lost money, while its land-rich, spec home-building competitors sustained far greater damage over the course of the pullback. Would we rather have at least some of the compensation paid to the CEO distributed to shareholders? Of course, but given the stock's long-term performance and the otherwise shareholder-oriented culture of the company, we're satisfied to continue holding it despite that.

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[24] Wall Street Journal, "Boeing To Tie More of Employees' Incentive Pay To Safety", March 7, 2024.
[25] Sir Arthur Conan Doyle, "The Adventure of Silver Blaze", The Strand Magazine, 1892.

Brand New Cadillac[26]

We're not opposed to companies having pleasant offices or even campus-like facilities where employees work in an environment conducive to collaboration and the free exchange of ideas. And yet some companies are conspicuous in their use of shareholder money to build temples to themselves and their leadership. Those of us with long tenure at Marshfield can still recall the time we visited a company headquartered in Minnesota, the Land of Lakes, where, while awaiting the CEO's availability, we watched as bulldozers were busy excavating a large hole outside corporate headquarters. Upon asking what was being built, we were told that a lake was being moved there from another part of the property. Far be it from us to micromanage expenditures to the extent that we would protest the relocation of a pond (it was actually pretty small, causing those of us not hailing from L'Étoile du Nord to wonder about the claim of having 10,000 "lakes"[27]), but the priorities exemplified by that decision were made clear to us: the company was being run at least in part for the benefit of the guy we were about to meet, out of whose window the new lake would soon be visible.

Some years ago, we owned Devon Energy, a company that seemed pretty conservative in the swing-for-the-fences oil and gas industry. For a long time, Devon distinguished itself by sticking to its guns in the natural gas space even as the market for gas languished. When we first visited the company in Oklahoma City, we were impressed by their patchwork of buildings seemingly stitched together with baling wire; they clearly had no time for the kind of glitzy showmanship of their rival Chesapeake Oil, with its nearby skyline-dominating tower. Scroll forward a bit, and we were perplexed by Devon's pricey acquisition of oil assets after such a lengthy period of restraint (and shortly before gas prices took off). We went back down to Oklahoma to talk with the CEO in order to understand his reasoning. As we left the airport, we noticed a second tower looming on the horizon; in addition to adding oil to its portfolio just as gas was about to recover, Devon had succumbed to the urge to compete with Chesapeake in the erection of a monument to itself. We sold the stock.

Contrast this with Fastenal, whose offices when we first visited them were modest at best, threadbare at worst. When they finally built new offices, they remained low-key and functional, with nary a lake in sight, despite its location in Winona, Minnesota. But even more appealing to us was the story they told on themselves and that we've repeated many times ourselves as evidence of their can-do culture: when they built their first distribution center, which was immediately adjacent to their headquarters, they misoriented the fulfillment line along the width rather than the length of the building, making it harder to accomplish all they needed to in the shorter run of the line. But they worked harder and faster and, ultimately, it became their most productive facility.

True to the spirit of this letter, there is an (apparent) anomaly among our holdings, and that's **Cummins**. Located in Columbus, Indiana, Cummins has hosted one of the most ambitious architecture programs in

[26] The Clash, London Calling, 1979
[27] 11,842 to be exact.

the country. In 1954, CEO J. Irwin Miller, who disdained bland post-war architecture, sought something more innovative for his hometown and established a fund to cover the design fees for dozens of public projects nearby. Architects such as I.M. Pei, Robert Venturi, and Eero Saarinen heeded the call, as did sculptor Henry Moore and glass artist Dale Chihuly. Kevin Roche, a Pritzker Prize-winning architect, designed the company's own headquarters, a precast concrete and glass structure built in 1983, still standing and arrestingly modern. Constructed on a former railroad yard, it was built in the shadow of Cummins's first factory. Sentimental, perhaps, but the consequence of Miller's sentimentality is a town of 50,000 that attracts some of the best engineering minds from around the world, as well as tourists paying tribute to what the American Institute of Architects has designated as the sixth most architecturally significant city in America.

I Wanted Everything[28]

Those old enough to remember Punk Rock in its nascent form will recall that its DIY culture and stripped-down aesthetic was a response to the pomp and bloviated excess of Prog Rock.[29] Sometimes allowing a company a little latitude to let its hair down and indulge in a bit of performative grandiosity permits it to sharpen its focus on what really matters: growing earnings over time and creating long-term value for its shareholders. But more often it reveals misplaced or corrupted priorities that erode returns to shareholders, either directly through their costliness or indirectly through a dysfunctional culture that values showmanship over stewardship. It's our job to see the difference. And while we can't have it all when it comes to positive corporate attributes—or the absence of negative ones[30]—it's also our job to decide what flaws are tolerable and what, in the end, are deal breakers.

Marshfield Associates

The information contained herein should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any securities transactions, holdings or sectors discussed were or will be profitable, or that the investment recommendations or decisions that we make in the future will be profitable. The opinions stated and strategies discussed in this commentary are subject to change at any time.

[28] The Ramones, Road to Ruin, 1978

[29] Wherever your musical proclivities lie between the two genres, be it with Rancid or Pink Floyd, perhaps we can at least agree that Yes was an awesome band (See, e.g., The Onion, "Scientists Still Unable to Determine Whether Yes A Good Band", January 15, 2020).

[30] Or we'd be 100% in cash.