Tariffs Provide Opportunity For Companies To Demonstrate Adaptability and Resiliency

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Tariffs have prompted market volatility as investors attempt to parse the potential implications on inflation, supply chains, corporate profits, interest rates, and economic growth.

While Riverbridge monitors such macroeconomic developments, we primarily analyze external catalysts based on their potential to influence the long-term earnings power of our portfolio companies. As fundamental, bottom-up investors, we seek to own businesses that we believe are less impacted by changing regulatory, political, or economic landscapes; are more adaptable than their peers and competitors; and are of sufficient importance and value to their customers so that they have pricing power should input costs rise.

With respect to tariffs, we believe the Riverbridge portfolios have several advantages. In aggregate, our portfolio companies import fewer goods and supplies than the broader market because we own a higher proportion of software, professional services, and information services providers.

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We have long appreciated software and services companies for their strategic customer relationships, high-value and often mission-critical solutions, and scalable business models. Though some trading partners have threatened new taxes on U.S. service businesses, we believe our portfolio companies with global revenue bases deliver a recognized return on investment such that their solutions will continue to be consumed by foreign customers, even at higher prices. In addition, many of our small and mid-cap holdings have a primarily domestic customer base, insulating them from retaliatory actions. Similarly, another major sector for the portfolio that is relatively insulated from tariffs is healthcare, as we generally own domestically focused care and service providers.

Our portfolios may also benefit from what they do not own. The businesses likely to be most negatively impacted are those producing or selling products in highly competitive or commoditized markets. For companies without a differentiated or high-value offering, tariffs cause an increase in the cost of doing business without clear offsets–maintaining prices results in margin compression; raising prices runs the risk of eroding demand. At Riverbridge, we seek to avoid companies with these characteristics.

Meanwhile, for our portfolio companies that do have global supply chains, we believe they have levers in their control to limit the impact of potential new tariffs. For example, the specialty retailer Floor and Décor (FND), which sources products directly and has diversified its supply chain in recent years, should be more nimble than smaller, independent stores that rely on third-party distributors. Just as importantly, the company bolsters its value proposition by offering services to professional installers that help them run and grow their business, such as payroll services, worker's compensation partnerships, and marketing tools. As a result, even if input costs rise, we expect Floor and Décor to be well-positioned to pass through price increases and gain market share.

For other companies, tariffs are not simply a challenge to be navigated but potentially a long-term growth opportunity. Longtime holding Fastenal (FAST), an industrial distributor, will see input costs rise in a tariff regime but, like Floor and Décor, wins business based on high service levels, inventory management, and technology, rather than simply offering the lowest price. Should tariffs have the intended effect of re-shoring manufacturing to the U.S., the addressable market for Fastenal's products and services could grow meaningfully and support accelerated growth.

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For nearly 40 years, the Riverbridge Investment Team has sought a consistent set of characteristics in the companies we own. To be considered for the portfolio, we must believe that a business has a management team and culture built for adaptability, a strategic position in their marketplace and with their customers, and a balance sheet that allows the company to internally finance its growth.

We believe entrusting capital to agile companies that can thrive in a changing world is the way to build a portfolio that endures.