Castelnau
GROUP

Quarterly Report

Castelnau Group Limited

30 September 2023

Introduction

It has been three months of progress on all our investments, and we provide further detail in the company update section below.

One of the most important developments for us in the quarter was the appointment in September of Richard Brown as CEO of Castelnau Group, and we are excited to have him on board. Richard joins us from Morgan Stanley, where he advised us and SPWOne on the Dignity acquisition. He has had a 14-year career in corporate finance after qualifying as a chartered accountant. He takes over from Graham Shircore who returns to the Phoenix investment team. Graham will continue to assist Castelnau, and we thank him in particular for his contribution to the acquisition of Dignity.

One of the areas of initial focus for Richard will be to help further evolve Castelnau's culture, specifically in ensuring that Castelnau is delivering the optimum support to its portfolio companies to give them the best opportunity to succeed and grow. Castelnau is continuing to develop its 'toolkit' and Richard will provide a more detailed update on the Castelnau value-add next quarter.

Castelnau Group Limited ("CGL") is a Guernsey closed-ended company listed on the Specialist Fund Segment of the London Stock Exchange. Formed by Phoenix Asset Management Partners Limited in 2020, its listed structure provides the manager with a permanent capital vehicle with which to make long-term investments and acquisitions in public and private businesses of all structures and sizes. It's investment philosophy involves acquiring large stakes in, and capital to, businesses that have, or can create, strong competitive advantages. Castelnau Group's portfolio comprises investments in Valderrama (Dignity), Hornby Plc, Stanley Gibbons Group, Showpiece Technologies Limited, Silverwood Brands plc and The Cambium Group, as well as in two `enabling' businesses, Rawnet Limited and Ocula Technologies Limited.

2023 Q3 Financials

Table 1: Summary Overview

	2022 Q2	2022 Q3	2022 Q4	2023 Q1	2023 Q2	2023 Q3	QoQ Change
Net Assets £m	£142m	£138m	£138m	£142m	£224m	£216m	-4%
Net Assets /share	£0.77	£0.70	£0.75	£0.77	£0.70	£0.68	-4%
Share Price	£0.83	£0.81	£0.69	£0.75	£0.76	£0.72	-5%
No. of shares	184m	184m	184m	184m	319m	319m	0%
Market Cap	£153m	£148m	£127m	£138m	£241m	£228m	-5%
Prem / Disc to NAV	8%	15%	-8%	-3%	8%	6%	
Assets							
Equities	£118.6m	£116.9m	£122.7m	£131.7m	£258.1m	£254.2m	-2%
Loans to Subs	£5.2m	£6.9m	£10.1m	£14.2m	£11.8m	£12.4m	6%
Cash & Equiv.	£20.7m	£16.2m	£7.6m	£2.2m	£8.7m	£1.3m	-85%
Share Price							
Hornby	£0.30	£0.29	£0.29	£0.25	£0.18	£0.17	-8%
Silverwood	-	-	£0.95	£0.85	£0.75	£0.30	-60%
Ownership							
Valderrama	0%	0%	0%	0%	66%	65%	
Dignity	21%	21%	21%	21%	0%	0%	
Hornby	55%	54%	54%	54%	54%	54%	
Phoenix SG	60%	63%	63%	65%	64%	64%	
Cambium	60%	60%	60%	60%	60%	60%	
Rawnet	100%	100%	100%	100%	100%	100%	
Silverwood	0%	0%	17%	1%	2%	1.8%	
Ocula	77%	77%	67%	49%	50%	50%	

Source: Phoenix Asset Management Partners Ltd.
Past performance is not a reliable indicator of future performance.

Table 2 below shows a breakdown of the Castelnau Group NAV by Asset.

Table 2: NAV Breakdown

Asset	2023 Q2 £m	2023 Q3 £m	Q3 % of NAV
Valderrama (Dignity)	191.0	192.3	89.2%
Hornby	16.6	15.2	7.1%
Phoenix SG	20.6	20.8	9.6%
Showpiece	0.0	0.0	0.0%
Cambium	14.9	13.0	6.0%
Silverwood	3.4	1.4	0.6%
Rawnet	6.6	6.6	3.1%
Ocula	4.9	4.9	2.3%
Total Equities	258.1	254.2	117.9%
CGSL	0.1	0.1	0.0%
Prepaid Fees	0.0	0.0	0.0%
Loans to enabling companies	11.8	12.4	5.8%
Cash	8.7	1.3	0.6%
Short Term Bonds	0.0	0.0	0.0%
GAV	278.7	268.1	
Accrued Liabilities	-55.0	-52.4	-24.3%
NAV	223.7	215.6	

Source: Phoenix Asset Management Partners Ltd.
Past performance is not a reliable indicator of future performance.

Table 3: Castelnau Q3 2023 Company 'Look-Through'

The below table attempts to allow investors to look at Castelnau Group from an alternative perspective – focused more on normalised metrics rather than NAV. The table also provides a consolidated view of Castelnau Group and its portfolio companies. The data includes ownership percentage per company, number of employees, annual sales figures, pre-tax profit, and other financial metrics.

Q3 2023	Pro-Rata Castelnau "Look-Through" ↓	Listed stakes		Unlisted stakes					
		Hornby	Silverwood	Valderrama (Dignity)	Phoenix SG	Cambium	Rawnet	Ocula	Showpiece
Castelnau (CGL) Ownership stake		54%	1.8%	65%	64%	60%	100%	50%	80%
Employees (approx.)	2,562	222	79	3,426	51	149	61	21	7
Sales annual 'run-rate'	**£193.5m**	£53.7m	nm	£216.0m*	£11.1m	£18.6m	£4.3m	£0.8m	0
per CGL share	£0.61								
underlying Pre-tax profit *run-rate*	**£13.4m**	**-£0.5m**	**nm**	**£24.0m***	**0**	**-£3.9m**	**£0.3m**	**0**	**0**
per CGL share	£0.04								
# CGL shares	319m								
CGL Share price (latest)	**£0.72**								
CGL Market Capitalisation	£228m								
CGL NAV 30/09/2023	£216m	£15.2m	£1.4m	£192.3m	£20.8m	£13.0m	£6.6m	£4.9m	£0.0m
CGL NAV per share	**£0.68**								
Premium	5.7%								

*Year to date.
Source: Phoenix Asset Management Partners Ltd.
Past performance is not a reliable indicator of future performance.

Update on the Group Companies

Dignity

As we discussed in the last report, we divide the current work at Dignity into two parts: capital structure work and business improvement. The capital structure work has continued following the agreement with bondholders in September. We don't have anything we can report now, but a lot of progress has been made in the quarter. We are pursuing a range of options and expect to have more to say in the next report. The goal is to put Dignity in a place where it has the capital it needs to execute the strategy, and to remove the constraints and risks that come from the leverage in the current capital structure.

The work of business improvement has been moving at pace. Almost the entire estate has now been reviewed on a site by site, business by business basis. From that work a best practice operating model has been derived. Now the analysis stage has completed, the execution and implementation phase will start in November. The plan is to start with one of the 12 regions to allow the execution team at Dignity to learn as they go. The execution team will then move on to the other regions. As previously stated, we expect the end estate to have margins of 30% and the exercise to ultimately release more in property disposal proceeds than it will initially cost in capex and increase profitability very materially.

Stanley Gibbons

CEO, Tom Pickford, and his team are making progress on the transformation of Stanley Gibbons. The company has codified the principles which will define its culture, and this is a key starting point for all our Group companies. October was a busy and highly successful period for auctions, with £1.1m under the hammer in one week. Also in October, Stanley Gibbons held its first ever Pokemon auction, embedding its addition as a new category in entertainment.

The Stanley Gibbons board is about to do something that might seem unusual, given our long-term investment horizon, and which we therefore feel requires explanation. They are investigating the opportunity to secure alternative investment to support their next phase of growth. This will involve commencing a formal capital raise sale process, which PwC has been appointed to run. The process will give potential investors the opportunity to truly assess the value of the Company's growth plans, against the backdrop of its current financial liabilities.

There are many potential outcomes of this process, one of which may result in a sale of all or part of the Stanley Gibbon subsidiaries. Phoenix is a party to the capital raise process, and as such we do not want to speculate on the likely outcome at this early stage. We will maintain an open mind to any potential offers and outcomes; however, Phoenix is supportive of the Stanley Gibbons board acting in a fully transparent manner as it positions itself for the future. We expect to be able to update more comprehensively in our next quarterly report.

Hornby

Part of CEO Olly Raeburn's mission is to organise the Group to give greater individuality to the brands, and that process is underway. It's an evolutionary transformation that should see the brands, which have different audiences, develop in different ways. Significant strategic progress was made during the quarter, and we look forward to its implementation and the associated benefits coming through.

One of the first outward manifestations of the new strategy at Hornby is the opening of WonderWorks in Margate in what used to be the visitor centre. This is the first experiential site that hosts all the hobbies and products of the Group, including Warlord Games. Many new concepts are being trialled for the first time, and once we have learned lessons from this site, and assuming it is successful, we hope to see other similar sites opened in the future.

Hornby wants to develop direct relationships with its existing customers and potential customers; WonderWorks is another way in which it can do that, and we hope it becomes a popular local destination. If you are ever in the area, please drop in to take a look.

Cambium

Cambium has been undertaking a productivity improvement drive which will restore the core list business to profitability in 2024. Unlike in funerals, where the death data is published every week, the ONS has only published marriage data up to the end of 2020. This makes judging the performance of the underlying business, distinctly from industry wide factors, extremely difficult. We know that after the peak year of 2022, this year has been one of year on year decline but the extent of that is hard to judge. We believe our list businesses have either maintained or gained market share.

In the past quarter, the rate of registrations has turned positive and the current rate of registrations for next year is running comfortably up on 2023, which indicates that the business will return to growth in 2024. The productivity improvement programme is intended to restore profitability even without growth.

Ocula

In the quarter, Ocula successfully added Blain's, Direct Ferries and Covetrus to its customer base as it ramps up its sales effort and demonstrates that it has products that work. It is on course to get its ARR (Annual Recurring Revenue) to £1m by the end of the year, which will lead to its next funding round in Q1 next year. We believe the value of the business has grown multiples of where it was at the last funding round, but we will only revalue it when this has been evidenced.

If you think you have a business or are connected to a business whose ecommerce operation might benefit from Ocula's Boost product, then please make an introduction. Click here for more information.

Rawnet

Following a challenging first half, Rawnet is now on track for profitability for the full year. The business has seen a recent shift in mandates away from lower-margin development work towards higher-margin strategy/UX work. Encouragingly, Rawnet has continued to win new clients outside of Castelnau Group, including ExtraHop and OutSystems in the last quarter.

Silverwood

Silverwood shares were suspended on 2 October due to on-going legal proceedings, upon which we cannot comment. We extended the repayment of our loan to 12 April 2024 to support the business through this period and hope to see a timely resolution to the situation. We can say from what we know that we do not anticipate that our investment will have declined in value as a result of this. In other words, this is not negative surprise.

Summary

All of our businesses are making progress in their improvement programmes. We are tasking all four core businesses to be profitable in 2024 and expect that to be achievable. There is a considerable amount of work going on in all the businesses, which can put a lot of strain on employees. We are enormously grateful for the dedication and hard work we see across the Group.

Intrinsic Value

We estimate that Intrinsic Value per share using the methodology Phoenix applies to its investments in its funds, is £4.22 per share (£1.35bn). That represents an upside of 487% from the period end NAV. This calculation does not allow for any performance fee that might accrue. In our view this measurement, applied consistently over time, is the best guide to future returns.

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.*

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