



Letter to Clients  
February, 2026

### Castle Keep

*“Sir Rupert built a sturdy moat,  
To keep out foes and help his boat.  
But when the drawbridge fell, ker-plop!  
He found his trousers full of slop.”*

Original AI “poem”

*“The first item of business in constructing a solid defense is to reduce the number of routes from which a Viking or other raider can approach your castle.”*

William Gurstelle, [Defending Your Castle](#)<sup>1</sup>

Warren Buffett famously compared the perfect business (and we paraphrase here) to sole ownership of the only source of water on an inhabited island. Note that exclusivity and built-in demand for a life-critical resource are key elements of this fantasy. But also essential to Buffett’s ideal is a moat (in this example, a literal one): even the most cavalier of entrepreneurs might rightly balk at shipping water to a distant land that has its own wellspring. We at Marshfield are big fans of (metaphorical) moats and will lower the drawbridge to our portfolio only for companies with clear, strong, and lasting ones. While neither monopolies nor captive customers exist to any meaningful extent outside of Buffett’s dream world, businesses can clearly still generate attractive returns without having absolute dominion over their customer and product. What they cannot do, however, is maintain those returns without some defensive tools in their arsenal.

The ability to repel or stymie the invading hordes anxious to snag a slice of a company’s profits involves luck, aptitude, and a touch of ruthlessness. Classically, economic moats have been defined as comprising five categories: (1) intangible assets like proprietary brands and patents (we would add culture to that list); (2) network effects where success accrues at an increasingly greater rate to the already successful; (3) switching costs or stickiness that

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<sup>1</sup> [Defending Your Castle \(Build Catapults, Crossbows, Moats, Bulletproof Shields, and More Definitive Devices to Fend Off the Invading Hordes\)](#), William Gurstelle, Chicago Review Press, 2014, p. 134, Kindle edition.

keep customers from leaving; (4) cost advantages, often as a result of size (think Amazon or Walmart); and (5) “efficient” scale, where the structure of the industry itself discourages multiple participants, as in geographically limited or niche markets or markets constrained by stringent regulation.<sup>2</sup> Each of these varieties of moat exists along a continuum from weak to strong and from temporary to reasonably sustainable.

The best defensive architecture is comprised of more than one of these moats in overlapping and mutually reinforcing ways. But there’s more to it than that: every moat should operate in tandem with and be supportive of that which makes the company special, namely its value proposition to customers and its strategy for delivering that value to them (in other words, the company’s “crown jewels”). It can be easy to confuse moat with value proposition or competitive advantage. Basically, a value proposition entices customers. A competitive advantage affords a company a leg up in offering that enticing value. And moat stands between both and the outside world of heaving competition. To simplify it further: **a moat is what gives a company the time and space to stay special.** And, as a corollary, the ability to reap the economic rewards of that specialness. A moat is not the better idea behind a new product; it’s the patent behind that better idea.<sup>3</sup>

In researching for this letter, we came across some lazy analyst commentary about CarMax’s purported moats, and their consensus is a doozy: the company has a data advantage, a national logistics platform, a “unique” business model, a car refurbishment process, and an appraisal program that fuels inventory acquisition. That’s great and all, but each one of those attributes is at best a competitive advantage rather than a moat. Perhaps they once had daunting scale to keep others out—a moat, but clearly not an insuperable one in this case, as it has already been breached by Carvana. Each of the other features can be copied down to the new car smell used in their refurbishment process.

## The Moats in Our Eyes

For the most part, the moats around our companies are relatively easy to categorize according to classical theory. Companies like **Visa** and **Mastercard** enjoy multiple moats. For starters, they own high visibility brands that consumers recognize and trust and that issuers like to work with; they have massive scale; and as the operators of the rails that

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<sup>2</sup> Warren Buffett first introduced the concept of a moat and identified the primary categories, but others have further refined the concept to focus principally on these five.

<sup>3</sup> Of course, patents do expire. In the breach, a promising pipeline of new patentable ideas can start to rebuild a moat. Or if brand loyalty is robust enough, sustained customer preference can at least prolong its life, if perhaps less durably than seventeen more years of IP protection would.

connect issuer to consumer to merchant to merchant acquirer and back again, they effectively own the network that ensures that digital transactions can be completed in a timely, efficient, and safe manner. It's simply not feasible—currently, at any rate—for a competitor to replicate the whole network, much less to get buy-in from participants at each of those connection points. Moreover, the more integral to the credit and debit system they are, the more success they have in extending and maintaining their centrality to the network they created (cue network effects), especially as transactors increasingly eschew cash in favor of digital payments solutions. Finally, they operate in an intrinsically oligopolistic industry that, in turn, provides structural advantages via efficient scale and the ability to absorb costs others can't, making them a juggernaut against which new entrants have great difficulty competing.

Also benefitting from scale and network effects is **UnitedHealth Group**, whose magnitude and ubiquity confer material advantages. It uses both its sheer size and broad scope of offerings (it owns a pharmacy benefits manager and numerous physician practices, among other things, in addition to its mighty insurance business) to embed itself in a system that has come to rely on it in such heavily regulated areas as Medicare Advantage.

**Moody's** benefits from an intangible barrier to competition in the form of a warm regulatory embrace. Moody's is an NRSRO<sup>4</sup> whose ratings are essential to investors looking to assess the creditworthiness of entities that issue public (and sometimes private) debt. In the aftermath of the financial crisis when the stock of the existing NRSROs was in the (literal as well as figurative) dumpster, a number of possible entrants—Palantir rumored to be among them—considered entry into the business, only to back away once the difficulty became clear.

**Cummins** also finds shelter behind the government's ample shield. It benefits from the stringent and ever-evolving regulatory requirements to which OEM truck manufacturers are held. Its know-how and engineering chops are unmatched as competitive advantages, but it is the configuration of the truck-making industry (effective scale!) that has helped Cummins create a deep moat for itself. The complexity of new rules and the technical knowledge required to implement them make it virtually impossible for each OEM to stay on top of every change and to produce the multiplicity of engine types needed for the business.

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<sup>4</sup> A "Nationally Recognized Statistical Rating Organization" or NRSRO is a registered entity approved by the Securities and Exchange Commission to issue ratings that assess the likelihood of corporate, government, and financial instrument issuers to repay their debt. There are ten such entities, most of them niche players, but three that dominate: Moody's; Standard & Poor's; and Fitch.

**Fastenal** also exemplifies multiple concentric and reinforcing moats; its “midwestern” culture, where getting the job done overrides thoughts of clocking out for the weekend, is intangible but an organic expression of who they are and, we would argue, impossible to achieve through a simple top-down mandate.<sup>5</sup> The stickiness that results from authentic (not merely rhetorical; we can tell the difference) customer-centricity and deep integration into the workflow of an organization intertwine to produce extremely high switching costs.

Finally, **Arch Capital** and **Progressive** possess intangible cultural attributes that showcase the kind of disciplined underwriting that, try as they might, competitors have great difficulty emulating. We have written ad nauseam about Arch retaining its underwriters through lengthy soft markets, in effect paying them NOT to write new business but instead to stay armed for their next battle, ready to put pen to paper as soon as the market hardens. Their focus on cycle management—moving into and out of businesses as the insurance cycle and the prices they can charge wax and wane—bespeaks a culture adept at shapeshifting to suit the environment. As to Progressive, many businesses claim to possess a data advantage; in property casualty insurance (unlike, say, used car sales) data is the lifeblood of profitable underwriting and risk selection. If truly proprietary and broader and deeper in scale and scope than the next guy’s, as we believe is true of Progressive’s pool of data, it can act as a moat, especially if layered on top of it is a sustainable advantage in better data-parsing. The ability to produce adverse selection for the rest of the industry can form a very wide moat, albeit one that others could in theory penetrate if they figured out the secret analytical sauce. And yet Progressive’s troves of both historical and current proprietary data, but more critically, their acumen in deploying it with precision (it is, for example, a pioneer in the use of telematics to collect, analyze, and price risks based on real-time driving behavior), intertwined with its strict culture of discipline, has proven itself to be unassailable over long periods of time in an otherwise commodity industry.

But even the most heavily fortified and durable-seeming moat can be overcome by the forces of clever mimicry, technological advancement, or simply catching an incumbent asleep on the bridge. As Benjamin Franklin famously observed about the country’s founding, the U.S. forefathers created for following generations “a republic, if you can keep it.” Something similar applies to companies in a capitalist ecosystem: those with a differentiated and attractive value proposition can establish a thriving business capable of accruing economic rents—but if and only if they can keep their advantages from being distributed like pieces of candy among their competitors. Unfortunately, the more attractive those rents, the more

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<sup>5</sup> While we typically think of a good culture as a competitive advantage, it can form a moat if it’s critical to either producing or delivering value to the customer AND difficult if not impossible to reverse-engineer and replicate. Much more on this below.

likely entrants will arrive and try to compete them away. Given enough time and resources, every castle can be breached. The trick is to treat the moat not as a static bit of masonry and water, but as something to which siege can be laid and therefore in need of continuous reinforcement. Understanding how a competitor may try to overcome one's defenses is therefore itself a critical component of moat-building.

In each instance below, we describe the kinds of things that our portfolio companies with otherwise robust-seeming defensive structures do in order to prolong and support them against clever competition. While companies looking to preserve their moat can take any of a series of approaches, including reinforcing it, reimagining it, creating an additional one, or engaging in offensive maneuvers, we appreciate how each of our companies uses tools that are consistent with its own culture and skillset. Sometimes, simply throwing enough sand into the gears of wanna-be marauders is what works; think of the "trip steps" in medieval English castles that can bring fast-paced invaders to a stand-still long enough for the protectors of the castle keep to better arm themselves. Sometimes training an eagle eye on up-and-coming competition and then neutralizing it with a juicy takeover bid before it can take flight might do the trick. In our view, the key for each company with the good fortune to have a sizeable moat is to retain its humility and to keep pushing against the arrogance of self-satisfaction. Winning is great, but the over-confidence that might accompany it can be destructive of sustained excellence. The ability to stay on point and at the ready and to keep fighting (or preparing) when it looks like the horizon is devoid of threats are essential to the durability of even the most impenetrable-seeming moat. Maintaining continuous awareness of current and potential competitors and guarding against potential weaknesses in one's own set of defenses—a healthy paranoia, if you will—is, perhaps, the best moat there is.

### **The Watchtower**

*"The earlier preparation for defense begins, the better are your chances for coming through unpleasantness in good shape."*<sup>6</sup>

Most companies are coy when it comes to questions about their competitors. In fact, it's the rare firm that cops to keeping an eye peeled as to what its rivals are up to. Having not been born yesterday, we pay little heed to those pleading innocent of such knowledge, focusing instead on what they actually do in anticipation of emerging threats to their market share and margins. While too much attention paid to what the other guy is doing can risk

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<sup>6</sup> See Gurstelle, p. 141

deemphasizing your own independent path forward, owning a moat obligates you to stay abreast of potential challenges to it.

This is where both **Visa** and **Mastercard** enter the conversation. They use their scale and knowhow to great strategic advantage. While their core moat of owning the payment system's "rails" is difficult if not impossible to attack, they also compete with others at various nodes along those rails, such as in settlement and processing. Not content to rest on their laurels and feast on their 60ish percent margins, they not only understand precisely where there might be exploitable chinks in their armor but also have a clear view of what's being cooked up by edgelords in Silicon Valley. While we never applaud undisciplined spending, these two companies are strategically flamboyant in their acquisitions, buying up potential entrants around the periphery of their central moat in a show of financial might and proactive attention that is both alluring to startups looking for an exit strategy and a warning to those who might balk at letting themselves be bought. Over the last five years alone, Visa and Mastercard have acquired Featurespace and Pismo (Visa, 2024), Tink (Visa 2021), Minna Technologies and Recorded Future (Mastercard, 2024), and Aiiia (Mastercard 2021), among many, many others, none of whose names we'd wager you'd recognize. Recent expansion into crypto and stablecoin on the platform end and offensive pushes into agentic commerce are helping them expand their reach and further defend their core. The companies' strategy also includes forging strategic partnerships with companies that might otherwise look to compete with them but that they can instead coopt, if only temporarily, into partnering with them. A good example is Ripple, which uses blockchain technology and with which Mastercard is joining to enhance its settlement capabilities. Each of these efforts is in service to the concerted attempt to neutralize disruption and discourage new entry. And so far, at least, the strategy seems to be working.

### **The Hidden Book Safe**

*"Sometimes it's better to be clever than strong."*<sup>7</sup>

Sometimes strong cultures can hide behind a deceptively mundane front. Among intangible moats, we would argue that culture is perhaps the most difficult to attack from without, even though it may seem wispy and ephemeral. Patents expire, noncompetition agreements get breached, and brands erode as fashions and preferences change. While we can recall numerous examples of attacks on a culture from within, leading to degradation or elimination of an otherwise effective culture, we can think of few examples of effective

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<sup>7</sup> See Gurstelle, p. 56

cultural appropriation. Our portfolio is brimming with singular cultures that we believe not even the most enterprising of assailants could readily replicate. Part of that is how each actively strives on a continuing basis to further embed that culture in the warp and weft of the company's strategy and muscle memory. We often hold up **Fastenal** as the poster child for a good, hard-working, "I guess you'd call us kind of Midwestern" sort of culture. The fascinating thing to us about this company, though, is not so much that it's been able to sustain this culture but that it's been able to sustain it through an enormous strategic shift that looked like it might dilute rather than reinforce its neighborly spirit.

Time was when Fastenal owned a fleet of small stores scattered mostly through agricultural America but also with a foothold in some smaller manufacturing towns. It tended to hire graduates from local schools, intentionally avoiding the fancier ones, opting to focus on the typically more down-to-earth aspirations of the farm kid. The company quickly gave those young people a degree of entrepreneurial autonomy that allowed them to prove their mettle by serving the folks that came into their stores in a hands-on way. You want some Gatorade to go with the bolts you came in for? Sure, we'll keep some on hand for you. You need safety equipment along with those screws? We'll supply the goggles you want and we'll remember that for next time as well. The introduction of industrial vending was born out of such thoughtful attention to the particular needs of its customers. The company flourished as a result and was, as far as we were concerned, the key to Fastenal's culture.

Fast forward to today, when Fastenal's store base has diminished relative to the size of the organization and no longer forms the spine of the company or shapes its training or business generation in quite the same way. In its place is a roster of manufacturing customers hosting Fastenal employees on-site to assist in managing the (literal) nuts and bolts of their businesses. Yet the small store way of doing business still informs Fastenal's operating ethos, inflecting it with the same kind of "whatever it takes" focus to get the job done right. So, what did we miss in worrying about this transition? We believe that we misunderstood the directionality of their cultural development. Instead of the culture resulting from store-level entrepreneurialism, their stores were a reflection of the pre-existing cultural DNA of the company. Taking away the stores didn't eliminate that genetic code, as it wasn't the stores per se that injected the culture but rather the culture that led to the early strategy of using stores to get close to the customer. Moving away from the small store paradigm to get even closer to the customer on the factory floor is actually what distinguishes the company's culture. In the process of making this big tactical shift, the company erected a new moat, intertwined with their pre-existing cultural moat: true stickiness. While customers had often preferred them to the competition, there was little other than fellow feeling (and the promise of some Gatorade) that kept them coming back. Now there are tangible switching costs that

make it difficult for a customer to leave. As we write, they are today actively contracting with customers to expand their tentacles on the shop floor through new technologies that automate replenishment and enhance inventory management systems. Try reproducing that, Attila and Tamerlane! Happily, we held onto the company as it went through its evolution, since it demonstrated pretty quickly that it had the chops to do so by building on, rather than degrading, its pre-existing cultural assets.

## **The Palisade Wall**

*“Making a palisade wall is simple, but care must be taken to build the wall so that the spaces between pickets are minimized. Choose logs for straightness.”<sup>8</sup>*

A tall wall with spikes at the top is daunting, to be sure, but any gaps in the vertical planks big enough to allow an intruder to squeeze through means it’s existentially flawed. Here’s where arrogance can do damage: a refusal to appreciate fully how the world might change, either slowly (boiled frog alert!) or all at once, can trap a company with a comfortable defensive advantage into believing that it can simply outlast the changes, never mind the daylight peeking through the slats. Unfortunately for them, however, new technology, in particular, doesn’t wait for potential users to catch up. Perhaps more to the point, lock-in caused by adoption of earlier generations of technology can sometimes turn a first-mover advantage into a fatal inability to pivot.

**Cummins** built its fortress on the unsurpassed power and durability of the diesel engine. Applications for those engines span long-haul trucking and off-highway machinery used in agriculture, construction, and emergency power—even heavy-duty consumer pickups. Its competitive advantage derives from decades of engineering know-how that they carefully cultivate and augment and that allows them to deliver excellence. The moat around that excellence is an interlocking one of best-in-class brand, a meritocratic and thoughtful culture and, most critically, the mountain of constantly changing requirements that govern emissions and fuel efficiency. The resulting industry structure incentivizes truck makers to outsource some if not all of their engine development and manufacturing; investing in each new regulatory tweak can be prohibitively expensive for companies for whom engines are only one part of the completed product. In consequence, Cummins stands as the lone manufacturer of diesel engines for large trucks not affiliated with an OEM truck maker, and it has become king of the hill across regulatory cycles for heavy- and medium-duty on-highway engines, even as those engines have been slated by global climate rules for the

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<sup>8</sup> See Gurstelle, p. 49

(eventual) scrap heap. Perversely, those directives have only improved the company's competitive positioning, as entry into or even maintaining diesel engine production at this stage in the game is a non-starter.

Cummins's success during this interval between the hegemony of the old and the victory of the new may put off its day of reckoning, but it does not eliminate it. The dilemma of how to manage the inevitable replacement of diesel in favor of the winning successor poses a direct challenge to Cummins's long-standing structural moat. Indeed, as the light peeping through the palisade walls of its defense grows brighter, the need for a defensive strategy becomes more apparent. Happily, Cummins can repurpose its existing moats and technology prowess toward next generation technologies. Having scale and a culture that has always embraced change are formidable building blocks for a new wall. By dint of its sheer size, resources, and cash-generating engine that can continue even as change renders it increasingly obsolete (not to mention its great good luck in benefitting from the AI boom in its generator business), Cummins has been able to embrace a wide range of low- and zero-emissions replacement power without being forced by its finances to pick prematurely from among natural gas, fuel cells, battery electric, hydrogen, all electric powertrains, and electrolyzers<sup>9</sup>. They can instead develop and push each new technology as the landscape evolves, weeding out winners from losers over time. Unlike new entrants or divisions of established companies forced to focus their technology bets in advance of the final vote of the marketplace, Cummins has the luxury to turn its scale plus diesel moat into a scale plus [insert winning technology here] moat. At worst, it will share top spot with some who might have guessed correctly on what technology would win, but it will have bested all the others who placed their bets on the loser.

As a comparison, look no further than Waters Corp., which we owned and then sold after we recognized that what looked like a secure moat comprised of an incumbency advantage (aka stickiness) married to patentable technological innovation in workflow for the pharmaceutical business was less imposing than met the eye. In actuality, their customers were always scouting for the newest thing and had little need to remain with the incumbent vendor so long as the specs of the replacement equipment were met. This resulted in a constant race among the manufacturers of chromatography and mass spectrometry equipment to keep innovating in order to stay ahead of their rivals, something known as a

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<sup>9</sup> As of February, Cummins has halted new commercial investment in the electrolyzer area pending further assessment, as market conditions and financial results, along with unfavorable regulations and incentives, have made this strategy less compelling. This is precisely what we expect them to be doing as they narrow their focus over time.

Red Queen business.<sup>10</sup> With no guarantee that Waters was more proficient at innovation than its peers, and with fewer switching costs than it appeared, we bailed.

### **Catapults and Battering Rams**

*“As [General] Sherman noted, obstacles themselves merely slow an attacker’s advance. They must be used in conjunction with offensive weapons.”<sup>11</sup>*

Scale can be an effective moat in industries where suppliers are willing to negotiate price concessions for buyers of size, giving the latter a cost advantage over their smaller rivals. Such cost advantages can be substantial or modest, thereby producing a more or less robust moat. As moats go, scale can rank pretty high along the effectiveness continuum when leveraging it to reduce input costs results in meaningful savings or when it’s interwoven with other moats such as network effects. But it can be more tenuous if it’s a company’s only moat, especially if that company has nothing special that’s tough to replicate at its core. Health insurance provides a great example of this. At bottom, health insurance is really a simple commodity business where know-how can be picked up on the fly and entry is relatively easy. Differentiation in a way that matters—especially where the buyers are often not the actual end customer—is quite difficult. Those buyers, whether employers, the government, or individuals, care principally about the price of a policy, even if that price doesn’t necessarily get them the breadth of coverage they’d prefer.

Enter **UnitedHealth Group**. The profound structural forces that have shaped the health care industry in this country have enabled United to construct a complex moat from what began as a sheer scale advantage into one that includes network effects that reinforce its omnipresence (a broader network of acceptance breeds more customers and, in turn, leads to a greater willingness to participate in the network) as well as cost advantages that extend well beyond those traditionally available to a buyer of scale. What United has been able to do is take the offense in reducing costs by becoming a provider in parts of the business where it thinks it can bend the cost curve to its advantage. It’s a creative solution that has given it access to many of the price-setting levers in the health space, resulting in greater control over costs and more elaborate enmeshment with virtually every part of the healthcare equation. In taking on parts of what the federal government so far seems reluctant to do—

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<sup>10</sup> Named by Curt Grimm and Ken Smith of the University of Maryland’s Robert H. Smith School of Business after the Queen of Hearts in [Through the Looking Glass](#), where Alice, running as fast as she can, makes no progress whatsoever. The pair borrowed the term from biology, where it is used to describe populations that become increasingly fit through evolutionary change.

<sup>11</sup> See Gurstelle p. 134

overt rationing of healthcare in this country—United has used the opportunity to step in as a de facto rationing agent. But by addressing costs more directly as part of that rationing mandate, it has reinforced its moat by becoming an offensive player in the system. It has a pharmacy benefits arm; it owns doctor’s practices, conducts ambulatory surgery in its own facilities, and operates urgent care outlets; it is the preeminent provider of data and analytics, selling to competitors as well as utilizing it themselves; and it provides payment solutions for providers of all types.<sup>12</sup> It is difficult to have a hospital procedure without touching at least one part of United’s vast network of assets. All of this together, especially as United continues to weave its web ever more intricately, make it very, very hard for either a competitor or even the government, a huge player in the space, to displace them.

United’s push into value-based care through its purchase of physician practices provides a terrific window into this strategy of insinuating itself into the very fibers of the system. Value-based healthcare delivery is, at least in theory, a win for all participants: it reimburses providers based on outcomes, quality of care, and efficiency rather than the number and complexity of procedures undertaken. It encourages collaboration among providers, resulting in better coordination and—again, at least in theory—fewer discrete “touches” of the patient. But therein lies the difficulty in implementing it: it requires full buy-in from physicians and coordination with other similarly aligned parts of the system in order to be effective. While it has been increasingly embraced, even by the American Medical Association (at least rhetorically), the traditional fee-for-service model persists. Where United has turned the tables on both the incumbent system and the chattering class critiquing it is in taking actual ownership of the physician practices and converting them to value-based care. While there are many lords, knights, and other vassals in the healthcare insurance system, we believe that this kind of offensive thinking has catapulted United into reigning atop the system.

## **Defensive Earthworks**

*“Since...threats arise quickly, often you won’t have the time and resources to build permanent fortifications such as moats or palisade walls. But it is possible to erect temporary obstacles to hinder or even thwart dangerous raiders.”<sup>13</sup>*

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<sup>12</sup> Demonstrating both its ubiquity and the potential dangers of the same, United’s Change Healthcare, a widely used payment processor in the medical space, was hacked in 2024 by the BlackCat ransomware cabal. This led to a massive theft of data, a widespread shutdown of processing capacity, and the payment of a \$22 million ransom by the company. This occurred before we owned it, under prior leadership that was running the company too hard and too fast for both our taste and that of the market, allowing us an entry point to a company that, now in better hands, continues to have a formidable series of moats.

<sup>13</sup> See Gurstelle, p.134

A company like **Domino's** has, to all appearances, a relatively weak and unstable moat. The value proposition it offers its customers is the preparation and quick delivery of good, well-priced food (even Momofuku chef David Chang has extolled its taste) via the competitive advantages of a tech-forward and intuitive user interface and state-of-the-art back-of-house technology that ensures it can prepare its pizzas and other dishes just in time for either pickup or delivery. But you might ask, so what? What protects this value proposition from competition with the mom & pop down the street or the Pizza Hut next door, not to mention any of the other QSRs scattered across our cities and towns selling salads, burgers, and tacos? For all its brand loyalty<sup>14</sup>, efficiency, and gee-whiz tech, Domino's is still in a commodity business where entry (if not the achievement of scale) is easy and procurement of ingredients a snap.

Much like Fastenal, what makes Domino's a formidable competitor and ties its capabilities into what we consider an effective moat is its differentiated culture. It will do whatever it takes to protect and continue to enhance its brand and to provide its customers with the product they crave. Following its near-death experience fifteen or so years ago after allowing its recipe to degrade and its market share to collapse, it has adopted a "test and practice" ethos where no product gets launched unless and until it has proven that it tastes good, can be executed perfectly with existing equipment<sup>15</sup>, and fits well with their brand. Perhaps most critically, though, it has proven time and again that it's willing to upset the apple cart by shaking things up in order to perfect a new strategy—but always one based around their brand and supported by clever marketing. For example, it understands that one of the fastest ways to lose a customer is to respond late to an order or to deliver outside the promised window. Enter their "fortressing" strategy, where franchise territories in high-density markets intentionally overlap so that the delivery radius is shrunk and high volume at one store can be compensated for by another store's availability. While cannibalization of sales is a short-term byproduct of this strategy, the company (as well as its franchisees, many if not most of whom began their careers at Domino's as drivers) is far-sighted enough to understand that over time, it's additive to sales and scale even though in the shorter term it might sting.

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<sup>14</sup> Brand loyalty can provide a very effective moat, particularly if the brand is sufficiently differentiated and well supported. If not, even a strong brand with loads of loyal customers can prove fragile. Case in point: Southwest Airlines, whose brand is premised on affordability. But the kind of penny-pinching that allowed them to build that brand also caused them to underspend on the technology underpinning the organization. The brand ended up being eviscerated in a weekend in 2022, when the airline endured a massive operational meltdown caused by a winter storm overwhelming its antiquated crew scheduling system. The thousands of cancelled flights during the Christmas holiday were a self-own that tarnished a brand long in the making. Without cultural or other buttressing, brand loyalty can be rather fragile.

<sup>15</sup> As Domino's CEO told us, they'd be willing to try any new product, as long as it went through the oven.

Successful as it has been, though, fortressing left a group of potential customers by the wayside: those who preferred ordering through third party delivery services like Uber Eats and DoorDash. In its measured way, Domino's adopted a strategy to capture customers through each of those avenues without diluting its own culture where the delivery driver is the crown prince; stores might get the orders from DoorDash but it's Domino's that delivers them. The ability to leverage such marketing successes as "emergency pizza" (aka buy one, get one) and its long-standing "mix and match" deal through alternative channels has been a huge success. And helping fuse all this together is Domino's loyalty program, which rewards transactions rather than ticket size, further encouraging their core customer to patronize them even if it's a small order (which tends to become a larger one given the cleverness of Domino's menu addition format). Everything the company does—even the small tweaks—is done with forethought, an eye and ear toward brand-reinforcement, and in a concerted effort to grow and expand their differentiated strategy. In the aggregate, these efforts have forged a cultural barrier to others' ability to overtake them.

As long-time investors in the QSR space, we appreciate the comparison between Domino's and its marketing- and operating-centric culture to that of both Yum! Brands and Chipotle. As should be clear from the above discussion, Domino's understands that it's really a marketing and execution company, and its leadership reflects that. Yum! has taken the opposite approach, resting on its franchise fee laurels rather than reconstructing the moat it lost when it spun out its China operations—its true crown jewel. Chipotle, a company we might be interested in buying again if it mends some fractures in its moat, did an excellent job of instilling greater efficiency in its operations following the exit of Steve Ells, who had allowed such things as employees using their own recipes to make guacamole. But in the process of cutting down on store autonomy to promote better productivity (no more extra scoops of chicken in your burrito!), there seems to have been a reduction in soul and warmth that had helped animate its brand and make a whole generation salivate for it. In making it more financially predictable, Brian Niccol may have exchanged its specialness for short-term profits. The cultural moat that instilled a sense of pride and ownership among the employees might have been swapped for a narrower moat surrounding something less worthy of protection. We keep watching, though, to see if enough of the moat has survived.

### **Trous de Loup**

*"Unless you're in imminent danger, you should not dig trous-de-loup [wolf holes]. These are effective but very dangerous!"<sup>16</sup>*

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<sup>16</sup> See Gurstelle, p.136

In the annals of siege warfare, trous de loup were legendary for their efficiency and devastating results. Wolf holes, at their most benign, slowed invaders down by forcing them to detour around them. At their most lethal, they killed or maimed those unfortunate enough not to clock them until it was too late. The most effective pits were disguised with branches and brush and the interiors were lined with sharpened spikes. While aimed at catching foes, however, trous de loup have a reputation for also tripping up allies unaware of their existence. The possibility of friendly fire, as it were, was thus an ever-present risk.

The modern commercial equivalent of the trou de loup is best represented in our portfolio by Progressive. Like Domino's, Progressive is in an industry that essentially provides a commodity product, where differentiation on the consumer-facing end is of little value, and price (and to a lesser extent, service) is the primary consideration in the purchase decision. Progressive is best appreciated by understanding the sophistication of its back end, with its massive cache of data and its almost forensic understanding of what separates a good risk from a bad one. Together with its adept marketing that can and does flex as market conditions change and its dual distribution strategy (both direct and through an agent) that allows it broad market reach, it has numerous attributes that separate it from the rest of the pack. Progressive's moat around those value-producing skills is well aligned with them; it has a strong brand, buffed and polished by its clever marketing campaigns featuring Flo, and it has scale, which allows it to better refine and implement its proprietary data and analytical tools. But it also has a sneaky streak in its culture that it quietly deploys to sandbag the competition.

In insurance, one of the greatest risks to a carrier is falling prey to "adverse selection". If one underwriter understands that a certain factor correlates with enhanced risk but its competitors are unaware of that relationship, the latter are at a distinct disadvantage in their underwriting picks and their pricing of them. This, in a nutshell, is Progressive's wolf hole strategy: not only can it side-step risks because of its superior knowledge but it can actually redirect those risks to a competitor of its choice. That kind of strategic steering is precisely what Progressive does through its multi-carrier model, where it acts as an intermediary on digital platforms, offering quotes from other carriers for both auto and homeowners policies.<sup>17</sup> While it focuses on acquiring customers with high lifetime value and binding them closely through offering homeowners insurance as well as auto (switching costs!), it has proven quite adept at steering agents as well as direct customers to rivals by turning transparency in pricing into a sword. The main risk it faces through such a practice is falling

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<sup>17</sup> See, e.g., "Destination Progressive...or One of These Other Carriers", February 29, 2024, [carriermanagement.com](https://carriermanagement.com)

unwittingly into its own wolf holes because of glitchy analytics. But to quote Tricia Griffith, Progressive's CEO, "This is where the fun starts."

### **Siege the Day**

Legend has it that China's Great Wall was breached not by armed hordes forcing a retreat but, rather, through open or unmanned gates. If history is any guide, companies would be well served to make sure they have a forbidding moat but also top-notch guards manning the entrances and towers. Leadership, as always, matters. A commitment at the top to moat building and maintenance is critical to a company's ability to protect its value-producing operations and strategy, even at the expense of short-term profits. Whether it takes the form of a better mousetrap, a more efficient distribution system, an analytical edge, or simply a tastier pizza, that core of value needs to be protected at all (or at least appropriate) costs. And then that protection needs to be maintained and even fortified over time. Otherwise, competitors sensing vulnerability will find a way to catapult themselves over even the widest moat and gain access to the crown jewels.

### **Marshfield Associates**

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