Quarterly Report

Castelnau Group Limited

30 September 2024

CEO Comments

At Castelnau, we remain deeply committed to supporting our portfolio companies where we can help them deliver the most value, aligning with the ambitious goals we've set in 2024. This focus made for a less relaxing but highly productive summer! In contrast to previous quarters, there have been no major changes to the executive leadership within our portfolio businesses and we are pleased to welcome Neil Sachdev MBE as the new Chairman of Hornby.

On the cultural front, we are launching a new initiative with a partner firm to help our portfolio companies embed and measure their culture, to align culture with strategy and to facilitate meaningful cultural change. On the innovation front, we were involved with the rebrand of Stanley Gibbons Baldwin, and have dedicated significant time with Hornby to help them ensure that the customer is at the heart of everything they do. On the technological front, we have been integral to the development of Cambium's AI-powered chatbot, helping ensure the enterprise resource planning ("ERP") systems across the Group are optimised, and that we are harnessing the benefit of AI across the Group. From a transactional perspective, we have been highly involved in the acquisition of Farewill by Dignity, and there are various other strategic initiatives we hope to see completed in the near future. We have started a partnership with Future First and are a proud sponsor of Fulham Cross Academy. We are hoping to inspire the next generation of entrepreneurs, and that one day we will be investing in one of their businesses!

Our efforts to drive knowledge-sharing and collaboration across the Group continue to yield positive results. Our set-piece roundtables continue to be well received, but perhaps more encouragingly are the areas where the collaborations are starting to happen organically. Recent initiatives include a Hornby retail "takeover" at the Stanley Gibbons Baldwins location on the Strand, a unique collaboration that drove cross-brand engagement. Additionally, our technological advancements, particularly around the AI chatbot development and ERP optimisation, are increasingly being shared across the group, enhancing efficiency and innovation.

Our partnerships remain a defining strength for Castelnau. During the period we welcomed input from Frasers in relation to Hornby's warehouse/logistics tender process, and also their co-investment into Iona Star. We see Iona Star as a good standalone investment, this confidence is underpinned by the historic track record of the Iona Star team where they delivered returns of >3x on invested capital. We are equally excited to have Iona Star as a partner more broadly, where we believe their knowledge, but also the businesses that they intend to invest in, will be highly beneficial to the wider portfolio. On the acquisition of Farewill, we have worked extremely closely with Sir Peter Wood and his team to support Dignity with that successful acquisition.

The acquisition of Farewill by Dignity is something we wanted to highlight specifically, not just as a good standalone deal, but because it embodies our strategic ambitions for Dignity. The transaction allows Dignity to accelerate its digital transformation more broadly, but also enables the business to engage with potential customers earlier in their end-of-life planning journey, given the additional later-life products Farewill offers in Wills and Probate. Farewill also offers at-need services and funeral plans, using a distinctive digital-led brand serving a distinct customer base. As well as being strategically compelling, the price paid is underpinned by the value of its will and probate bank. The acquisition is expected to complete in early 2025 after FCA approval, but the combination of strategic rationale and underpinned value is something we look for when we deploy capital. Clearly the hard part, being the integration and execution of a strategy that looks great conceptually, is still to come.

As part of our focus on shareholder engagement, we were pleased to have Zillah Byng-Thorne (CEO of Dignity) join us at the recent Castelnau Group investor roadshow. We plan to enhance the granularity of our financial disclosures for Dignity in 2025 and welcome any suggestions on how we can further improve our interactions with investors going forward.

We continue to believe strongly in our unique portfolio of companies and the embedded value creation opportunity inherent within them.

Richard Brown, CEO

CIO Comments: Are Growth & Cost Cutting Incongruous?

As an external observer of businesses, we usually find that they are either in growth mode or cost cutting mode as if the two were incompatible to happen at the same time. The language and mood of the two tend to be different; growth is a positive thing that business "invests" in, whereas cost cutting is painful, requires a loss of people and sacrifice of those that stay and comes at an "expense" plus write-offs. Cost cutting is usually forced on businesses in response to poor performance, it is necessary rather than desired. However, we think the best businesses are doing both at the same time, it becomes embedded in their culture, either instilled by a founder from the start or introduced by a transformative leadership at some point in their history and turned into culture.

At Castelnau we have businesses that need to do both at the same time. They need to improve their profitability and the productivity of their capital, but at the same time the real long-term value we see in them comes from growth and being able to reinvest capital at high rates of return.

We have been assisting them in programmes that aim to achieve both at the same time.

One way of doing that is to remain customer focused. An accounting led approach to cost saving can do long-term damage to the customer proposition and ultimately be value destroying. A customer only approach when not linked to commercials can also be value destroying. If a business can't deliver its product or service for a profitable return on its capital then it is not a business, it is a charity and it is unsustainable. If customers are not willing or able to pay a price that delivers those returns, then unless the business can find a way of delivering it more productively, it won't exist. Tim Martin, the Founder of Wetherspoons, always says that you have to earn the right to charge a certain price and we think that is correct. This means that some businesses can improve their profitability by doing a better job for customers. All of our businesses serve a customer requirement that lends itself to being rewarded for delighting them. We believe that all of them can also be more efficient and productive.

Cost cutting taken in isolation tends to look for savings that come from redundant resource, waste, better procurement and potentially operational efficiencies and all of those are valid. However, if you take any change as an opportunity to improve what you do for customers and apply some innovation and creativity, then what can seem like a negative can be turned into a positive. Change is an opportunity to improve what we do and the customer proposition.

As an example, think of the role of customer service agents. Innovation offers an opportunity to do this with technology, chatbots and the like, and many businesses are implementing these in a way that saves money but doesn't do much for the customer experience. We see this as an opportunity to improve the customer experience, not just by providing assistance 24 hours a day and at weekends, but also by building unscripted experts who have full product and service knowledge. Customers are conscious when they are dealing with a human that they are taking up someone's time and that constrains how much they ask, whereas a really good AI assisted customer service bot, if it is truly knowledgeable and helpful and infinitely patient, might be used even more by customers and leave a better impression.

We are working on achieving this in a way that is transferable around the Group. We need humans, the very best of them, but when augmented properly we can make them much more productive and at the same time, delight our customers and if we keep going about things in this way it will turn into culture.

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 Q3 Financials

Table 1: Summary Overview

	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2	2024 Q3
Net Assets £m	£224m	£216m	£231m	£249m	£317m	£320m
Net Assets /share	£0.70	£0.68	£0.73	£0.78	£0.99	£0.99
Share Price	£0.76	£0.72	£0.76	£0.76	£0.77*	£0.98
No. of shares	319m	319m	319m	319m	319m	323m
Market Cap	£241m	£228m	£241m	£242m	£245m	£315m
Prem / Disc to NAV	8%	6%	4%	-3%	-23%*	-2%
Assets						
Equities	£258m	£254m	£273m	£297m	£368m	£373m
Loans to Subs	£12m	£12m	£16m	£17m	£19m	£21m
Cash & Equiv.	£9m	£1m	£0m	£0m	£0m	£0m
Share Price						
Hornby	£0.18	£0.17	£0.16	£0.38	£0.20	£0.22
Silverwood	£0.75	£0.30	SUS	SUS	£0.23	£0.23**
Ownership						
Valderrama	66%	65%	65%	65%	65%	65%
Hornby	54%	54%	54%	54%	54%	54%
Phoenix SG	64%	64%	64%	64%	64%	64%
Cambium	60%	60%	60%	60%	60%	86%
Rawnet	100%	100%	100%	100%	100%	100%
Silverwood	2%	1.8%	1.8%	4.7%	29.9%	29.9%
Ocula	50%	50%	50%	49%	49%	44%

Source: Phoenix Asset Management Partners Ltd.
Past performance is not a reliable indicator of future performance.
* The market had not had the opportunity to react to the uplifted June NAV (June NAV announced on 4 July) at end of the Q2 period.
**Castelnau values Silverwood Brands using DCF methodology rather than at share price due to insufficient trading volume for accurate value.

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

Table 2: NAV Breakdown

Asset	2024 Q2 £m	2024 Q3 £m	Q3 % of NAV	Q3 % of GAV
Valderrama (Dignity)	323.6	323.6	101.2%	82.1%
Hornby	18.5	19.9	6.2%	5.0%
Cambium	8.0	11.3	3.5%	2.9%
Silverwood	7.0	7.0	2.2%	1.8%
Ocula	5.4	5.7	1.8%	1.4%
Phoenix SG	3.4	3.3	1.0%	0.8%
Rawnet	2.4	2.4	0.8%	0.6%
Total Equities	368.2	373.2	116.7%	94.6%
Loans to portfolio companies	19.1	21.2	6.6%	5.4%
Prepaid Fees	0.2	0.0	0.0%	0.0%
CGSL	-0.1	-0.1	0.0%	0.0%
Cash	0.0	0.0	0.0%	0.0%
Short Term Bonds	0.0	0.0	0.0%	0.0%
GAV	387.4	394.3		
Accrued Liabilities	-69.9	-74.4	-23.3%	N/A
NAV	317.5	319.9		

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

Table 3: Castelnau Q3 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.

Q3 2024	Pro-Rata Castelnau "Look-Through" ↓	Listed stakes: Hornby	Listed stakes: Silverwood	Unlisted stakes: Valderrama (Dignity)	Phoenix SG Ltd (Stanley Gibbons)	Cambium Intl Ltd. (Cambium)	Rawnet	Ocula
Castelnau (CGL) Ownership stake		54%	30%	65%	64%	86%	100%	44%
Employees (approx.)	2162	227	203	2,745	62	110	35	31
Last 12 month running Sales	**£334.2m**	£56.2m*	£12.4m**	£421.3m***	£8.8m	£17.5m	£3.3m	£1.1m
per CGL share	£1.04							
Last 12 month running Profit	**£83.8m**	**-£8.7m***	**-£5.7m****	**£149.2m*****	**n/a**	**-£5.9m**	**-£1.5m**	**-£1.5m**
per CGL share	£0.26							
# CGL shares	323m							
CGL Share price 30/09/24	**£0.98**							
CGL Market Capitalisation	£315m							
CGL NAV 30/09/2024	£319.9m	£19.9m	£7.0m	£323.6m	£3.3m	£11.3m	£2.4m	£5.7m
CGL NAV per share	**£0.99**							
Discount	-1.6%							

*Last 12 months to March 2024.
**Last 12 months to June 2024.
*** Adjusted profit before tax excludes consolidated accounting adjustments relating to the funeral plan trusts, exceptional items and other non-recurring costs. The number includes benefit of surplus received from the funeral plan trusts during the period.
Source: Phoenix Asset Management Partners Ltd.
Past performance is not a reliable indicator of future performance.

Update on the Group Companies

Dignity / Valderrama

Given the significant changes to the leadership team at Dignity in recent months, we are pleased to see how quickly the team has come together, and the operational execution that is starting to be delivered. Following the repayment of c. £82.6m of Dignity debt (primarily using the funds withdrawn from the trust surplus over the summer), combined with improving EBITDA performance, Dignity is generating cash in excess of its debt service and investment costs.

The freehold disposals have continued at pace, and the expectation is that Dignity will have generated c.£20-25m net proceeds from the disposal of closed branches and excess residential property by the end of the year. The capital will be reinvested in the business. As we touched on last quarter, the debt repayment made over the summer reduced the debt service costs by £5.8m in FY24 and is expected to be c. £9.2m lower next year.

During the period, Dignity updated the market that it no longer expects to exercise the option with the bondholders to facilitate the early repayment of the bond. Whilst we still have this option available until the end of the year, the amended approach is driven by the improved outlook for the business and derisked balance sheet.

As discussed in the CEO section, Dignity announced the acquisition of Farewill during the course of October. Farewill is an award-winning digital end-of-life services business that provides later-life products including wills, probate, at-need funerals and pre-paid funeral plans. The acquisition allows Dignity to broaden its audience, expand its product offering, modernize its infrastructure and strengthen its talent pool. The value of the business is underpinned by the established will and probate bank, and its brand. The addition of the ability to deliver wills and probates enables Dignity to engage with potential customers earlier in their later-life planning journey. It's an important strategic acquisition, and we look forward to completion in early 2025 following FCA approval.

Dignity delivered revenue of greater than £250m and EBITDA greater than £40m for the twelve months to June 2024. As Dignity has listed bonds, we are currently unable to say anything further, but Dignity will update in due course.

Hornby

We are pleased that Neil Sachdev MBE has joined the Hornby board as independent Chair. Neil is an experienced NED that works with a number of Public Service organisations including chairing the HM Land Registry, EastWest Rail Company and Network Rail Property Company, and previously he worked as a senior executive in property and operations at both Tesco and Sainsbury's.

Hornby have been busy focusing on a combination of reducing operational complexity and costs, whilst driving sales by both delighting their existing customers and growing the customer base. Given the level of activity, we are pleased that Penny Teale is joining the business as COO.

A white paper on the hobby industry, 'The Return of the Hobby' was published, which Hornby has used to generate strong engagement in the press about the importance of the industry.

Hornby is improving its focus on the end-customer, and in particular looking to expand the potential addressable market of its products by targeting subject categories it does not already address. Airfix for example has new category range launches planned for 2025 and 2026 – we are excited about the potential to engage new customers with the hobby.

Pocher have signed an exclusive licence with Ferrari during the period, clearly a fantastic partner, which we hope can help drive Pocher to the next level.

Hornby has also made progress on cost cutting and reducing complexity in the business. There has been a significant headcount reduction at head office during the summer. Hornby is also running a warehouse/logistics tender process, which should result in a better outcome for customers as well as cost savings, and there are further strategic initiatives being undertaken that we hope to be able to update on during the next quarterly.

Stanley Gibbons Baldwins ("SGB")

Some of you will have noticed the reference to Stanley Gibbons Baldwins rather than the Strand Collectibles Group this quarter. This is the second (and final…) rebrand in the last 12 months, the initial rebranding did not resonate with customers or use the value that is embedded within these well-known brands. This was a mistake which we have learned from, and the business has addressed this in its revised approach.

The last quarter has been relatively stable period for the business, where the focus has been on embedding the new management team, reassuring customers post the administration and leadership changes, and focusing on growing the core auction, stamp and coin businesses. During the period it was great to see that Royal Mail has selected SGB as its new independent arbiter for potential suspect stamps, reinforcing SBG's stamp authority in the UK market. The new bullion business continues to grow, whilst maintaining attractive margins.

SGB have made a key hire in terms of the digital catalogue, with a product owner to oversee the development joining the team. We hope the development of the digital catalogue can start in earnest now and expect the first version to be launched during 2025. We believe having a digital catalogue for stamps, and other collectibles subsequently, is a key component of the future of SGB.

Ocula

Ocula raised £3.25m in a Series A round last quarter. Since then, a further £750k has been raised to complete the funding round, which should be sufficient to support the business for the next 24 months. The additional funding came from NYO Capital, and Jose Luis-Gomes. Jose leads Google Cloud's North American retail & consumer division, including sitting on the board of Alphabet's independent growth fund, and has joined the Board of Ocula with a particular focus on helping the business grow in North America. We have also rotated the Castelnau Group representative on the Ocula board, with Phoenix investment team member, Alex Campbell, joining. As a result of the completed fundraise Castelnau's equity ownership of Ocula has moved to 41.6% post the end of the quarter.

Ocula have recently developed a new feature for Ocula Boost designed to enhance eCommerce copywriting with an AI co-pilot, that creates best-in-class product pages. Since the fundraise Ocula have added new clients including B&Q, Home Hardware and Buffalo Jeans, and adding ARR remains a key focus – given the target of delivering ARR of greater that £5m in the next 24 months. For the first time they have also started to see some customer churn, there are learnings in each of the scenarios where customers have been lost, and a key focus for the business now is minimizing churn going forward.

Cambium

Cambium is continuing to focus on improving its customer offering and growing revenues. During the period, Cambium relaunched the WPC website and re-platformed Rock My Wedding, both changes should result in improved functionality and customer journeys. As part of Cambium's continued focus on cost efficiencies it completed its head office move and is continuing to look at further ways of reducing its cost base in a sustainable way. The wedding list business continues to be impacted by some headwinds as customers are increasing the proportion of cash on their lists, and product pledge is down. Cambium is trialing various initiatives, based on customer feedback, to address these areas. Registrations in the core business are still encouraging, currently c.8% up next year compared to the current year.

At Rock My Wedding, the re-platforming brings all development and design inhouse, which will improve implementation speed and effectiveness. The focus remains on generating quality content, recruiting venues and suppliers (with a focus on quality over quantity) and acting as a customer funnel to the core business. The focus at Little List remains on increasing conversion levels.

During the quarter, Castelnau increased its ownership in Cambium from 60% to 86%, following the conversion of certain Cambium holders into Castelnau Group shares. More details can be found here.

Iona Star

Iona Star announced the first close of its fund in late September, with up to £10m committed to the fund by both Castelnau and Frasers Group, and with final close expected to be before year end.

Iona Star is targeting early-stage companies focused on the convergence of data and AI and is managed by industry experts in the technology and data space. They have a strong track record in delivery, the previous fund run by the Iona Star team delivered returns of over 3x invested capital, and we believe they will be able to drive significant returns in Iona Star. In addition to the financial benefit from the direct investment in Iona Star, we are also excited about the opportunity for the investments Iona Star will make to benefit the wider portfolio. We expect Iona Star to have completed on their first investments before the next quarterly, at which stage details will be provided on the specific investments themselves.

Silverwood

The focus at Silverwood remains fundamentally on growing sales in each of its core brands. The precise routes to achieve sales growth are different between the each of the brands, but with a focus on expansion across their channels and into new markets. The integration of Cosme Science, which was acquired earlier in the year, is proceeding on plan.

Rawnet

Following the appointment of Sam Love and Gyles Marshall as the leaders of the business over the summer and right-sizing of the company, the focus has been on driving new business with a particular focus on strategic work. Progress has been made with new business since their appointment, with c. £135k of new business won since the new business plan was put in place.

The key strategic focus for the remainder of the year, as well as delivering the sales target for 2024, is ensuring that the business will be profitable in 2025.

Intrinsic Value

We estimate that Intrinsic Value per share using the methodology Phoenix applies to investments in its funds is £4.05. That represents an upside of 308% 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:

Razor and Blades

Latent Data Assets

In January 2024, Reddit, an internet chat forum, disclosed that it had entered into data sales agreements with an aggregate value of over $200m. The data in question being forum conversations that Reddit had accumulated on its platform over two decades since its inception. Until that point, Reddit made most of its money solely from advertising and forum membership fees. In one fell swoop, the business revealed a latent asset, one that is now highly sought-after as a training set for large language AI models. In so doing, Reddit also up ended its business model.

In previous thought pieces, we have tried to highlight various aspects of how great businesses are run. We have discussed customer centricity, corporate culture, playing the long game, the benefits of scale and we examined execution. An area that we have not yet broached explicitly is business models.

A business model might be described as a catch-all phrase that basically describes the framework of how a specific company chooses to add value to customers and how it makes money in the process. Razor and Blades, a stalwart of MBA case-studies for decades, has for some time now been over-shadowed by the trendier direct-to-consumer (d2c) and more recently x-as-a-service (subscription) models as the pinnacle of business model evolution. As the Reddit development suggests, business models remain highly dynamic.

Business Innovation

The Oxford dictionary describes innovation as "a new method". Whilst most discussions of innovation centre on technology, i.e. new technological methods - what gets less recognition, is business innovation - that is, new business methods of extracting value. It seems to us that both go hand in hand. In parallel with the extraordinary technological innovation of the 20th century was a series of business practice innovations that mirrored it.

Early 20th century business formation favoured conglomerates. The conglomerate was perhaps an obvious approach to gaining and deploying massive scale in product development, customer reach and frankly, market dominance. The market success of GE, GM, DuPont et al was then held up as proof of the model's power. It didn’t last; the burgeoning tech industry of the 1960s and 1970s was a fertile ground for not just disruptive new technology, but also disruptive new business models. The evolution of business models since say the 1970s has been relentless and continues in the 2020s.

The semiconductor industry is as good a proxy as any to review this evolution. Weighed down by massive capital requirements, corporate sprawl and the need for specialisation, once dominant vertically integrated IDMs (integrated device manufacturers) like IBM and Philips became a dying breed. New business models soon emerged to replace these tech conglomerates: the principle one being Foundries (outsourced manufacturers such as TSMC), coupled with the newly termed 'Fabless' model (asset-light design-only companies like Nvidia) facilitated far superior return on capital and created dramatically increased dynamism in the sector. It didn’t stop there. EDA (electronic design automation), dedicated Capital Equipment vendors (ASML) and not least IP (intellectual property like ARM) also showed how highly specialised business models with distinct revenue models could be adopted and restore high ROCEs in the industry. Business model innovation, it seems, was just as important as the technological innovation.

The chip companies' customers were themselves also evolving their businesses rapidly, again mirroring the technology sector's rapid evolution. Apple, originally a business selling hardware systems to consumers, evolved into a business that still sells hardware to consumers, but also subscription services and perhaps most notably, has itself revealed a massive latent asset. That asset was the stealth toll bridge it has built, which extracts over $20bn from Google each year for the privilege of being the default browser on apple's hardware devices.

Silicon Valley has led business innovation over the last two decades. Companies like Google and Netflix have led the charge in not only technological innovation but also adopting smart scalable business practices. The Valley has followed suit en masse across a raft of markets. At one end of the spectrum, Amazon developed AWS and, via a creative business model pivot turned what was a cost centre into a $70bn+ revenue division. At the other end, the CTO of Vizio, a TV company has candidly admitted that its business is about "the post-purchase monetisation of the TV" - in other words, selling customers' TV usage patterns. Customer monetisation is not new of course - Airlines have long relied on a similar but perhaps more acceptable approach to monetising their high- spending customers through rewards programs and credit card partnerships.

Notwithstanding those examples, DELL, one of the survivors of the tech industry is a superb example of constraint-driven business creativity.

A Pioneer

To say that Michael Dell was ahead of his time is an understatement. Mr Dell pioneered the direct-to-consumer business model decades before so-called 'd2c' became a thing in business schools. Dell also understood the power and value of his business' data as a predictive business tool.

Founded in 1987, DELL the business is a fascinating and still evolving business case study. It is fascinating because, like Costco, Southwest and Ryanair, it implemented an extremely smart business model to realise a very high return business inside the constrains of what is a cut-throat and typically low return end-market. Ostensibly, Dell setup an ultra-low-cost business that sold direct to customers. That might sound passé here in 2024, but in the 1990s that alone was massive undertaking in what was then an industry and supply chain very entrenched in its ways. Early-on, Dell (and his unsung-hero CFO Thomas Meredith) discovered and leveraged the subtle but highly advantageous side-effects of their chosen business model. This HBR article extract gives a flavour for the business innovations that Dell and his team pioneered:

> *"the direct model turned out to have other benefits that even Michael Dell couldn't have anticipated when he founded his company. You actually get to have a relationship with the customer he explains. And* ***that created valuable information which in turns allows us to leverage our relationship with both suppliers and customers. Couple that information with technology and you have the information to revolutionise the fundamental business models*** *of major great companies.....Most important, the direct*

> *model has allowed us to leverage our relationships with both suppliers and customers to such an extent that I believe it's fair to think of our companies as being virtually integrated. That allows us to focus on where we add value and to build a much larger firm much more quickly."*

Source: *"The Power of Virtual Integration: An Interview with Dell Computer's Michael Dell", HBR, 1998*

In short, Michael Dell had realised the predictive power of his business' data. DELL, the business, in effect created a virtual vertical-integration business model by "blurring the traditional boundaries and roles in the value chain". DELL famously pioneered just-in-time delivery of stock. Less famously, it was DELL's CFO Thomas Meredith that had realised that the relatively low margin nature of their business, coupled with a ridiculously fast deflating input-stock necessitated a culture obsessed with low stock and cash-collection. The outcome was, in effect, a negative working capital business model and a massive boost to ROCE. CFO Thomas Meredith deserves huge credit for this as he recognised the impact that the business model would have on ROCE.

As Bill Gurley presciently observed in his Fortune article (extracted below), Dell had stumbled-upon an interesting new stage in the evolution of business models: negative working capital. They collected money from customers before they have to acquire components or spend money. This phenomenon allowed the company to grow without raising capital, even if day-to-day profitability is zero.

> *"Dell's incredible five days of inventory allows it to pass on component price declines faster than anyone else in the industry. But perhaps the unique aspect of Dell's business advantage is its negative cash conversion cycle. Because it keeps only five days of inventories, manages receivables to 30 days, and pushes payables out to 59 days, the Dell model will generate cash–even if the company were to report no profit whatsoever."*

Source: *"A DELL for Every Industry", Fortune, 1998*

That very insightful passage was written well over twenty years ago and yet it is fascinating that those hugely attractive attributes of that business model remain quite a rare find in today's businesses.

The Next Wave

The relentless pace of innovation in AI today suggests that business models will continue to evolve rapidly. The reddit example above offers just one example for how latent assets might be discovered and monetised within other companies today. DELL shows that such assets can be monetised internally via higher ROCE.

It is worth pondering what similar assets in other companies might prove to be: similar user-generated content, retail transaction data, or it might even be proprietary know-how such as a codified version of the company's procedures.

There are likely many more Reddits out there.

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Contact Details

Castelnau Group Limited
www.castelnaugroup.com

Investment Manager
Phoenix Asset Management Partners Ltd
64-66 Glentham Road
London
SW13 9JJ
Tel: +44 (0)20 8600 0100
Email: Info@castelnaugroup.com

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Registered as an Investment Adviser with the Securities and Exchange Commission

Administrator
Northern Trust International Fund Administration Services (Guernsey)
Les Banques, Trafalgar Court
St Peter Port
GY1 3QL