Thought Piece:

The Long Game

One of the competitive advantages that we believe Castelnau Group enjoys is its long time-horizon. As we outlined in our first quarterly report in Q4 2021, *"we assess opportunities with a very long timeframe and will pursue investments that benefit from that"*. This is not a new revelation of course, and Warren Buffett puts it well; *"the stock market serves as a relocation centre at which money is moved from the active to the patient"*. The stock market rewards patience.

Forrest Mars (1904-1999) was one such businessman who played the long game. His is a business that is well worth studying and Mr Mars' long-term attitude lives on today in the business that his father founded in 1911. Former Mars Inc CEO, Grant Reid, said in a recent FT interview *"we want to build a business that's here for the next 100 years"*. One hundred and twelve years on from its founding, it is clear that Mars Inc is a business built to last.

It is sometimes under-appreciated that taking a long-term approach also affords tremendous freedom for unorthodox thinking. Forrest Mars embraced what were, at the time (and even by today's standards), some very unconventional approaches to management, business strategy and even accounting.

In 1947, upon taking over the business, he laid out "The Company's Objective" which introduced Mars' pioneering concept of 'mutuality of service and benefits' to those he deemed the seven key stakeholders of the business. Consumers came first on the list, Shareholders (then, and today, the Mars family) came last.

This was corporate and social responsibility decades before it became a three-letter acronym. It was also to prove a hugely value-creative corporate culture. Mars was, in effect, building a wide moat - obliquely - by incentivising all stakeholders to be constantly in sync with the company. This stakeholder list even included competitors: Mars originally engaged his main competitor Hershey's as his key supplier when he created the m&m's product in 1941. Above all though, Mars' genius was perhaps to realise the importance of purpose as a driver of culture within a corporation. Clarity of purpose is something we regularly see in great businesses.

Again, well ahead of his time, Mars himself would later personally setup an in-house research unit called Mars Catalyst tasked to *"challenge conventional business thinking and to develop breakthrough capabilities for the firm"*. This Catalyst unit later devised and implemented a sophisticated system for predicting cocoa commodity markets in the 1970s and is today at the forefront of global research into social capital.

Mr. Mars created a business system that prioritised volume growth, employed exceptional rigour in tracking return on capital (he targeted and delivered-on a mighty 22% return hurdle that notably calculated capital on an original cost accounting basis) all the while being very careful to nurture all the stakeholders that were central to its success. He was obsessed with quality and incentivising staff productivity and loyalty (Mars Inc never unionised).

No surprise perhaps but we can see this stakeholder-centric (what he would have called 'mutuality') approach being recognised and copied in many great businesses today. In

Berkshire Hathaway's 2004 annual report, Warren Buffett calls attention to how GEICO divided the spoils among its stakeholders that year.

> *"Indeed, GEICO delivers all of its constituents major benefits: In 2004 its customers saved $1 billion or so compared to what they would otherwise have paid for coverage, its associates earned a $191 million profit-sharing bonus that averaged 24.3% of salary, and its owner – that's us – enjoyed excellent financial returns."* - Berkshire Hathaway 2004 (emphasis ours)

Mutuality remains one of Mars' five core principles almost 25 years after Forrest Mars' death (the full list being Quality, Responsibility, Mutuality, Efficiency and Freedom). As the company puts it today: A mutual benefit is a shared benefit; a shared benefit will endure.

We think Buffett and especially Ben Graham, a man who devoted entire chapters to depreciation, would approve of Mars' unorthodox and prudent approach to measuring returns on a total asset basis by using original cost accounting. Buffett was perhaps less enthused by Mr Mars' attempts to unseat See's Candy in California when, in retirement (!) in 1978 he setup a new luxury candy brand Ethel M's which was ultimately acquired by Mars Inc in 1988. Clearly not holding any grudges, 30 years later, Buffett helped fund Mars' 2008 acquisition of Wrigleys via a $6.5bn credit and preferred equity for which he earned a handsome return.

In 2019, after funding a multi-decade academic research project, Mars Catalyst co-published a book (*'Putting Purpose Into Practice'*) which examines the so-called 'economics of mutuality' (EoM).

The book is very interesting and includes case studies of many businesses including, not least, Mars Inc itself. In that particular case study, then-CEO John Mars was questioning what was 'the right level of profit' at Mars Inc. Mars was troubled that the company's profits might even be too high and that the company's stakeholders could be driven to squeezing too much margin from each other thereby creating a disequilibrium! It seems to us that this is a question only a company focussed on the long run could ask itself. It is reminiscent of the Costco and Amazon cultures which reinvest profitability into the customer offering and resists the temptation of letting margins rise.

Forrest Mars was an eccentric and some of these eccentricities pervaded the business - not least the idea that the pet food divisional management must be willing to eat its own cooking - literally! But his legacy is assured. Above all, Mars' history is a testament to the power of long-term thinking.

Why does long-term thinking matter? The author Morgan Housel puts it well:

> *The most important investing question is not, "What are the highest returns I can earn?" It's, "What are the best returns I can sustain for the longest period of time?" Average returns for an above-average period of time leads to magic.*