Castelnau
GROUP

Quarterly Report

Castelnau Group Limited

31 March 2024

Introduction

CEO Comments

Last quarter's commentary covered the work Castelnau Group had undertaken to ensure it's clear what it means to be a Castelnau portfolio company, and how we can foster the best environment for our businesses to perform. These initiatives have been launched and we are pleased with the initial results. The knowledge sharing events such as the CEO quarterly, CFO and technology forums, have all had a positive impact in terms of ideas and learnings that mean the companies are better as a group than as individual companies. A good example of this is a discussion at the technology forum regarding the optimal structuring of development teams. This has led to the best practices observed in one of our portfolio companies being embraced by other businesses in the Castelnau Group.

We also talked about the importance and focus on capital allocation. This is an area where we will continue to spend a significant amount of time with our management teams. Whilst we have seen strategic transactions like the acquisition of the business and assets of Corgi Model Club by Hornby evidencing a thoughtful approach to capital allocation in a transaction, we are keen to ensure that we instil a similar approach across the Group when it comes to more day-to-day, but equally cash consumptive areas such as capital expenditure. Embedding a capital allocation focus within the culture of our businesses is a complicated process – but it is fundamental to our core investment beliefs.

We have been highly focused on building strong foundations at each of our businesses, which we hope will translate into operational performance. A fundamental aspect of this is getting the right management teams in place and we are pleased with the developments across the Group in this area – which Gary will touch on in more detail below. We have made some strong progress with Zillah Byng-Thorne joining as CEO at Dignity, Victoria Lajer as interim CEO & Jenni Hughes-Ward as CFO at Strand Collectibles, alongside the reinforcement of our non-executive directors with the appointments of Nick Batram at Hornby and Mark Power at Silverwood.

Operationally, there has been a focus on ensuring that the businesses are efficient and adopting technological best practices. At Cambium there has been a significant amount of work undertaken on the path to profitability in its core business, leveraging automation and AI, which we hope will deliver productivity and fundamental value gains. The ongoing operational work at Dignity also continues at pace, with the latest wave of the store estate rationalisation launching in April. Encouragingly, the number of funeral homes being closed is now expected to be lower, but with the same significant EBITDA saving as marginal stores are being kept open, showing the learnings as the process has progressed.

At Ocula, time was taken to deliver a product that the business thought genuinely delivered a market-fit and Ocula Boost has facilitated growth in ARR from £1m in December to £1.4m in April via the acquisition of new clients. The work that went into creating this really great product has now started to pay off.

Finally, we have seen the strategic relationships we have as a Group manifest themselves in a positive way for one of our portfolio businesses with the announcement of the investment in Hornby by Frasers, and the agreement for Mike Ashley to provide consulting services.

Whilst operational and strategic positives are starting to come through, we understand that there is a huge amount we need to deliver. These operational and strategic 'shoots' need to convert into tangible value upside for our shareholders and that remains a key focus. We also continue to learn from our mistakes; certain leadership changes, and the course corrections that have been needed at Rawnet/Cambium given market pressures shows the importance of remaining agile and thoughtful.

We strongly believe in our unique portfolio of companies and that 2024 is an important year of delivery at Castelnau Group.

Richard Brown, CEO

CIO comments

The Leadership Challenge

The single most important factor in the pursuit of creating great businesses is the leadership and in particular the CEO. Culture, strategy and capital allocation flow from the CEO, and so one of the most important responsibilities we have at Castelnau is finding and supporting the right CEOs for our businesses. That also means acting when we've got that appointment wrong.

Apart from working out the characteristics we should recruit for, we need to be able to assess and monitor how they are doing, work to help them in any way that we can including giving feedback. When we fail, we need to derive the right lessons from that failure to improve our future recruitment and current engagement.

During the quarter, we released an AI CEO on OpenAI's GPT store (called Leo the Servant Leader). Leo has been trained on some of what we regard as the seminal works and case studies in great leadership, customer centric strategy, effective decision making and strategy, etc. and we believe Leo gives great answers to questions that CEOs face, but we would never have Leo run one of our businesses. Why? Because CEOs lead they don't manage, they make things happen, they don't just answer questions, and the way things happen in companies is through people and so ultimately CEOs are people who can get others to do things. At the same time, they must understand their marketplace and competitive landscape, anticipate the future and shape their organisation to respond to that in a commercial way. Culture, which is every great company's secret sauce, is something that is ultimately set and shaped by the CEO, not by their words, but by their actions. Warren Buffett described it as being like the way children learn their values from their parents, not by what they say but by what they do.

The CEO role is the most varied in a company and yet it requires skills and capabilities which may not have been covered in the CEO's rise to that job. Capital allocation is one of those. How capital is allocated, and how the returns on that capital are allocated will have an enormous impact on the value of the company through time and yet most CEOs know little about how to do it well before they get the job, this is our experience from all the listed company CEOs we have met over the past 25 years.

Because the job is so unique it is hard to know how someone will perform as a first time CEO and so we should expect a high error rate, but we believe it is a challenge that lends itself to continuous improvement. We expect to lower our error rate through time.

The transformation required at Dignity is of such a scale that we decided with Sir Peter Wood that we needed a CEO with a proven record and one which we could evidence. Zillah Byng-Thorne fits that bill in spades and although only formally starting on 1st June we've been able to see her in action for months now and have been very impressed. Sir Peter had first-hand experience of Zillah when she bought his business, Go Compare. You can research her yourself. Accolades aren't the same as track record, but the London Stock Exchange's PLC Awards have a habit of selecting meritocratic winners and Zillah was the 2021 CEO of the Year.

When we invest in minority positions at Phoenix in listed companies, we have to accept the leadership as is and if we get those judgements wrong then we have to suffer the consequences and have very little ability to influence things (look at the sorry tale of Randall & Quilter as a case in point) and therefore have to move on. At Castelnau, we don't have that problem, we get to choose the leadership and then the challenge becomes us and our capability to get that right. 25 years of continuous improvement within a proprietary framework has made us better at the listed CEO judgements, and we are approaching the Castelnau challenge in the same way, we expect some errors, but we also expect to build expertise.

Gary Channon, CIO

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, Strand Collectibles Group, Showpiece Technologies Limited, Silverwood Brands plc and The Cambium Group, as well as in two `enabling' businesses, Rawnet Limited and Ocula Technologies Limited.

2024 Q1 Financials

Table 1: Summary Overview

	2022 Q4	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2024 Q1
Net Assets £m	£138m	£142m	£224m	£216m	£231m	£249m
Net Assets /share	£0.75	£0.77	£0.70	£0.68	£0.73	£0.78
Share Price	£0.69	£0.75	£0.76	£0.72	£0.76	£0.76
No. of shares	184m	184m	319m	319m	319m	319m
Market Cap	£127m	£138m	£241m	£228m	£241m	£242m
Prem / Disc to NAV	-8%	-3%	8%	6%	4%	-3%
Assets						
Equities	£123m	£132m	£258m	£254m	£273m	£297m
Loans to Subs	£10m	£14m	£12m	£12m	£16m	£17m
Cash & Equiv.	£8m	£2m	£9m	£1m	£0m	£0m
Share Price						
Hornby	£0.29	£0.25	£0.18	£0.17	£0.16	£0.38
Silverwood	£0.95	£0.85	£0.75	£0.30	SUS*	SUS*
Ownership						
Valderrama	0%	0%	66%	65%	65%	65%
Dignity	21%	21%	0%	0%	0%	0%
Hornby	54%	54%	54%	54%	54%	54%
Phoenix SG	63%	65%	64%	64%	64%	64%
Cambium	60%	60%	60%	60%	60%	60%
Rawnet	100%	100%	100%	100%	100%	100%
Silverwood	17%	1%	2%	1.8%	1.8%	4.7%
Ocula	67%	49%	50%	50%	50%	49%

Source: Phoenix Asset Management Partners Ltd.
Past performance is not a reliable indicator of future performance.
* Silverwood currently suspended from trading.

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

Table 2: NAV Breakdown

Asset	2023 Q4 £m	2024 Q1 £m	Q1 % of NAV
Valderrama (Dignity)	222.1	222.1	89.4%
Hornby	14.8	35.1	14.1%
Phoenix SG	10.5	10.4	4.2%
Cambium	12.2	12.2	4.9%
Silverwood	2.5	6.9	2.8%
Rawnet	6.2	5.1	2.1%
Ocula	4.9	4.9	2.0%
Total Equities	273.1	296.8	119.4%
CGSL	0.1	0.1	0.0%
Prepaid Fees	0.0	0.0	0.0%
Loans to enabling companies	16.4	16.6	6.7%
Cash	0.1	0.0	0.0%
Short Term Bonds	0.0	0.0	0.0%
GAV	289.8	313.5	
Accrued Liabilities	-58.5	-65.0	-26.2%
NAV	231.25	248.5	

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

Table 3: Castelnau Q1 2024 Company 'Look-Through'

The below allows 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.

Q1 2024	**Pro-Rata Castelnau "Look-Through"** ↓	**Listed stakes** Hornby	Silverwood	**Unlisted stakes** Valderrama (Dignity)	Phoenix SG Ltd (Stanley Gibbons)	Cambium Intl Ltd. (Cambium)	Rawnet	Ocula
Castelnau (CGL) Ownership stake		54%	4.7%	65%	64%	60%	100%	49%
Employees (approx.)	2,270	238	79	2,983	65	135	52	23
Last 12 month running Sales	**£257.6m**	£56.2m	£7.9m**	£313.4m***	£9.2m	£18.8m	£4.1m	£0.8m
per CGL share	£0.81							
Last 12 month running Profit	**£5.1m**	**-£8.1m***	**-£3.5m****	**£22.1m*****	**n/a**	**-£6.0m**	**-£0.3m**	**£-1.9m**
per CGL share	£0.016							
# CGL shares	319m							
CGL Share price (latest)	**£0.76**							
CGL Market Capitalisation	£242m							
CGL NAV 31/03/2024	£248.5m	£35.1m	£6.9m	£222.1m	£10.4m	£12.2m	£5.1m	£4.9m
CGL NAV per share	**£0.78**							
Discount	-2.6%							

*Last 12 months to September 2023.
**Last 12 months to June 2023.
*** Last 12 months to December 2023. Adjusted profit before tax excludes consolidated accounting adjustments relating to the funeral plan trusts, exceptional items and other non-recurring costs.
Source: Phoenix Asset Management Partners Ltd.
Past performance is not a reliable indicator of future performance.

Update on the Group Companies

Dignity / Valderrama

The transformational work at Dignity continues to progress at pace, one key area of significant focus has been ensuring we have the right talent at the business. We are pleased that Zillah Byng-Thorne has agreed to join us as CEO from June, bringing with her an outstanding reputation and significant relevant experience. Kate Davidson MBE has become CEO of the crematoria division, reporting to Zillah, ensuring that the extremely attractive business gets the dedicated focus it needs to drive growth. Steve Masters has joined the Group to lead the realisation of the leasehold and freehold estate.

The store estate rationalisation continues to progress well. Unmanned stores were closed in January and the latest wave of store closures was initiated during April. This process will drive a significant run-rate EBITDA improvement as loss-making stores are exited. The process of selling the excess freehold estate has commenced as well and we anticipate significant incremental cashflow from this during 2024. Changes to the training and incentive packages in the funeral store around memorialisation during the quarter has also led to positive results – just getting memorialisation levels back to 2019 levels would provide a greater than £6m EBITDA boost.

Trading in the first quarter across funeral homes and crematoria has been impacted by a lower death rate than expected during the start of the year, however we expect that to normalise. Funeral plan sales are ahead of budget in 2024, primarily driven by improved training in store, and we are pleased to see the growth trajectory there.

Work continues in earnest to ensure that the capital structure at Dignity is optimised. A range of options are being progressed, and we are constantly focused on ensuring long-term shareholder returns are optimised as part of this process.

Hornby

Group sales for the year ended 31 March 2024 were £56.2m, marginally ahead of last year. Margins were behind due to higher tooling amortisation – albeit there has been some improvement of margins in the last 6 months of the year. There has been significant investment in people, with a new sales and marketing team, alongside adding research, data and loyalty capabilities.

Stock remains too high at £14.6m but it has reduced by £3m since Hornby's half-year results. This remains a key area of management focus.

Hornby acquired the assets and intellectual property of Corgi Model Club ("CMC") during the quarter. CMC generates c. £2m of revenue at 15% operating margin, and the deal was structured in a way to be broadly 'cash neutral' to Hornby. Future earnouts are based on delivery of profits in CMC and Corgi.

Part of the CMC deal saw Guy Stanthorpe joining Hornby to be their Corgi brand MD, and a brand MD of Pocher has also been hired delivering on plans for the new management team structure initiated at the business at the end of 2023.

During the quarter Frasers Group took their holding in Hornby to 9.1%, and Mike Ashley signed a consultancy agreement (for no compensation) that will see him support Olly Raeburn, particularly in relation to systems, operations, logistics and, where relevant, broader matters of strategy. We are extremely excited about the potential for this relationship, and the impact Frasers' expertise in these areas of collaboration could have on Hornby.

Cambium

Registrations year on year are currently up 10% showing signs of progress after a challenging 2023, and various initiatives have been executed across the business improving efficiency across Cambium. Conversion rates are lower than expected YTD however, and this is an area of current management focus. A forensic 'unit economics' exercise was undertaken in Q4 2023 – a key output of which is a path to profitability ("P2P") roadmap being agreed for implementation in 2024. This roadmap includes productivity gains from automation and AI.

An improved version of the Rock My Wedding website is expected to launch in May and Cambium hopes that this will improve the customer funnel to its wedding brands. At Little List, Cambium's baby registry site, focus remains on ways to boost conversion of the high traffic volumes that are seen on the site.

Strand Collectibles Group (formerly Stanley Gibbons)

Given the administration process which Strand Collectibles Group went through before Christmas a key focus of the business in the quarter has been to ensure customers have confidence in the company going forward – this is particularly crucial in the auctions business.

The auctions business has performed resolutely under the circumstances, winning a highly competitive £1.5m stamp auction in April of the Hay Morgan collection of King George V. Management remains highly focused on the customer and their experience, with a range of improvements being implemented during 2024.

Victoria Lajer has been appointed as interim CEO, as we parted company with Tom Pickford in Q1. Victoria has a significant amount of philatelic and collectibles experience, as well as ambition to drive future growth. We were pleased to welcome Jenni Ward-Hughes as Strand Collectible Group's new CFO during March as well.

Strand Collectibles has launched its bullion business and we have increased funding to the coin trading business as part of our growth plans. We remain excited about the opportunities ahead at Strand Collectibles, particularly as it looks to digitise the business and expand the funnel of future collectors.

Silverwood Brands

Silverwood's shares remained suspended for the first quarter of the year; however, we were pleased to see them recommence trading today. The shares were suspended as Silverwood went through the process of unwinding the acquisition of its 19.8% holding in Lush, which required a complex legal process including a capital reduction and shareholder vote.

Silverwood received strong shareholder support for the unwinding of the transaction during March 2024.
During Q1 Castelnau agreed to convert its £4.4m unsecured loan into 8.1m ordinary shares in Silverwood as well as retaining £0.9m of unsecured loan. The conversion means that following the capital reduction, Castelnau's ongoing ownership of Silverwood Brands will be 29.9%. At the same time as this conversion, Andrew Gerrie, Silverwood's CEO subscribed for c.1.9m shares raising gross proceeds of £1m for the company, as well as providing a £0.5m convertible loan.

Given the more significant relative size of holding, Mark Power was appointed as a non-executive director onto the board of Silverwood to represent Castelnau Group's interests.

During Q1 Silverwood closed the acquisition of Cosme Science Corporation, a premier Japanese manufacturer of beauty products and its 100% subsidiary Dr. Baeltz.

Rawnet

Rawnet continues to work hard in what has been a tough market with client spending below expectations. The repositioning of the business towards strategy/UX work has taken place during Q1 to better place Rawnet for the demand it is seeing.

We introduced a new staff incentive scheme during Q1 to align the wider business with delivering profitability, and we continue to think about other mechanisms to further align Rawnet's performance to that of the Group.

Ocula Technologies

Ocula is continuing to deliver on its growth trajectory for clients and annual recurring revenue ("ARR"). ARR is now over £1.4m with Ocula having signed Monoprix, The White Company, Bradfords, Coty, Lex Autolease and Tractor Supply since our last report. The strong revenue growth is positive to see but is even more impressive given that it is being generated at the same time as the management team is executing its latest funding round. The funding round continues to progress well and is now expected to be complete in H1.

Iona Star

Regulatory approval has been given for the launch of the fund, which we expect to take place by the end of H1. The Iona Star team has been working hard to line up a pipeline of opportunities. Indications of interest in the Iona Stars fundraise is highly encouraging, with a number of strategic investors potentially subscribing alongside Castelnau Group. We hope to be able to fully update in the next quarterly report.

Intrinsic Value

We estimate that Intrinsic Value per share using the methodology Phoenix applies to investments in its funds is £4.36. That represents an upside of 459% 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:

Size Matters

Size Matters

Recent site visits to Shirebrook and Swords served as a reminder of the beauty of ultra-high-volume operations, seen running smoothly. Whether it is the seamless sorting, delivering and selling of 250 million sports apparel units annually or the low-cost transportation of 168 million humans around Europe, seeing both businesses in action highlights their unusual trait - they thrive as they grow. These businesses, by design, get better with increased size; their economic moats widen.

Few companies are engineered this way. Companies that truly operate what has become known as 'scale economics shared' business models are very scarce. Yet most external shareholders of businesses demand growth (preferably perpetual) on the not unreasonable assumption that growth is a primary factor determining returns and corporate value. (Whether all those shareholders really appreciate that a high growth business with a low return on capital destroys value is not always clear).

In fact, excessive growth in the wrong hands can at the extreme, kill a business. Lord Myners once alluded to this:

> *"When it comes to financial companies, growth is not necessarily good and when it comes quickly, it's time to ask questions."*

In his book, Small Giants, Bo Burlingham suggested it was no coincidence that only 4 of the 14 companies he profiled had shareholders who didn't work in the business. Burlingham's book makes the connection that those business owners who wanted to build great companies without chasing growth typically had to eschew external investment.

So there is always tension within companies in determining the appropriate level of growth. Bigger is often, but not always, better.

Growing Pains and Remedies

In the corporate world, growth does not come naturally, it needs to be nurtured, sometimes cajoled and always fed. That feeding often brings unwanted side effects for some companies.

> *"When you double the business, the complexities of your business are probably going to quadruple by that time"* - Joszef Varadi, CEO of WIZZ

In retrospect, a notable side effect of Covid-19 in the corporate world was growing pains. A raft of companies, buoyed by the sudden jump in product demand, added significant capacity within their online businesses. The demand step change ultimately proved temporary, but the side effects of the over build lingered. When the Covid tide receded, stock levels were readjusted, but it took longer to recognise or acknowledge degradation of corporate culture. The better businesses showed they were better tuned to recognise these less tangible and undesirable side effects.

> *"Our corporate organisation had grown very large, much more senior than in our history, and very expensive. Despite this much higher level of investment, we were not getting more done, but rather less. More senior people meant more people one had to meet with to coordinate plans and to negotiate what to do. This led to long strategy documents extolling plans for a given area, which then took time for others to read. This led to more meetings. This was a bad cycle. "* - Niraj Shah, CEO of Wayfair

Niraj Shah's reference to a bad cycle of "more meetings" resonates it seems. Shopify's COO says that a meeting is a bug. To that end, at the start of 2024, Shopify sought to eliminate 12,000 (not a typo!) meetings for the year ahead. The company built an internal meeting invitation system which computes the implied dollar cost of each scheduled meeting in terms of executive time spent. One shared screenshot of a simple one-hour meeting scheduled with seven executives suggested that the computed cost of the meeting would be $2,115 if it went ahead!

Reality Checks

The above examples suggest that businesses need growth plans and organisational structures that are grounded in reality. Could the corporate world perhaps use other real-world disciplines to help design for growth?

For example, an anthropologist might suggest that since corporations are ultimately social entities, it is likely there could be natural limits to the sizing of effective human groups within a company. Diverse examples like Jeff Bezos's 2-pizza meetings, Neolithic tribe sizes or W.L. Gore & Associates 150-person divisional group size limits, all suggest this has some merit. The Gore business (of Gore-tex fame) is a renowned follower of Dunbar's Number, and it seems to be highly effective. Dunbar, himself an anthropologist, describes his rule of thumb informally as "the number of people you would not feel embarrassed about joining uninvited for a drink if you happened to bump into them in a bar." The fact that Gore has 12,000 employees is a reminder that this innovative organisational structure is not an impediment to growth, rather a highly effective way to design for it.

Nature too, might be a useful reference for growing our human-designed corporate systems. Trees don't grow to the sky. Nature, by design, insists on buffers, uses redundancy and is extremely patient. Nature is also subject to atrophy. Atrophy is very real in the corporate world (aka fading returns) and is a headwind that long-term organic growth forecasts perhaps too often ignore.

Perhaps base rates (i.e. studying history) can also provide a useful sense check. Michael Mauboussin undertook an extensive study of the median growth rates of companies in the Russell 3000 from 1984-2000 to derive a database of base rate levels of growth and profitability. The study found, unsurprisingly, that optimism and over-confidence are common in forecasts. As Mauboussin puts it: *"Executives and investors commonly rely on their own experience and information in making forecasts (the "inside view") and don't place sufficient weight on the rates of past occurrences (the "outside view")."*

Right Sizing

So is there a 'right size' for a company at any given time? Hard to say. Perhaps it is more useful to invert the question and to ask whether we can identify when a company is not right-sized. In such a case, it is either not taking advantage of growth opportunities (too small) or has not put the corporate structure in place to run the business at a larger scale and has grown too quickly (too large).

A primary responsibility of any CEO is capital allocation, which also means resource allocation and, correctly sizing the business. The corollary also means downsizing if growth has been too fast. A former Nike CEO was reported to have called the Apple CEO for advice after he became CEO of Nike. Steve Jobs' advice? "Just one thing: Nike makes some of the best products in the world. Products that you lust after. But you also make a lot of crap. Just get rid of the crappy stuff and focus on the good stuff." Jobs basically told Parker to right size the portfolio.

This can be a tricky task for CEOs to acknowledge considering that most executives are explicitly incentivised to find and realise growth. Simon Wolfson, CEO of Next, was candid recently on the dangers of setting explicit growth targets. *"The risk is that if targets are set, they will be met"* he told us. Wolfson's point is not that growth targets are easy to achieve. Rather, his point is that if growth is made a primary target (in the absence, say of return on capital or other constraints), the incentives are high to reach that target, possibly at the expense of other unintended consequences.

Constraint Breeds Productivity

Constraint breeds creativity. You see this in start-up organisations or in companies that have cut out the corporate bloat. Famously, WhatsApp had only 34 engineers serving its then 450m users when it was sold to Facebook for $1.9bn in 2015. Today, Telegram another huge social media business counts circa 900m users but has only 50 full-time employees (and no HR department!). Clearly these are the exceptions, the outlier beneficiaries of global, highly scalable platforms, but their efficiency is nonetheless a thought-provoking example of what can be achieved from small employee headcounts. AI might create (or indeed release) another raft of such small beauties.

Jim Simons of Renaissance Technologies once recounted his investment principles. Number one on his list of principles is to 'be guided by beauty'.

> *"Just as a great theorem can be very beautiful, a very very well-run company that's really working on all things very very efficiently, that can be beautiful."*

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