The Cavendish Partnership

July 2021

Dear Partners,

Our portfolio rose 7.8% in the first half of the year, based on our current investment in eight businesses: 6 in North America, 1 in Europe, and 1 in Australasia.

Given our long-term goal of double-digit annual returns, these results are adequate. We try not to fool our partners (or ourselves!) that we have much control over our short-term performance. There will be times when our portfolio is dragged down by the wider market and as your portfolio manager, I will make some decisions that ultimately disappoint. We want to be clear that our 'edge' is expected to come primarily from the long-term mindset of our partners. Allowing us to step away from the highly competitive pursuit of predicting companies' quarterly results and enabling us to seek insights with a much larger payoff that are more consistent with our multi-year holding period.

Therefore, in your letters we will purposefully shy away from discussing markets, short-term events or any other information that becomes irrelevant almost as soon as it is written. Instead, our focus is to help current and perspective partners understand our investment process and to clearly explain how it is implemented over time.

A good place to start is with our investment philosophy and the guiding principles that shape our decision-making. We associate as Value Investors, but not the kind of Value Investing that is often portrayed in the financial media, relating to owning a basket of quantitively 'cheap' companies. That's not our focus at the partnership. Instead, we favour a simple definition of Value Investing - the very same one that was first explained to me when I started my investors' journey - containing just three component parts:

We think of a stock as a piece of a business. We see ourselves as fundamental business analysts following real businesses not stock price watchers following price movements.

We think long-term and are unperturbed by short-term market fluctuations. We are unconcerned about short term price movements, and we see market drawdowns as an opportunity to buy more of the businesses we like.

We buy with a margin of safety. We spend our time estimating the value of a business and will only invest if we can pay a lot less than what we think the business is worth.

Notice that 'relative cheapness' is not mentioned here. We are not seeking a portfolio composed of the cheapest companies but a portfolio of investments with the largest difference between price (what we pay) and value (what we think the business is actually worth). This gap creates our *margin of safety*. Defining our expected return over time and serving to protect us against permanent capital loss due to unforeseen events or errors of judgement.

Recently we've been finding our best ideas analysing businesses that are going through fundamental changes. There are companies that have struggled for many years and are clearly not achieving their full potential - creating a general pessimism and leading to great uncertainty about the future. Especially, when these short-term fears drag down the *price* and cause others to underestimate a company's true long-term *value*.

To search for these opportunities, we are generally not looking for a run of the mill change in the CEO or a new launch of the latest product or service, but a company with a future that will be nothing like its past. Our sweet spot is a company that is truly re-inventing itself by going through t*ransformational change*, where the current effectiveness of the business model is questionable, but there are signs of a much richer future.

Transformation is an idea often associated with nature and spirituality. On this subject, one of our partners recommended Deepak Chopra, who recently tweeted ***"Just when the caterpillar thought the world was coming to an end, it turned into a butterfly"***. Our investment approach has a similar focus on uncertainty, pessimism, and re-invention. We want to buy into caterpillars and if we get it right, ultimately end up owning a butterfly – a growing quality company, run by honest and trustworthy management, that we're happy to partner with for many years.

Within the current portfolio, Permanent TSB and Park Aerospace represent two examples that help explain our investment in transformational change.

Permanent TSB. The small Irish Bank that is unrecognisable from the part it played in the Global Financial Crisis. When capital leaves an industry, it naturally causes competition to decrease and geographical consolidation to occur. With only a few competitors remaining, it's common for pricing power to return and profitability to improve to a more *normal* level. After many years of pain following the financial crisis and one of the worst housing bubbles in Europe, the Irish Banking system is finally showing signs of this recovery.

At the peak of the housing bubble in Ireland, there were ten banks (seven domestic and three foreign) competing to issue increasingly risky loans into an overheating market. Yet as of today, with the impending departure of Ulster Bank (owned by the UK's NatWest Group) and KBC (owned by the Belgian group of the same name) the Irish Banking system is left with only three main competitors. When an industry goes from ten competitors down to three, we sit up and take notice, especially within a regulated and historically profitable industry such as banking. Canada and the Nordic region have some of the most consolidated banking systems in the developed world and have also proved to be some of the most profitable and resilient over decades.

The Irish housing market is finally showing signs of stability. Regulators have implemented mortgage lending rules that are among the strictest in Europe and house prices continue to be supported by a chronically undersupplied market where homebuilders are estimated to be constructing only about half of the new homes required to meet demand.

Permanent TSB is the smallest and simplest of the remaining Irish Banks. It takes in deposits from customers and conducts most of its lending in the form of repayment mortgages, administering around a fifth of the Irish mortgage market. After almost a decade, we believe Permanent TSB is in the final stages of transitioning from issuing questionable mortgages in a highly competitive environment to issuing conservative loans within a more lenient competitive environment. We have already seen three straight years of profitability prior to the Covid-19 pandemic combined with improving asset quality as the number of non-performing loans is reduced to around the European average.

After bailing out Permanent TSB, the Irish government still owns around three quarters of the bank. We are partnered with them as they work to improve the banking system with the aim of ultimately selling their shares to investors at a politically acceptable price. This may take some time but as patient investors we are prepared to wait because we believe that the future of Permanent TSB will be a much more profitable endeavour than its past.

Park Aerospace. A struggling electronics company that has morphed into a growing Aerospace materials business. Park Aerospace operates a single pre-impregnated composite materials facility based in Kansas. At its heart, Park is a family business. The Shore family owns over a tenth of the business and have run the company since it was founded in 1954. The current CEO, Brian Shore, has been at the helm for nearly a quarter of a century.

For most of its history, Park Aerospace (as it's known today) wasn't an Aerospace company at all but an electronics business. It was called Park Electrochemical and originally generated most of its sales from selling materials for printed circuit boards. The transition from Electrochemical to Aerospace took place over many years and started back in 2008 with a decision to invest in a purpose-built facility designed to make materials for the Aerospace industry. This was a bold and costly investment since developing Aerospace products requires multi-year qualification periods due to the extremely high safety standards. Park came up against these barriers and it took two years to produce a prototype, six years to deliver a product, eight years to sign a long-term supply agreement, and a full decade to become profitable.

We love to own small, niche, cash generating businesses that provide 'mission critical' products and services to their customers. A critical product is very difficult to replace and therefore a supplier can retain power to raise prices over time and will often oversee a sticky source of cashflow over very long periods. Park's new Aerospace business certainly fits this mould. It's main contract, which runs until 2029, is as the sole supplier for Nacelles (the cases that go around aircraft engines) for most of Airbus's new single isle commercial aircraft (the A320-Neo family). Additionally, Park has been growing its defence business, and is one of only two US-based suppliers to have achieved the qualification required to supply pre-impregnated composite materials to the US Defence Department.

Recognising the value of this new enterprise, the board shrewdly took the decision to sell the electronics business and now focuses solely on the higher growth and better-quality aerospace component. At the Partnership, we started looking at the company towards the tail end of this transformation but are still optimistic about its prospects as Park cements its place as an aerospace materials business and benefits from the bounce back in air travel following the pandemic. We're excited about the future and are fortunate to be partnered alongside Brian Shore and his family.

These two investment writeups cover about a fifth of the partnership's current portfolio and are designed to give you a taste of each investment thesis without financial jargon. We'll continue explaining the remainder of the portfolio over subsequent letters. However, if any of you want to dig deeper and would like a detailed breakdown of the risks and opportunities for a particular investment, please let us know as we would enjoy discussing this with you.

You will receive our next letter in January 2022. In the meantime, I'm available to our partners for any questions and I look forward to our discussions over the rest of 2021.

With all good wishes,

Adrian

Partnership Snapshot

Portfolio Breakdown, 31st June 2021 (%)

Cash	16.9
Kangaroo Island Plantation Timbers	14.4
Permanent TSB	13.6
Aimia	11.8
Schmitt Industries	10.9
Urbana	10.0
Trecora Resources	7.9
Park Aerospace	7.6
Rubicon Technology	6.9

World Allocation, 31st June 2021 (%)

United States	33.3
Canada	21.8
UK	16.9
Australia	14.4
Ireland	13.6

Track Record of Investment Advisor

2017	13.0 %	£ 1,129
2018	1.9 %	£ 1,151
2019	2.0 %	£ 1,174
2020	22.9 %	£ 1,442

Source: Inception 23rd May 2017. Adrian Ford's 'unaudited managed accounts' represented using a notional £1000 investment. Results are net of all fees and transaction costs.

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