The Cavendish Partnership

July 2022

Year	%	£
2021	15	£ 1,145
YTD 2022	2	£ 1,171
Annualised	***11***	

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 2% in the first half of 2022, based on our current investments in 9 businesses: 5 in North America, 3 in Europe, and 1 in Australasia.

We've experienced relatively strong outperformance this year against a backdrop of falling stock markets, but we must again admit that we have little control over short-term movements in the portfolio (either up or down). When making investment decisions we target absolute (not relative) returns over many years and therefore our results are better assessed over much longer time periods.

During the first half of the year, our cash position rose slightly from 19% to around 25%. This increase was mainly due to the recent acquisition of one of our larger holdings: Trecora Resources, a US based speciality chemicals company that we've owned since the start of the partnership. The acquisition price was disappointingly low, but we still realised a small positive return on this investment overall.

As equity prices fall and investor sentiment continues to sour, *we* are slowly becoming more aggressive and expect to be a net buyer of securities over the second half of the year. We have plenty of cash on hand and most our portfolio companies are similarly positioned, with around two thirds having no net debt. This means our management teams enjoy fortress-like balance sheets designed to weather difficult economic environments and could even benefit from distressed sellers in need of capital.

To invest our cash, we continue to target smaller public companies that are going through a wide-ranging transformation. In this letter, we'll be looking at an example from our current portfolio.

Pressure Technologies. A debt fuelled acquisition strategy that's been reversed to reveal a high-quality business alongside two opportunities for growth. The UK based company Pressure Technologies was a small gas cylinder manufacturing business when it was listed on the AIM stock market (the smaller of the UK's stock markets) in 2007. Since then, Pressure Technologies has been through two distinct phases.

The first began shortly after listing, when the management team followed the popular strategy of targeting rapid growth through acquisition. Over the next decade, Pressure Technologies expanded by bolting on six new businesses, moving into alternative energy and oil & gas component manufacturing. For a time, sales and profits grew, but when a falling oil price led to a slowdown in capital spending, the company's growth strategy faltered. The precarious mix of the increasing debt and reducing cash flow eventually forced the management team to shed assets, shutting down or selling off many of the recently acquired businesses.

The second phase began in 2018 when the management team was replaced. The new team quickly scrapped the acquisition strategy, cut costs within the oil and gas manufacturing businesses, and re-focused capital spending on Chesterfield Special Cylinders, the original business listed in 2007.

Based in the north of England and with a long history dating back to 1897, Chesterfield Special Cylinders (CSC) manufactures high pressure gas cylinders. Made from steel, these cylinders are generally between two and twelve meters long and are exceptionally heavy - for example a nine metre cylinder weighs around 6 tons! CSC is one of the only companies in the world who can build, supply, and service these *ultra-large* cylinders, which are used on submarines, ships, and fighter jets within complex systems such as breathing apparatus and nuclear reactors. Each high-pressure cylinder is purpose built to exact specifications and supplied to defence programs that last well into the 2030s. The specialised and mission critical nature of these products combined with long-term defence contracts provides a sticky source of predictable (albeit lumpy) contract cashflows.

Given the quality of CSC and the sensible actions of the management team, we have been buying shares at a reasonable valuation based solely on the defence business. This gives us two potential sources of hidden value:

1) <u>The remaining oil and gas manufacturing businesses.</u> Until recently lossmaking, all three are now recovering alongside a higher oil price driving the return of industry capital expenditure. Each is now smaller and more efficient, meaning that another downturn is unlikely to be disastrous, but a sustained rebound would represent a material source of profitability for the company.
2) <u>Hydrogen refuelling stations.</u> In the past few years, CSC has become the leading European supplier of high-pressure gas cylinders to hydrogen refuelling stations. Although nascent, this market has a potentially long growth runway as hydrogen becomes more widely adopted for transportation, especially amongst heavy goods vehicles and buses.

Whilst we wait for a recovery, we are content to be invested alongside a management team who are well aligned with us. Although not large owners (normally our preference), their ultimate rewards are heavily tied to a much higher share price. Thereby creating a mutually beneficial situation and strengthening our conviction that the future for Pressure Technologies will be considerably brighter than the past.

As always, we include these writeups as a brief introduction to our portfolio companies and not as a complete list of the potential risks and opportunities. We are always open to feedback, and so if our partners would like to discuss any of our investments in more detail, we'll happily walk you through our thinking.

Our next letter will be sent out in January 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

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Partnership Snapshot

Portfolio Breakdown, 30th June 2022 (%)

Kiland	16.6
Permanent TSB	11.7
Aimia	10.1
Park Aerospace	9.6
Currency Exchange International	8.1
Pressure Technologies	6.9
Rubicon Technology	6.3
Schmitt Industries	3.5
Asset Co	2.4
Cash	*24.7*

World Allocation, 30th June 2022 (%)

UK	34.1
United States	19.4
Canada	18.2
Australia	16.6
Ireland	11.7

Portfolio Turnover (%)

2021	14
YTD 2022	18

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 (%)

2017	13	£ 1,129
2018	2	£ 1,151
2019	2	£ 1,174
2020	23	£ 1,442
2021	15	£ 1,653
YTD 2022	2	£ 1,691
Annualised	**11**	

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.

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