The Art of Compounding

We often come across interesting and helpful interviews and presentations, but a fairly recent podcast interview with Mitch Rales – who founded the Danaher Corporation with his brother in 1984 – was especially meaningful to us. Since 1988, our investment criteria has been built upon the work of W. Edwards Deming, whose ideas were instrumental in developing the Toyota Production System in Japan after World War II. Mitch and his brother Steven Rales were the first to successfully bring this management philosophy back to the United States via their then fledging company, Danaher. This management philosophy has evolved over the decades into a business system now referred to as "Lean". Building upon their learnings from Japan, the "Danaher Business System", according to the podcast, has compounded its investors' capital at over 21% per year for 40 years, resulting in an 1800 times multiple on original invested capital (a 180,000% total return over that time). To our knowledge, neither Mitch nor Steven have ever given a comprehensive sit-down interview until this piece entitled, "The Art of Compounding". We highly recommend you listen:

https://podcasts.apple.com/us/podcast/mitch-rales-the-art-of-compounding/id1154105909?i=1000654291328

Mitch's philosophy echoes our belief that compounding capital is about compounding learning. Using Deming's work as the foundation, the journey Mitch describes to the public for the first time closely parallels the odyssey we have been on over roughly that same period. Ultra long-term thinking can be a lonely existence and hearing Mitch articulate his similar path was both encouraging and exhilarating. The ultimate Northstar of this pilgrimage has been to develop or identify companies that can create a culture at all levels of an organization that best unleashes the human potential. We evaluate this using the following criteria:

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

Mitch eloquently describes compounding as a long-term proposition that builds over decades (both for capital and knowledge). As the compounding model matures the results improve exponentially. As we have described in several of the prior quarterly Tarkio Fund letters, we believe we have significantly broadened our learning process over the past six years with the work that Jeremy and Dominic have done both walking factory floors around the world and the learning that has accrued from working to transform the cultures at two local companies. Based on this learning, we have been incrementally repositioning and upgrading our portfolios toward companies that we can identify as having best in class cultures. Or better yet, toward companies on a steep cultural improvement curve that we believe has not yet been fully appreciated by other investors and therefore not yet reflected in the stock price. Also, as Mitch describes, meaningful rates of compounding are never linear, and each successive level of improvement produces results that snowball into the future. As such, we have never been more optimistic about the prospects for the Tarkio Fund's portfolio.

Over the years, we have stressed again and again that the power of long-term compounding means that short-term interruptions are insignificant when it comes to building meaningful wealth. As a result, what most investors deliberate over, for us, is nothing more than noise. Notice that Mitch has worked hard to insulate himself from the noise most investors fret about, which we believe is one of the reasons neither of the Rales brothers has given a public interview previously. We have pointed out in the past that Warren Buffett has also recognized the importance of creating a insulated and isolated work environment so as not to get distracted or influenced by the geopolitical/macroeconomic news of the day. For this reason, both Buffett and

Rales had the foresight to conduct their investment process inside the virtual bubble of a publicly traded company. They also try as much as possible to insulate the managers of the companies they control from these same distractions. We believe this is a component of their success that is universally underappreciated.

As manager of the Tarkio Fund, we have tried to create the most insulated environment reasonably possible. Remember, long-term compounding powers through the never ending "noise of the day." Our steadfast belief in this, "Most Important Thing"[1] underpins our humble office in a city as far away from Wall Street as possible, and encourages us to try as much as possible to avoid emotional reactions to short-term events. In the interview, Mitch talks about benchmarking. Using two of the greatest capital compounders of all time as a benchmark, we believe creating an environment that tries to insulate us from the emotions of the day is truly an enormous benefit for the "greater good" of our shareholders.

It is always good to have one's business and/or life philosophy reinforced from time to time. That said, we are especially grateful when it is so passionately described by Mitch Rales, truly one of the greatest compounders of capital and knowledge of all time. Long-term compounding through continuous improvement is a joy that both diminishes the hysteria of the moment and makes each day a new adventure that will be a little better than the day before. Thank you all for traveling on this atypical journey with us.

Respectfully,
The Front Street Capital Management team
Manager of The Tarkio Fund
Michele, Ginger, Jeremy & Russ

On September 30, 2025, DHR was 3.78% of the Tarkio Fund Portfolio at a share price of $ 198.26 a share.

[1] See the recent Tarkio Fund letter entitled *The Most Important Thing* which was distributed to shareholders April 2, 2025.