



As the advisor to the Tarkio Fund, Front Street Capital Management's purpose is to create meaningful wealth over long periods of time for our clients. To accomplish this purpose, we invest capital in companies we believe will compound cash flow over the long term, holding them as long as they continue to get better and better. Many of these companies can be defined as "lean thinking" organizations. In this letter, we will try to explain how a truly "lean" company can fit into our investment criteria in furtherance of our purpose.

Readers of our quarterly letters will know that we believe companies that exhibit the following qualities are well-positioned to improve continuously well into the future:

- Long-Term Focus
- Integrity, Humility, and Trust
- Employee Empowerment
- Teamwork and Cooperation
- Purpose and Passion
- Disciplined Capital Allocation

Our criteria are based on the principles of management outlined by W. Edwards Deming that helped create the foundation of the Japanese lean manufacturing revolution of the second half of the twentieth century – exemplified by Toyota and its Toyota Production System. Our readers will certainly have seen us use the word "lean" (as well as its cousins "kaizen," and "continuous improvement") on a number of occasions over the years. But what do we mean by "lean" and why do we invest in "lean-thinking" companies?

Under our definition, a truly "lean" company has a strong, noble purpose that goes beyond simply trying to make money and strives to create something beneficial for society. In creating that societal benefit, the lean company provides something of value to customers, for which they are happy to pay money.

In order to produce this value for their customers in furtherance of their purpose, lean companies (like all companies) undertake many, many operations and tasks. As a company grows and tries to provide more value to more customers, these operations/tasks become more complex. Unlike most organizations, lean companies focus on the distinction between those tasks that actually provide value to the customer and those that don't. Here's an example from one of our 15 or so "lean" companies: While making dental implant devices, Envista's (NVST) employees operate the CNC machines that form the titanium screw, which is value-added work. But they also spend time beforehand setting up the machines to do their work, they deal with employee benefits paperwork, they restock the office supply cabinets, and they formulate overseas sales strategies (which are all examples of non-value-added work). Value added work is a task that provides direct benefit to the customer, like building the product. Non-value-added work is something that doesn't add direct benefit to the customer, like restocking the office supply cabinet. Another way to think about the distinction is: What tasks are customers willing to pay for?

Of course, both lean companies and non-lean companies have a variety of value-added and non-value-added activities. It is estimated that at least 95% of all activities of for-profit companies are non-value-added activities (with the least amount of value-added work being provided by the management level). Unfortunately, in many non-lean companies, management ignores waste and instead tries to focus resources on making the value-added work more efficient. On the other hand, lean companies, like Envista, continually strive to reduce the amount of non-value-added activities they undertake in order to be able to devote more of their resources (like time, money, people power, energy, etc.) to those activities that actually provide value to the customer in furtherance of their purpose. Spending resources on non-value-added activities is a waste of these resources.

So lean companies develop techniques and systems that help their employees:

1. identify activities that do not add value as well as problems that get in the way of undertaking value-added activity,
2. figure out systematic ways to solve the problem or reduce or eliminate the wasteful activity,
3. measure whether their solutions are effective,
4. implement effective solutions and share them with others inside the company,
5. learn from the previous 4 steps so that once the problem is solved, it does not reoccur, and
6. continuously repeat steps 1-5 forever, always solving more and more problems.

Together, these techniques and systems constitute a company's so-called "lean toolbox." Truly lean companies empower all of their employees to use these problem-solving techniques in order to find and eliminate waste and to solve problems in their workspace. In most organizations, managers or executives make decisions about how best to solve problems and issue directives down the organizational chart so that those decisions can be carried out by the employees on the front line. Our lean-thinking companies expect, encourage, and develop their employees to be able to identify/solve problems on the spot continuously. They believe that front-line workers have more information than management about front-line problems and their causes. Through purposeful

training, companies develop an army of problem-solvers that help drive continuous improvement, innovation, and – importantly – the flexibility to be able to thrive in rapidly evolving market conditions.

Employees are motivated to find waste and solve problems because it is easy to see how non-value-added waste gets in the way of serving the purpose of the company (producing value for the customers). The more noble the purpose, (and the more that purpose is emphasized by the company) the more it will attract team members who are motivated to find ways to add more value. In our lean companies, adding customer value leaves employees feeling a sense of fulfillment, so they become passionate about finding ways to improve the company's ability to provide more and more value in furtherance of its purpose. This can be as easy (and rewarding) as looking around and saying, "How can I make my job easier today?" We believe that employees are only motivated by pay as much as it takes to fulfill basic needs and wants (a good standard of living). But we believe true, lasting motivation comes from a connection to a shared purpose and the trust that the organization places in them to fulfill the purpose to the best of their ability.

In truly lean companies, the leaders' role is to create the environment for this process to occur continuously into the future, everywhere in the organization. Rather than solving problems themselves, great lean leaders spend their time creating environments of trust amongst employees and their leaders. Instead of a boss who thinks they know all the answers (or just as bad, a boss who believes he has the *right* to make all the decisions), great lean leaders focus on supporting the problem-solving activities of the employees who are actually adding value for the customer. They foster cooperation, support the free flow of information, and create incentive systems that promote collaborative problem solving. For us, the best lean companies do so by creating an environment of trust. If lean leaders can do this well, they can foster continuous improvement throughout a company that gets better and better long into the future. Thus, great lean leaders are constantly focused on the long-term. How can they create the ingredients for long-term continual improvement and cultivate the next generation of lean leaders through the process of developing problem-solving employees?

The upshot of this lean thinking process is that employees are happy and more passionate about their jobs. Employee retention and engagement is better. They are better at solving problems. The organization is better at overcoming obstacles and taking advantage of opportunities. Innovation increases. The company provides goods and services that create more value for their customers. At the same time, they are able to use fewer resources to produce these products (profit margins go up). Customers view the brand as more and more trustworthy. Customers get more value for what they are paying, so customer loyalty is high. The company continuously comes up with innovative products that provide additional customer value. The trusted brand and increased customer value results in more pricing power. Market share increases. And the result is that cash flow can continue to compound for as long as this system can sustain.

Our job is to make sure we are confident that these companies continue sustaining their cultures in accordance with our criteria. Every time we visit a company, we learn more about the systems they use to identify/solve problems, to continually reduce waste, and to develop their employees in lean problem-solving. And we can usually see them getting better every time we go back!

This is one area where we, as the advisor to the Tarkio Fund are working to add value, as these visits help us to be able to judge whether a company's best days will continue to be ahead of them. As long as that remains the case, we will continue to hold shares of these businesses indefinitely into the future.

Warm regards,



Russ, Michele, Ginger, Jeremy & Dominic
The Tarkio Team

On December 31, 2022, NVST was 3.9% of the Tarkio Fund Portfolio at a share price of \$33.67 a share.

The mention of any investments in this commentary should not be considered a recommendation to sell or purchase the security(ies) mentioned or similar investments. Please consult an investment professional on how the purchase or sale of such investments can be implemented to meet your particular investment objective or goals. Investments in securities and/or similar investments are subject to risks. It is important to obtain information about and understand these risks prior to investing.

Mutual fund investing involves risk. Such risks associated with the Tarkio Fund (including but not limited to Small/Medium Capitalization Risks, Foreign Securities Risk, Fixed Income Securities Risk, Non-Diversification Risk, and New Fund/Adviser Risk) as well as applicable investment objectives, charges and expenses must be considered carefully before investing.

An investor should consider the investment objectives, risks, charges and expenses carefully before investing. A prospectus containing this and other information may be obtained by visiting www.tarkiofund.com or by contacting 866-738-3629. We encourage you to read the prospectus before investing.

Tarkio Fund is distributed by Arbor Court Capital, LLC - Member FINRA/SIPC.