The Standfast Report

COMMENTARY FOR INTELLIGENT INVESTORS
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Dear Reader, Wilkesboro, NC, May 20, 2023

With all the media noise (TV, podcasts, blogs and newspapers etc) about beating the market, it is worth noting that even though I fancy myself as a non-indexing investor <u>I expect to always have a large portion of my 401k invested in very broad-based, very cheap U.S. stock market index funds</u>[1] because I believe in the long-term wisdom of such investing and because such funds are the only funds available to a large portion of my 401k that I also like.

<u>I continue to increase and roll my 4-week T-Bills</u> because their rates have remained relatively attractive in recent weeks.[2] The Fed raised interest rates again this month[3] and it is not clear when they will come down again. Banks have started to compete somewhat with their CD and savings account rates (at least with larger accounts on a case-by-case basis), but they don't seem to be trying to compete with T-Bills broadly. Very short-term T-Bills are still working as an excellent place to park cash, but this interest rate environment won't last forever...perhaps not even for the rest of 2023.

<u>Builders FirstSource, Inc.</u> is a supplier and manufacturer of building materials, manufactured components and construction services to professional

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[1] I recommend the book *Common Sense on Mutual Funds* by John C. Bogle. Mr. Bogle was the founder of Vanguard and is credited with starting the first total stock market index fund accessible to private investors. Warren Buffett has expressed appreciation for what Mr. Bogle has done for the American investing public. The gist of Mr. Bogle's book is that cheap, passively managed total stock market index funds have historically returned more to investors than actively managed funds, that most actively managed funds are expensive and that the interests of active managers are not normally fully aligned with the interests of their investors. If I could recommend only one source for investing wisdom, it would be *Common Sense on Mutual Funds*.
[2] About 5.4% for CUSIP 912797FP7 to be issued May 23. See: https://treasurydirect.gov/auctions/announcements-data-results/
[3] https://www.federalreserve.gov/newsevents/pressreleases/monetary20230503a.htm

homebuilders, sub-contractors, remodelers and consumers. The company has approximately 570 locations in 42 of the several United States.[4]

The P/E ratio of 7.55[5] is moderately concerning because it comes at a low point of revenue and profit relative to 2022 Q2 and the prior significant uptrend of revenue and profit. Strangely, the share price rose to record highs in the neighborhood of $107.00 during the May 3 earnings call in pre-market trading on news of profit lower than 2022 Q4 and lower than 2022 Q1. Perhaps the company is seen as a relatively good investment in today's economy, maybe management has proven some sort of value by maintaining some profits leading into an uncertain year of inflation and rising interest rates etc, maybe the Q1 share repurchases (~5.5% of shares outstanding) gave it a boost or maybe the projected Q2 revenue increase to $4-$4.2B[6] is being taken for granted...But overall, unless a bright future is being priced in, the price jump seems unfounded. The share price rose to new record highs this week closing at $120.24 on Friday.

Historical revenue and profit growth have been excellent over the years, but their business is in a sort of middleman position that could suffer if builders start aggressively cutting costs. Overall I am sure they *can* provide added value and convenience in this middleman position, but I suspect the big homebuilding players will look to get closer to product sources for better prices if housing construction goes into a hard time this year or next. Their biggest product category "Lumber and lumber sheet goods" (35.6% of 2022 Net sales) was down 63% from 2022 Q1 and down 57% from the 2022 quarterly average making it the "loss culprit" of the quarter.

Builders need what the company provides, but it is a competitive, fragmented industry and there is no guarantee that they have a monopoly on quality, service or price. I don't see a moat around this castle.

Unlike a company that grows merely through sales, the company has very significant acquisitions and therefore a large Goodwill item on the balance sheet...which combined with the Intangible assets item and the already high ratio of Liabilities to Assets (0.56) causes me to be pessimistic about balance sheet strength.

On the abstract side of things, the company has solid objectives, solid values and solid marketing strategy.[7] They also say they are ready to make tough decisions to cut costs in a downturn such as idling or closing facilities and divesting of non-core businesses.[8]

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[4] See page 7 of Form 10-Q for quarterly period ending 03/31/2023.
[5] Yahoo! Finance. https://finance.yahoo.com/quote/BLDR?p=BLDR&.tsrc=fin-srch
[6] Q2 2023 Company Guidance, Net Sales: https://finance.yahoo.com/news/builders-firstsource-reports-first-quarter-110000182.html
[7] Form 10-K for year ending 12/31/2022, pg. 7. Particularly: "Consistent with our core values, our goal is to be recognized by our customers as the preferred supplier, by our employees as a safe, diverse and inclusive workforce, by the industry as being at the forefront of innovation, by our stakeholders as an ethical company and by the communities in which we serve as a good corporate citizen." and "We seek to attract and retain customers through exceptional customer service, leading product quality, broad product and service offerings, and competitive pricing."
[8] Form 10-K for year ending 12/31/2022, pg. 31, *Liquidity.*

Perhaps my greatest frustration with Builders FirstSource, Inc. is that the price went up instead of down on May 3 on news of decreased Q1 earnings and I missed the boat...The price at the close on Friday May 19 was up about 25% from the days just prior to the May 3 earnings call.

As I recently wrote to a friend regarding confidence about beating the market...My opinion is that a value investor's goal is not to beat the market per se over any given period of time but rather to make good investments that he/she feels good about and that produce a decent return over time. The trick is to avoid all the disasters, not necessarily to pick the blockbusters. It is very, very hard to pick the blockbusters, and usually involves so much risk that I would personally be very unlikely to *try* to pick blockbusters. Basically, I look at the stocks I own the same way I would look at a business that I could theoretically own and manage...like an accounting firm, a car wash, a logging company, a grocery store, a utility company etc...For me it's about the historical profits, the debt levels, and the somewhat more ambiguous question of whether or not I think the business will be around for a long time. Investing this way causes me to care more about my investments and to feel better about them than I would feel about owning the S&P 500 plus some bonds. If someone wants to spend a lot of time on their investments then I would hope that they listen to every recording of Warren Buffett they can find and read a lot of 10-Qs and 10-Ks, but if someone doesn't want to spend any time on their investments then I would hope that they buy one very cheap, very broad-based total U.S. stock market index fund plus a very safe fixed-income component. I haven't yet determined what that fixed-income component should be, but I would guess a very cheap, very safe U.S. corporate bond or Treasury fund...perhaps a pure Treasury fund[9] or actual treasuries.

I have eased my consistent consumption of finance and investing podcasts because I found it to be more important to focus on things that are specifically interesting to me...Even good podcasts have noise and lack density of value much of the time. I still listen to some episodes when they look good.

Just for fun...If you had purchased shares at the close on April 26, 2023 of the companies I discussed in the third issue of *The Standfast Report* *regardless of what I wrote about them* and held those shares to today, then those positions (exclusive of any dividends) would have changed as follows:

Third Coast Bank[10]: +24.5%
AMMO, Inc.: -8.4%

For comparison...

S&P 500 (^GSPC): +3.4%

[9] E.g. the *Fidelity® Treasury Only Money Market Fund* (ticker FDLXX) or the *JPMorgan 100% US Treasury Securities Money Market Fund* (ticker HTSXX). Disclaimer: The author has a financial position in FDLXX.
[10] Third Coast Bancshares, Inc. (ticker TCBX).