



Once again, the subject of this quarter's letter is Lumen Technologies.

The most difficult thing in investing is to be able to wake up daily and evaluate each holding based upon the quality of the company and the valuation of the underlying stock while looking out as far as possible into the future. The performance of the stock *in the past* is meaningless in this evaluation. In fact, focusing on the stock's prior history can be counterproductive for evaluating the future cashflow and valuation of the underlying company.

In the case of our holding Lumen (formerly Level Three and then CenturyLink), the stock was a positive contributor for the first fifteen years that we owned it. The past five years of company performance have been comparable to "The Perils of Pauline." The resulting stock performance has been a detractor to the performance of the Tarkio Fund during this period. It is already difficult for an individual investor to ignore past experience when evaluating a long-held position. Because we advise a publicly traded fund, our ideas and activities are subjected to added scrutiny the individual investor does not experience.

Our investment process is long-term and research-driven, which we believe enables us to wake up every morning and take a fresh view of our holdings. This process helps to shield us from being distracted by past experience or outside scrutiny. Note: The last thing an investor wants to consider when determining the value of a company's cashflow stream into the future is the price the investor previously paid for the stock.

Our last letter on Lumen was written back in May of this year, about 6 months into Kate Johnson's tenure as the new CEO. Since that time, we have had the opportunity to do a lot more research, learning quite a bit more about Kate's prior work transforming companies, and her current efforts to transform both the culture and the strategy at Lumen.

Let's start first with the culture. Kate was formerly President of all U.S. operations for Microsoft during the transformative years when Satya Nadella led one of the greatest corporate cultural transformations of all time. Kate is a believer in Brené Brown's research-based, psychoeducational process for breaking down barriers in organizations so people can communicate effectively to solve problems and innovate. At Microsoft, she introduced many of these concepts across the organization. At Lumen, one of Kate's first actions has been to offer a copy of Brown's "Dare to Lead" book to all twenty-nine thousand Lumen employees, conducting book clubs of cross-functional team members to discuss effective communication. This is as bold and courageous an initiative as I have seen in my forty plus years studying corporate cultures. "Dare to Lead" is as much a psychology book as it is a business book. It deals with the roles of vulnerability, shame, and courage in leadership. I cannot imagine the push-back she received initially – particularly from the folks who work on buried cables or climb telephone poles all day – to sit down twice a month for what they must have perceived as a "kumbaya session." That said, we understand that a recent outside employee survey revealed the program has over eighty percent buy in across the whole Lumen organization. This is a company that has been cobbled together over thirty years to aggregate dozens of companies that had built out the fiber optic network during the telecom boom of the 1990's. The result is that Lumen now owns and operates one of the most comprehensive fiber optic backbones in the nation (over 400,000 miles of fiber optic cable). The downside to all this consolidation was a collection of operating businesses that didn't seem to have a common culture. We believe the company was probably hungry for real leadership, hence the quick and enthusiastic buy-in by the team. We also believe that this cultural transformation is well in line with our criteria for great corporate cultures.¹

Second, let's see how Kate is transforming Lumen's strategy. For us, the company's comprehensive fiber optic backbone is one of the most valuable assets on the planet. During the early years of the internet, network traffic grew at over 100% per year compounded for over a decade. According to Cisco, global internet traffic in 1984 was 15 Gigabytes per month. By 2014, *each user* of the internet used more on average than that amount (an increase of 2.7 billion times the traffic in 30 years). As that base grew, the growth rate has moderated but continues to compound at over 25% per year, with a Gitnux review of various reports (including Cisco's) concluding that global internet traffic surpassed 100 billion Gigabytes in 2022. With the proliferation of Artificial Intelligence, 5G, and the Internet of

¹ We look for companies in which management exhibits the following:

- Integrity - Humility of Management - Trust
- Long-Term Focus
- Purpose and Passion
- Employee Empowerment – Drive Fear Out of the Organization
- Teamwork – Cooperation, Not Internal Competition
- Disciplined Capital Allocation

Things, that compounding rate could well re-accelerate. There are few certainties in this world, but network traffic growth compounding at meaningful rates far into the future is as close as any we can imagine.

After the telecom bust in 2001, there was tremendous excess capacity in the network. As a result, the industry sold their services as a fixed price model, selling multiyear contracts for unlimited traffic use ever since. Under the fixed price model, the power of compounding internet traffic works against the pricing power of the industry. We always thought this industry needed an outside thinker (like somebody from the technology world) to help change this “beaten dog” mindset within the industry. This fiber backbone is vital to solving society’s problems and enabling the way we engage with the world. Without that fiber, the world as we currently know it would not exist. Think about that.

We often say that telecom services deserve to be sold “by the scoop” and not “all you can eat.” Under this price per use model, the compounding of internet traffic at high rates works to the benefit of the industry at modest incremental cost to customers. With Lumen’s cultural transformation, Kate is attempting a revolutionary industry pricing model transformation. She is in the process of rolling out a “network as a service” model that will eventually encompass all the products and services they offer (a “pay by the scoop” model). This is another move that took courage, and could be the catalyst for the industry to become more recognized for its value to society.

Companies are complex organizations, and even though we have written several times on Lumen, there are of course aspects to this story we have not covered. Recently, the Wall Street Journal, has published stories (rightly) questioning the handling of telephone lines manufactured before 1940, many of which used lead as an insulator. Several of the large incumbent telephone service providers are the most affected. However, Lumen’s lines laid before 1940 seem to be a very small percentage of their network because the company’s fiber backbone was mostly built during the telecom boom of the 1990’s. We do not know how this will unfold exactly, but we think it is important to disclose.

Looking forward, Lumen is a dynamic unfolding story with a CEO we feel could turn out to be a transformative, courageous leader. The stock is currently selling at a valuation that we feel is as attractive as anything we have owned in the recent past. They have plenty of challenges as they attempt to fully unlock Lumen’s potential, and you can be sure we will be evaluating their progress every step of the way. Looking in the windshield rather the rearview mirror, we believe the potential free cash flow per share upside for Kate Johnson’s Lumen is in no way reflected in the current valuation of its stock.

As always, please call us at (406)541-0130 if you have any questions.

Thank you from Russ and the Front Street Capital Management Team!



Russ, Michele, Ginger, Jeremy, and Dominic

On September 30, 2023, LUMN was 3.05% of the Tarkio Fund Portfolio at a share price of \$1.42 a share.

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