KANBRICK

April 7, 2025

Dear Partners and Friends,

Time is a finite resource, and the tension between long-term and short-term is always present. Exercise requires pain today for a healthier future. Learning takes time today and is an investment in a more productive future. Saving and investing involve consuming less today for a wealthier future.

In many ways long-term and short-term thinking are just two sides of the same coin. You must win today to survive long-term, and the choices of today shape the future. However, a short-term focus alone often comes at the cost of long-term success and sustainability.

Examples of this abound and aren't limited to business. Take farming, an area we know well having grown up in Kansas. Imagine a farmer who has a 3 or 4 year time horizon to farm a tract of land. Maximizing yields over a couple of years is very different than sustainably harvesting for decades. The short-term approach leans heavily on excessive fertilizer and tilling, while the longer-term approach requires building the soil through cover crops and crop rotation. If you are renting the field for a few years, then you'll take a very different approach than a long-term owner.

One of the most powerful maxims from our time at Berkshire Hathaway was to run every business like it is your family's only asset and you'll own it for 50 years. This is a drastically different mindset than the typical private equity firm which is focused on maximizing EBITDA for an "exit" in 3 to 4 years.

Charlie Munger's truism of "show me the incentive, and I'll show you the outcome" rings true here. The tactics to achieve this are heavy on the fertilizer with loads of debt combined with an emphasis on 100-day plans, Excel spreadsheets, and quick-win initiatives like:

- Implementing across the board cost cuts without regard to the culture or operations of the business.
- Raising prices significantly to quickly grow earnings without regard to long-term customer relationships.
- Rapidly buying as many companies as possible to scale the "platform" and benefit from "multiple arbitrage," without regard for strategic fit or integration.
- Maximizing debt to marginally increase returns without regard for how this limits flexibility, restricts investment, and creates fragility.

Quick is the operative word because the clock is ticking and the treadmill running. The approach is inherently transactional – companies become "deals" that are part of a "portfolio", people become "headcount" and "synergies", and the goal of a 3x "exit" becomes everything.

Just as important are the things that get culled like investments in culture, talent development, brand, research and development, product development, customer service, and long-term growth opportunities. This becomes especially acute in the year before "exit" – next year's harvest is someone else's problem. For example, why invest in developing a new product that will reduce earnings today, while the next owner reaps the rewards. Rather than building for the future, the business exists to be packaged and harvested for sale.

Interestingly, nearly every family and founder run company we've met – including our own family cabinetry and farming businesses – takes a different approach. Jeff Bezos captures this in his 1997 Amazon shareholder letter noting:

"Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies"

We think a long-term mindset is a differentiator in an increasingly short-term world. Why is this the case? At the most basic level, removing an artificial 3 to 4 year constraint makes it easier to optimize for building a great business and maximizing value (and it has some nice tax advantages). A great business rewards its owners' patience, and public companies like Wal-Mart, Microsoft, and LVMH show the benefits of long-term compounding.

Take Wal-Mart – they opened their first store in 1962 and grew rapidly to 24 stores and $12.7 million in sales by 1967. A great return over 5 years, but this was just the beginning. Today Wal-Mart has more than 10,500 stores and generates over $640 billion in net sales. Long-term thinking alone isn't sufficient – there are lots of other determinants of success including market, moat, and management – but time is an important component of building something special.

In practice, thinking long-term requires acting today. The proverb *the best time to plant a tree was yesterday and the second best time is today* rings true. We think the best companies combine a long-term mindset with a relentless focus on executing today. Often business leaders ask us about our approach to building enduring companies. Our starting spot with a new partnership is building a strong foundation and aligning on where we are today, where we are going, and how we will get there. Instead of focusing on 2 to 3 quick wins and a 100-day sprint, over the first year we focus on five areas:

- Listening and Learning – for example at JM Test Systems (JM Test) we interviewed around 75 team members to get to know the culture, the team, and their perspectives on our opportunities.
- Building the Plan – we host multi-day offsites with the leadership team of each company to create a shared vision of our next decade along with a 3-year strategy to guide our march towards this vision.
- Resourcing the Plan – we ensure we have the right people, dollars, and time aligned to our plan (often this requires new investment to support growth).
- Cascading the Plan – we share the plan across the organization, develop the right goals and KPIs, and create profit sharing plans to win together.
- Tackling it Together – we roll-up our sleeves and tackle the plan together.

These pillars provide the springboard for future growth and our ambition of reaching full potential. Rather than being a renter with a short timeline, we focus on sustainable farming. The approach is tailored to each business and a few examples include:

- Investing in our team – for example, JM Test's new bonus plan doubled payouts versus last year and Marine Concepts significantly expanded its employee insurance and benefits offering.
- Creating a culture of acting like an owner to manage costs, increase margins, and enable more investment in growth (versus focusing on quick cost reductions).
- Embracing a kaizen continuous improvement mindset and providing problem solving training to support this across the organization.
- Investing in long-term growth – this includes building our dealer network at Marine Concepts, opening new laboratory locations at JM Test, and building the capability at each business to acquire and integrate companies that are a strong strategic fit.

These areas don't always pencil perfectly into a business case. However, in our experiences growing up in family businesses, serving as CEO and CFO, and working with countless companies, we've seen these investments consistently pay off over time, especially when paired with a strong focus on execution and continuous improvement. The result is stronger companies that deliver for customers, team members, and owners.

Building for the Future / Next Five Years

> *"Go as far as you can see; when you get there, you'll be able to see farther." – attributed to J.P. Morgan*

Five years ago, we founded Kanbrick to empower individuals and organizations to realize their full potential. Our initial insight was simple: many owners of exceptional founder-led and family-owned businesses sought an alternative to the short-term focus of traditional private equity. We believed the world didn't need another private equity firm, but the 30 million small and midsize companies did need a long-term partner dedicated to helping them achieve their full potential.

In our conversations with hundreds of family-owned companies, it has become clear that people are looking for more than just capital. Running a midsize company is hard: cash is limited, firefighting is daily, and there are more good ideas than resources to execute. We've refined our approach to better support this.

As we look ahead, we are focused on achieving our purpose through a combination of tailored long-term capital, the impact of our growing Kanbrick Community, and the power of the Kanbrick Business System (KBS) in our companies and in our Kanbrick Community. Within these pillars, we embrace being long-term owners not business flippers, builders not financial engineers, and partners in every sense of the word. We are fortunate to tap dance to work every day and are still in the early innings of building Kanbrick.

<u>Long-Term Capital</u>

Capital is the fuel to achieve dreams. On a personal level, this might be buying a house, going on vacation, or paying for school. And for businesses, it is the lifeblood of growth. Our capital does a combination of both – it supports business growth as well as the personal goals of the shareholders.

Our initial focus was solely on majority partnerships, and we've expanded to make select minority investments based on feedback from business owners. Ultimately, we view ourselves as problem solvers focused on family and founder owned companies – we aim to deeply understand the goals of the owners and the growth opportunities and capital needs of the business. From there we create individual options tailored to each situation. Our goal is win-wins that ensure the business is positioned for success, the ownership group achieves its goals, and both we and the employees share in future growth.

Auctions work great for buying used farm equipment, but finding a partner for a business should be more like a matchmaking approach. Our partners – who care deeply about their business, their people, and their company's future – typically are looking for an alternative to traditional private equity or a strategic buyer that:

- Protects and enriches their legacy
- Accelerates their growth through a combination of capital and our KBS resources
- Diversifies their wealth while still offering upside opportunity

For instance, we often assist people in navigating succession planning. This process might involve buying out a majority shareholder or purchasing shares from inactive family members. We are especially excited when the family or founder wants to continue to partner with us and remain shareholders going forward. JM Test Systems is a prime example, where we helped simplify estate planning, diversify the family's holdings, and accelerate growth. Scott Morrison, the Executive Chairman at JM Test, described his family's thought process as:

> *"Kanbrick was the clear choice given their long-term perspective, experience building businesses, and focus on partnering with family and founder-owned businesses."*

Alchemy Analytical Group (AAG), our newest investment, is another wonderful example of a partnership that aligns to our long-term model. Greg Molter was looking for capital to accelerate growth and was excited to work with our KBS team after participating in the Kanbrick Community. We invested in a minority position and are working together to build the business for the next stage of growth.

It is an honor to work with exceptional founders and owners, and we are proud that all the owners we've worked with have maintained meaningful ownership stakes. If you or someone you know is thinking through what is next, then we would welcome the opportunity to confidentially discuss your goals and options. We promise to help think through different options (even if it doesn't include Kanbrick), while being responsive and maintaining confidentiality. For our part, we typically focus on high-quality companies with the following characteristics:

- Industry: Consumer, Business Services, Manufacturing, and Distribution
- Size: Greater than $5M of pre-tax profit
- Location: Headquartered in North America
- Type: Majority or minority investments

Many of our best relationships come from referrals. All we need is an email or phone introduction, and then we will take it from there. To learn more, make an introduction, or connect with us, please reach out at build@kanbrick.com.

Kanbrick Community

Charles Schultz, the creator of Peanuts, notes "in life, it's not where you go, it's who you travel with". Our experience as CEO and CFO showed us leading a company is a rewarding journey that can also be lonely, frustrating, and challenging. Bringing together a group of business leaders to learn and grow together was why we started the Kanbrick Community. It is the resource we wanted for ourselves.

The Kanbrick Community started with our Build with Kanbrick program, an accelerator for midsize companies. We hosted our first cohort of 5 companies in Spring 2021 and have since expanded the flagship program to 9 cohorts and 50 companies. A recent Build with Kanbrick participant shared the following about the experience:

> *"Think of Build with Kanbrick as a hands-on, practical, and advanced Executive MBA, led by some of the smartest minds in business, investing, and leadership, in an interactive setting. I am fortunate to have been a part of this cohort. I am honored to have been able to get to know the Kanbrick team and my fellow cohort members. I recommend this program to CEOs looking to scale their businesses in today's complex environment, who are committed to learning, plus are excited to meet and interact with some incredible people!"*

Recognizing the demand for more connection and learning, we have expanded the Community to include events, content, and resources. Today, we have nearly 3,000 Community members including 1,500 leaders in our CEO Circle. And the opportunities to engage have grown. We host 2 flagship events each year, the CEO Summit and our fall Business Builder event. Additionally, we offer numerous opportunities to learn, connect, and grow via webinars, our monthly digest, white papers, and informal calls with the Kanbrick team to talk through challenges. We are on a mission to provide leaders with opportunities to learn and grow with like-minded peers.

Great companies are shaped by exceptional leaders, and the Community exists to bring these people together on the quest for full potential. If you or someone you know is interested in joining the Community, please visit https://kanbrick.com/community/ to learn more.

Kanbrick Business System

Our third pillar is providing midsize companies and their leaders with the resources, advice, and tools they need to unlock their full potential. At the heart of this is the Kanbrick Business System (KBS)— a comprehensive approach that helps businesses align their people, processes, and culture with their strategic vision, ultimately driving long-term value creation.

Inspired by learnings from industry leaders like Danaher and Marmon, we've refined KBS over the past decade to tackle the unique challenges faced by midsize businesses. These often include:

- Crafting and clearly communicating an actionable strategy, emphasizing prioritization and focus.
- Translating strategy into disciplined execution across a growing team by cascading objectives and creating rigorous accountability systems.
- Ensuring the right organizational structure, talent, and incentives are in place to meet ambitious goals.
- Building and sustaining an ownership mindset and high-performance culture as the business scales.

Our KBS team collaborates closely with each of our partner companies to implement KBS and embed its principles. Our efforts concentrate on two core building blocks:

1. People: Making sure organizational structure clearly supports strategy, cultivating the right team, aligning their incentives, and consistently investing in their engagement and professional growth.
2. Operating System: Aligning around a coherent and focused strategy, developing company-wide KPIs and budgets directly linked to strategic goals, and establishing a consistent cadence of meetings and reporting to support effective execution.

While our team also supports growth initiatives like strategic pricing optimization, customer segmentation, and acquisition integration planning, we maintain consistent focus on reinforcing these foundational elements.

Beyond the direct impact within our companies, we share the KBS tools and resources broadly within our Kanbrick Community. Members of the Community often describe KBS as a natural next step after tools like the Entrepreneurial Operating System (EOS). The kaizen mindset is central to KBS, and we continuously seek to improve the Kanbrick Business System. Whether at a Kanbrick-owned company or a Kanbrick Community member, our ambition remains the same: to help midsize companies and their leaders reach their full potential.

<u>Looking Ahead</u>

Looking to the next five years, we plan to continue building these pillars. Our long-term capital enables us to tailor solutions for family and founder owned businesses and accelerate growth. The Kanbrick Community helps leaders connect and grow. The Kanbrick Business System provides the practical tools, resources, and expertise to unlock full potential. Our focus on kaizen and getting better every day means our approach isn't static – we'll continue to learn, grow, and refine our approach to better support the companies and people we serve.

<u>Year in Review</u>

"Perfection is not attainable, but if we chase perfection, we can catch excellence." - Vince Lombardi

People build great companies, and we are blessed to work with an incredible team across Kanbrick and our companies. Our core values of "live with integrity", "win together", "get better every day", and "act like an owner" guide how we live and work. While there are too many accomplishments to cover in this letter, a few highlights not already discussed include:

- Our Kanbrick team grew to 12 people. We had 3 new team members join us: Meg Harris as SVP of People, Amanda Lynch as VP of Finance, and Brett Roseman as Director of KBS. They have all hit the ground running. We are always looking for people who find joy in striving to be the best to join us.
- We made our first minority investment in Alchemy Analytical Group (AAG). AAG is a leading manufacturer and distributor of consumables and reference materials for laboratory equipment with over 180 employees. We got to know AAG Managing Director Greg Molter through our Build with Kanbrick program and the Kanbrick Community, and we are excited to continue to support Greg and the broader AAG team's organic and M&A growth strategy.
- AAG is actively looking for acquisitions in the atomic spectroscopy and broader laboratory consumable space – we would welcome any ideas or intros.
- JM Test had another record year and currently has over 500 team members serving more than 10,000 customers. We believe in winning together, and our new profit-sharing plan doubled payouts to

employees compared to last year! We continue to embrace a service focused mindset with the goal of "making test equipment easy".

- In Q1 2025, Scott Morrison transitioned from the CEO role to Executive Chairman and Andrew Treanor became the CEO. Scott delivered a remarkable track record of compounding growth at a double-digit rate over his 22 years as CEO. We are thankful for his leadership, and we are excited to welcome Andrew to JM Test. Andrew previously served as CEO of Pampered Chef and has hit the ground running in Q1.
- JM Test rolled out a new organizational structure to support future growth and more clearly define roles and responsibilities across the organization.
- In March 2025, JM Test Systems entered the Canadian market with the acquisition of BHD Instrumentation. BHD aligns to the JM Test core of calibration service, rental, and distribution and has 3 locations in Canada. JM Test also acquired Alabama Scale & Instrument and B-Right in Q1 2025. We couldn't be more excited to welcome these three companies to JM Test.
- Marine Concepts achieved a new revenue record and continued to grow its dealer footprint to 21 dealers across the United States. If you want the World's Best Boat Cover visit us online to request a quote.
- Last fall, Steve Handel joined Marine Concepts as CEO. Steve joins us after having served as COO at Caring.com and in various leadership roles at Red Ventures. We are grateful for Dawson Shamblin's interim leadership of the business, and we are excited to partner with Steve and Marine Concept's team.
- In March 2025, Marine Concepts acquired Coastline Boatlift Covers. The acquisition doubles our size, expands our product offering, and deepens our Florida footprint. We are excited to keep building with the Coastline team.

Just as importantly there were countless daily wins across each business – things like finding new ways to measure and improve our customer experiences and more clearly defining career tracks for our team members. We are blessed to work with such a wonderful group and are proud of all we have accomplished.

Other Thoughts: Middle Market Moats

"Here we must run as fast as we can, just to stay in place. And if you wish to go anywhere you must run twice as fast as that." – Through the Looking Glass by Lewis Caroll

We think companies must evolve faster than the outside world or face irrelevance, decline, and eventual extinction. Between AI, tariffs, and the broader macro environment, the rate of change is increasing and this creates new challenges for leaders. Purely winning through execution is tough – it is exhausting, never gets easier, and the rewards of success are limited. Moats or competitive advantage offer a way to counter this challenging environment. This is a topic we frequently discuss with business owners and below we share a few observations and thoughts on the topic.

First, a moat represents a competitive advantage that protects a business from competition. Moats are a function of the business and industry structure, and they allow a company to avoid being commoditized in an economic sense. A good business should generate above average returns and be able to sustain this in the fierce competition of capitalism. We find Pat Dorsey's framework for classifying moats into four buckets insightful:

- Cost advantages
- Intangible assets
- Switching costs
- Network effects

Each bucket often has different sub-moats – for example intangible assets include intellectual property and brands, and cost advantages could be driven by scale or access to unique resources. Moats are not born. They are built. On Day 1 a company inherently has no competitive advantage, but over time they can become a formidable barrier. If we invert, it is also helpful to define what a moat is not – it is not just a great product or great management but a structural advantage. And not every company has a moat.

The moat should be more than just identifiable – it should lead to above average economics over time. We like to measure this based on earnings before interest and taxes (EBIT) divided by net working capital plus net fixed assets in the business. In this case, higher is better because you are earning more profit for each dollar invested in the company. Michael Mauboussin has some great pieces on this topic including "Measuring the Moat" if you are interested in learning more.

Most of the literature on moats and strategy focuses on large Fortune 500 companies. Yet, the same concepts and ideas apply to midsize companies. Correct market definition is fundamental to strategy, and we find midsize companies with moats often participate in one of two markets types:

- Local markets – e.g., businesses like home services or rock quarriers are inherently local
- Niche markets – e.g., the market for golf course software

Once the market is properly defined, we think Dorsey's framework works well for midsize companies. For example, a plumbing business can build a strong local brand and also have more scale than its local competitors. This in turn enables it to have a more efficient marketing engine, better technology and support capabilities, and higher profitability, which can in turn be invested to drive more growth. Another example is vertical market software where the product has switching costs and serves a relatively small total market. This makes it hard for a new entrant to enter and compete because the cost to do so isn't worth the size of the prize.

In assessing moats, we generally think about three components: strength, durability, and runway. These dimensions impact the long-term cash flows and thus value of a business. Strength is how wide or strong the moat is today. For example, we think a company like Visa has a wide moat today. Even with a billion dollars, it would be nearly impossible to displace Visa without a major tech or regulatory shift. The second component is durability, which is how long the moat is likely to persist. Wrigley chewing gum is likely to have a more durable moat than a technology product given the rapid pace of change in the technology sector. Third, runway reflects the opportunity to reinvest while continuing to earn high returns from the moat. Chipotle's growth from 16 stores in 1998 to 500 stores in 2005 is a good example of reinvestment runway (it also happens to be one of our favorite places to eat at Kanbrick). Often, niche markets have strong, durable moats but limited runway because once you get outside your core market someone else has a competitive advantage. The best moat is strong, enduring, and has lots of potential for reinvestment – a rare and very valuable bird.

Just like rivers, moats are not static. They are constantly widened or narrowed. This change occurs based on multiple factors including strategic choices, competitor choices, execution quality, regulatory changes, and technological innovation. Technological innovation can be particularly impactful and historically has occurred in 20 to 30 year cycles. The evolution of AI appears to be the next paradigm shift – following things like the railroad, electrification, and the internet – that will rewrite the rules of the game. We are focused on this across our companies and think it is an important strategic challenge; although, some businesses will undoubtedly be more significantly impacted.

Moats define how do we beat our competitors or at least keep them at bay. However, customers buy the value you provide not what protects your business from competitors. Thus, the best companies connect their moat with their customer value proposition. This defines why customers choose a given business. Customers don't directly care about your cost advantages or intellectual property. Instead, they have a job to be done and a set of key decision criteria.

In our view, the best value proposition connects the customer value to the moat or strategic advantage. For example, Costco's moat is its cost advantage (e.g., scale in purchasing, low-cost stores, membership model, and working capital model) and brand (intangible asset). These drive its consumer value proposition flywheel of offering exceptional prices on a curated selection of high-quality products which in turn attracts more customers and drives more volume leading to lower prices. Competitors aren't able to match these aspects, so Costco is able to both offer a superior customer value proposition and also maintain its strategic advantage.

Moats and strategy are hard. This is an area we focus on deeply with our companies and across the Kanbrick Community. If you want to learn more, please check out our strategy content. We also are always glad to connect to talk more about your business and its strategy.

<u>Closing</u>

Duke Basketball has NCAA Tournament t-shirts that say "Nothing Easy". This describes the process of chasing a National Championship or building an enduring company. The recent market turmoil represents another challenging situation with lots of complexities. While the near-term impact is uncertain, we remain optimistic about the long-term future – despite numerous obstacles over the past century including wars, pandemics, and recessions, our economy and people have shown remarkable capacity for resilience, change, and growth.

Reflecting, reading, and learning are a key part of the quest for excellence. Each year, we share a few of our favorite books that have shaped our thinking. This year's books cover a range of topics from leadership to parenting to AI:

- *The 15 Commitments of Conscious Leadership: A New Paradigm for Sustainable Success*
- *The Anxious Generation: How the Great Rewiring of Childhood Is Causing an Epidemic of Mental Illness*
- *Supremacy: AI, ChatGPT, and the Race that Will Change the World*

Please reach out for our full reading list or any book recommendations to share.

We are blessed to go on the journey with a wonderful group of people and excited to keep building Kanbrick brick by brick to be the resource we wanted for our family businesses.

Thank you for your support and partnership.

Best,

Brian Humphrey   Tracy Britt Cool