The Cavendish Partnership

January 2023

Year	%	£
2021	15	£ 1,145
2022	16	£ 1,325
Annualised	***15***	

Inception 1st January 2021. Represented using a notional £1,000 investment with results rounded to the nearest %. Net of all transaction costs with no management fees charged since inception. Individual partners accounts may differ.

Dear Partners,

Our portfolio rose by 16 % in 2022, based on our current investments in 12 businesses: 8 in Europe, 3 in North America, and 1 in Australasia.

After a year characterised by mostly flat or falling global stock markets, our relative performance has been good - a result we could easily attribute to investment skill. Instead, we hold more nuanced views, especially when our approach is based on achieving absolute (not relative) returns over many years. Our partners are generally indifferent to the weekly, monthly, quarterly, and even annual price movements in our portfolio, which allows us to maintain a multi-year time horizon and provides us with a distinct advantage over most other market participants. An advantage we patiently employ in the pursuit of double-digit annualised returns alongside minimal risk of permanent capital loss.

We are not immune to the unavoidable stresses associated with falling stock markets. The effects of which can reduce investors time horizons as professional managers attempt to preserve capital and ultimately their own jobs. The main difference is that our partners recognise that it's precisely these periods of falling stock prices and increasing uncertainty when the best long-term investments can be found. Whilst others are running for the hills, we are calmly rummaging through the remnants looking for those few bargains that have been needlessly discarded.

In the latter half of 2022, we made four new investments, bringing our cash position down to around 2 % of the portfolio. In most environments, we tend to move slowly and cautiously, but over this period we found exceptionally good opportunities. In the UK, an aggressive and ultimately un-funded government spending plan created a short period of financial instability and added to an already in-expensive universe of smaller companies. We took advantage and invested in Appreciate Group, Creightons, Palace Capital, and Titon Holdings.

Moving into 2023, our strategy remains consistent. We continue to focus on transformational situations where we can clearly identify hidden value – alongside good businesses and shareholder friendly management teams. In this letter, we've included two examples:

Creightons, a recent investment based in the UK and Aimia, a Canadian company we've owned since the start of the partnership.

Creightons. A low-margin capital-intensive manufacturing company moving up the value chain towards becoming a premium branded products business. Creightons is a UK listed company based in Peterborough that develops, manufactures, and markets personal care and beauty products. The company focuses on the haircare and skincare sector, and manufactures items such as shower gels, baby products, pillow spays, and face creams. These are sold across a wide range of end markets: from *mass market* discount retailers for prices starting at £1, all the way up to *premium* skin care brands sold directly to consumers for over £50.

Creightons has a long history as a natural products company dating back to the 1950s. Yet, our focus has been on the recent past, starting in the year 2000 when the company was the verge of bankruptcy. The current Chairman, William McIlroy, bought a large stake and took control of the board before quickly appointing Bernard Johnson as Managing Director. These two have remained central figures in the company's progress and hold the exact same roles today. Together, they still own over 30 % of all shares outstanding and both take low salaries. Instead, earning most of their compensation based on Creightons operating performance, with each receiving a bonus that amounts to roughly 5 % of the company's after-tax profits.

For many years Creightons was a steady but unremarkable manufacturing business - consistently profitable but earning low operating margins (around 3 - 5 %) alongside lacklustre returns on capital (around 10 %). Sales were almost entirely based on the following two segments:

- *Contract manufacturing.* Manufacturing products (mainly skincare and haircare) to an exact formulation on behalf of third-party brands. Often described as simply *filling tubes*.
- *Private Label*. Creating, developing, and marketing products on behalf of major UK supermarkets and pharmacies.

A positive change in Creightons results started around 2016, a few years after developing and growing another business line focused on *Branded Products*. This started with a single *Creightons* brand but has now grown to more than 8 distinct individual brands that are sold across the full range of end markets (*discount* to *premium*) both in the UK and abroad. Much of this growth came from the following three drivers:

1. <u>Internal Brand Development.</u> Creightons identified smaller and underserved parts of the market where bigger brands could not or would not compete. This led to the creation of niche products focused on *need states* such as curly or frizzy hair (*The Curl Company* and *Creightons Frizz no more*), problems sleeping (*Feather and Down*), and female hair loss (*Creightons Bambeautiful*). Returns on investment have been high, for example, *The Curl Company* cost around £0.5 million to develop and is now one of Creightons best-selling products, reportedly worth around £6 million (managements estimates).

2. <u>Bolt-on acquisitions</u>. Creightons acquired Broad Oak toiletries out of bankruptcy in 2016 for £0.6 million. This added manufacturing capacity and the capability to produce higher margin products, such as fragrances and candles. In 2019, Creightons acquired its first individual brand (*Balance Active*) from Brodie and Stone for £0.5

million. Then in 2021, the remaining Brodie and Stone brand portfolio for £4.8 million and the premium skincare brand *Emma Hardy* for £7 million. These acquisitions added another five distinct individual brands in the higher-margin categories serving the *masstige* and *premium* end markets.

3. Growing export sales. Creightons has doubled export sales over the past five years to around £10 million today. These sales are often made at higher prices than in the UK. For example, discount brands that are normally sold for around £1 can be sold abroad at £3-4 due to differentiated *Made in the UK* branding.

This transformation was working spectacularly. Creightons sales grew at an annualised rate of over 15 %, from £21 million in 2016 to £61 million for the reporting year 2022 (ending 31st March 2022). But it's the changes that have taken place further down the Income Statement that looked even more promising. In 2016, Operating Profit was around £0.4 million, or just 3 % of sales, but rose steadily to over £4 million in 2022, reaching 7 % of sales. Returns on capital correspondingly rose from 8 % to 20 % over the same period.

As we move into 2023, results will be muted due to ongoing integration issues, slowing sales, and rising inflation. This expectation of poor results and a falling market valuation has allowed us to purchase shares at a bargain price that ignores the company's improving business quality and longer-term prospects. We are confident that this transformation is only just beginning and expect a return to steady, profitable, and higher-margin growth over the next few years.

Aimia. A struggling loyalty points company transforming into a profitable Investment Holding Company. Aimia began life as a Canadian public company in 2005. It was listed on the Toronto Stock Exchange following the spin-off of Air Canada's loyalty points plan into a separate entity. Over time, this new entity grew steadily by acquiring stakes in a handful of other smaller loyalty businesses.

For many years, results were lacklustre and Aimia remained an un-exciting prospect for shareholders. Then everything changed in 2017 when Air Canada unexpectedly announced it was planning to end its contract with Aimia. The potential loss of the company's largest client caught shareholders by surprise and knocked a spectacular 80 % off the market value within a month!

This instability created the conditions for a New York based activist investor, Mittleman Brothers, to lead a shareholder campaign and remove the beleaguered management team. A new team was installed, led by Philip Mittleman, who set about selling off the remaining loyalty assets and re-investing the proceeds with the aim of creating a diversified Investment Holding Company. Thus far, management have made a handful of relatively small private and Venture Capital (VC) type investments alongside buying back over 30 % of all shares outstanding.

As of Aimia's last financial report (dated 30th September 2022) the company had Net Assets of around 800 million Canadian Dollars – consisting of roughly 600 million in cash and liquid investments and another 200 million in private and VC investments. On the liabilities side, Aimia has no debt but pays regular dividends on Preference Shares with a face value of just over 200 million Canadian Dollars.

We like uncomplicated investment ideas, and you don't get much simpler than a company priced at well below its Net Assets, which consist mainly of cash. With a market value currently sitting around 350 million Canadian Dollars, there is clearly a large discount.

The management team agree. They are trying to close this discount by buying back shares, whilst also targeting large and profitable acquisitions. In the past, investment activity has tended towards fast growing and more speculative endeavours that have not yet provided Aimia with sustainable profitability or cash flow. Thankfully this approach is changing, and the CEO Philip Mittleman has been clear about the characteristics of future acquisitions:

- *a history of substantial free cash flow over a complete market cycle*
- *guided by experienced management teams*
- *a focus on assets that can generate income to the holding company*

Acquisitions of this type would be a positive step-change. Firstly, Aimia would move from being an unprofitable and cash heavy entity towards becoming a fully-fledged and fully-invested Investment Holding Company. Secondly, Aimia would make best use of over 700 million Canadian Dollars of historic tax losses, providing the opportunity to shield future taxable gains for a period lasting well into the 2030s.

Owner operated, sustainably profitable, tax-efficient, and growing Investment Holding Companies are often prized by investors and trade close to Net Asset Value. We are therefore remaining patient as we track Aimia's transformation from a shrinking and unprofitable loyalty points business into a growing and profitable Investment Holding Company.

Including Creightons and Aimia, we've now written about seven of the twelve companies currently in the portfolio and we will continue to write about 1-2 every six months until we have covered the entire portfolio. As always, we value your feedback and would be happy to discuss any of our investments in more detail.

Our next letter will be sent in July 2023. In the meantime, we thank you for your continued trust and I look forward to our conversations over the remainder of the year.

With all good wishes,

Adrian Ford

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Partnership Snapshot

Portfolio Breakdown, 31st December 2022 (%)

Permanent TSB Group	14.6
Kiland	13.0
Appreciate Group	12.4
Currency Exchange International	9.6
Park Aerospace	9
AssetCo	7.7
Palace Capital	7.7
Aimia	6.9
Creightons	6.7
Pressure Technologies	4.0
Top 10 Holdings	**91.4**
Cash and Equivalents	*2.0*

World Allocation, 31st December 2022 (%)

UK	43.7
Canada	16.4
Ireland	14.6
Australia	13.0
United States	9.0
Germany	3.3

Portfolio Turnover (%)

2021	14
2022	33

Rounded to the nearest % and calculated by taking the lesser of purchases or sales and dividing by average net assets

Track Record of Investment Advisor (%)

			MSCI All World		*FTSE All Share*	
2017	13	£ 1,129	8	£ 1,082	5	£ 1,050
2018	2	£ 1,151	-5	£ 1,030	-10	£ 948
2019	2	£ 1,174	22	£ 1,258	19	£ 1,131
2020	23	£ 1,442	12	£ 1,406	-10	£ 1,018
2021	15	£ 1,653	20	£ 1,692	17	£ 1,193
2022	16	£ 1,911	-9	£ 1,547	1	£ 1,199
Annualised	**12**		**8**		**3**	

Source: Inception 23rd May 2017. Adrian Ford's 'unaudited managed accounts' represented using a notional £1000 investment. Results are rounded to the nearest % and net of all fees and transaction costs. Index data from Yahoo Finance with MSCI All World represented by iShares MSCI ACWI UCITS ETF Acc (LSE: SSAC) and FTSE All Share by SPDR FTSE UK All Share UCITS ETF Acc (LSE: FTAL)

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