

EDITOR'S NOTE: *This interview has been updated.*

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Quim Abril, president and portfolio manager of [Draco Global SICAV](#), tells us that he invests in companies with competitive advantages and focuses a lot on the possible risks that these companies may suffer; what you look for in them what type of companies you look at. Also, he shares some books that are worth reading.

Global MOI in Spanish: *Tell us about your training and your career.*

Quim April: My financial training in its beginnings is still the typical one of most of the students who study business, ADE, or economics, and they are not very clear about what to do in the first place. A class on financial markets in my business studies piqued my interest in the stock market. I remember the professor telling us about gurus like Graham or Buffett and their double-digit annualized returns. At the end of the class, I went to the teacher and asked him what had to do to be a fund manager; his answer was blunt: 1) Read everything possible about the best American fund managers; 2) take a good master degree in financial markets; 3) learn accounting in-depth, and 4) manage an investment fund as soon as possible.

Said and done, from that moment on, everything I did was aimed at following the teacher instructions. I started with some small jobs as an accountant, which helped me much to understand accounting secrets. Subsequently, I studied a master's degree in finance while joining a small fund manager in Barcelona as a junior manager. It was a tough time because it coincided with the end of the technology bubble, and it was not easy to be an employee of an investment fund manager.

A great influence in giving accounting the importance it requires was my sister, a senior auditor at the time at a Big Four, a key reason why I later decided to pursue a master's degree in Auditing. In hindsight, I recommend to anyone who, before entering the world of fund management, work for a few years as an auditor. During the Master in Auditing, I discovered Thornton L. O'glove and his book [Quality of Earnings](#), which helped me understand how many times a balance sheet and a cash flow statement can be leading indicators of the future operational evolution of a company. It was not until the end of 2003 when I began to practice everything I had learned first at the Caixa Penedés fund manager and later at BMN Asset Management.

My main task was to look for good business models with sustainable competitive advantages. I tried to minimize the possibility of encountering accounting red flags, first in a Spanish equity fund, and later also in a European one. During those years, I took the opportunity to read most of the books of great investors such as Graham, Buffett, Fisher, Munger, Lynch, Soros, etc. But in reality, those who subsequently impacted me the most were other well-known managers and analysts: Pat Dorsey,

Aswath Damodaran and Mark Spitznagel.

Pat Dorsey is known for creating his Morningstar Competitive Advantage Rankings, which is a tremendous help in understanding a company's business model. Later I discovered with Damodaran how to translate this Dorsey business model into an Excel sheet with all the necessary adjustments to make a reliable and real valuation. Finally, after the financial crisis of 2008, I realized that a portfolio with quality companies, diversified and bought at reasonable prices, was not enough to avoid a fall in the stock market of more than 20% in an economic environment of recession or depression. It was then that I began to think that, on certain occasions, a portfolio of stocks required something else, precisely a tail risk strategy such as Mark Spitznagel or Vineer Bhansali did.

Finally, in late 2012, I received some recognition from Citywire for including me on their list of [the world's 1,000 best fund managers](#). The study took into account the risk-adjusted five-year annualized return. Within this classification, there were 10 Spaniards, the second being a short distance from the first, Iván Martín (now in Magallanes Value Investors). As a result of the good returns obtained by the managed funds, I began to consider creating my own investment vehicle seriously. This is how, at the beginning of 2015, I left BMN Gestión at that time already Banco Madrid.

Creating your investment vehicle always takes some time and initial learning and raises the necessary capital to get started. At that time, I wanted an investment vehicle that was accessible to foreign investors, and that would allow me to focus my portfolio on my best ideas. Finally, the vehicle was a hedge fund with Audentia Capital, thus fulfilling all my previous requirements.

Global MOI: *What is the investment criteria of Draco Global SICAV? How has it evolved?*

April: The value proposition of Draco Global SICAV is to invest in the best of both worlds, large market capitalization companies known to all and the other extreme, small market capitalization companies unknown and with low analyst coverage. Large companies are included in the fund when they have a temporary problem that does not invalidate their long-term competitive advantage. Small companies simply because they are cheap because they are unknown to the investment community.

We are very demanding when it comes to including a company in the portfolio; it must have some sustainable competitive advantage and a certain percentage of recurring income. But only these attributes are not enough, so we also look for the following:

3. **Scalable business model:** It is one where a company can maintain a sustained growth in sales and profits, with the potential market being sufficient to grow continuously. This scalability can also be found in niche markets through small market capitalization companies.

OptimizeRx [OPRX] is an IT company in the health sector that unites pharmaceutical companies, EHRs (Healthcare Health Record), and doctors in the United States on its platform. Its potential market (TAM) is more significant than two billion USD by digitizing medical prescriptions and patient records. We like to invest in companies where the relationship between market capitalization and TAM is minimal. This market expects to grow to USD 32Bn in 2024, as it is a relatively new business.

Armanino Foods [OTCMKTS: AMNF] is the leading brand in the production and marketing of fresh and frozen pesto sauces and other sauces and kinds of pasta in the United States and Canada. The opportunity for AMNF is excellent and growing, thanks to the growth of premium foods in the United States and worldwide. In the United States, AMNF still has little presence on the East Coast and Asia; today it only accounts for 5% of sales.

Water Intelligence [LON: WATR] is the world leader in precision and invasive leak detection in drinking water and wastewater. Its potential market (TAM) is substantial due to the scarcity of water due to the aging of the infrastructures due to the climate impact. According to the Federal Environmental Protection Agency, on average, the leaks per household in the USA can represent more than 10,000 gallons per year of water lost, equivalent to 1 billion gallons per year on a national scale. Outside the USA, the World Bank estimates that between 30% and 40% of water can lose due to leaks.

4. **Long-term secular growth trend:** A company must be present in an industry that offers long-term structural growth via some theme that will be the engine of future economic growth, such as demography, digitization, or outsourcing.

Booking Holdings [BKNG] is an exciting example of long-term secular growth. Online tourism is growing faster than the global economy and offline tourism. Phocuswright estimates that the online travel market will grow at a compound rate of + 14% in the next few years. If we take into account that online tourism only represents 45% of the total, that the penetration rate could grow by 2% per year, and that the tourism market as a whole will grow approximately one + 4% -5% annually; then a sustained growth of online tourism of 8% -10% could expect over the next few years.

Dassault Systemes [EPA: DSY] is a French PLM-type software company used to design, produce, and manage products in aerospace and defense, industrial equipment, marine and offshore, and consumer goods. This software allows adding different programs from other software along the entire value chain of a product, from the generation of the idea and its manufacture to the marketing and final sale. The drive towards digitization is a structural feature of the industry that should mitigate the impact of an economic slowdown or recession, making it easier to continue to grow its sales year after year.

Universal Health Services [UHS] is one of the nation's largest and most respected healthcare and hospital service providers. It has more than 350 general care hospitals, mental health centers, and outpatient centers in the USA, Canada, and the United Kingdom. Population aging acts as long-term structural growth for UHS. Today in the USA, there are more than 60M people over 65 years of age (15%), and it expects that this rate may reach 23% in 2050. UHS is present in the states with the highest growth and dynamism of the United States, Texas, California, and Florida.

5. **Attractive sector structure:** Key factor that determines to what extent a company can be of quality. Some industries allow a few companies to maintain high rates of return on capital. Still, most of them must operate within monopolies, mini-monopolies, local monopolies, oligopolies, or fragmented markets with a leading company.

KONE [HEL: KNEBV] is the world's fourth-largest supplier of elevators and escalators. The company began producing elevators in Finland in 1918; it generates income by selling new elevators, escalators, and maintenance services on its installed base. KONE operates in an oligopoly, together with other companies such as Schindler or Otis and where the first five companies control more than 70% of the global market.

Societe LDC [EPA: LOUP] is the leader in the French poultry market. Historically specialized in the slaughterhouse sector, the group has diversified and internationalized over the years. The group is present in all the poultry segments: whole poultry, cut products, and prepared meals. LOUP has a 45% market share in France; it is a local mini-monopoly thanks to its quality and brand recognition. The desire to consume local products favors the French group, benefiting its premium brands more than other foreign brands.

Global MOI: *How do you generate investment ideas?*

April: Mainly participating in online communities of investment in stocks, where we contribute ideas, and in return, we also receive them. In the United States, for example, we find Seeking Alpha, MicroCapClub, Morningstar, or Value Investors Club. In Europe, there are fewer, but one that I like is value and opportunity. We also participate in other lesser-known clubs, but I prefer to keep the names for now.

Apart from these forums, we also have some screen, although it is not quantitative but only qualitative. Finally, we do not like to invest in ideas from other investment funds; we always prefer to find our opinions.

Global MOI: *How much importance do you give to management? How do you value management? Any CEO you admire?*

April: We will hardly invest in a small company if we have not previously had access to management to discuss its business model and the potential risks.

In our opinion, this is a crucial aspect of our analysis. This is why our fund does not invest in Japan, due to the inability to talk to Japanese companies, regardless of their market capitalization. Before investing in small companies, we always force ourselves to speak with the company twice, the first with the CEO or owner to analyze the business model and its potential risks, and the second with the CFO to minimize accounting red flags. In general, we think that no CEO is to admire because then our opinion about the company might not be neutral.

Global MOI: *How do you find the balance in your portfolio between focusing on your best ideas and the diversification needed to control the risk of downside?*

April: Our portfolio comprises about 25 companies because there are few good ideas and why to have a fund with 50 companies or more ETFs already exist. We think that with 25 companies and without sectoral concentration, the risk is sufficiently diversified.

Additionally, we control risk by 1) Investing in the company when the price is close to our "worst case or negative" scenario; and 2) The tail risk strategy. This fund implements a tail risk strategy to protect the equity portfolio from large drops, such as during the 2008 financial crisis or the 2000 tech bubble.

When investing in stocks, you have to consider the business cycle, but do not try to predict exactly when the next economic downturn will be. Stocks tend to start to decline just before periods of economic recession and to rebound strongly on signs of recovery. Jeremy Siegel shows that from 1802 to 2012, the United States has experienced 47 recessions with an average duration of 19 months and 34 months for expansions; that is, the economy has been in recession almost a third of the period a sixth since the Second World War. During an economic downturn, equity indices typically experience large losses depending on the intensity and duration of the recession. Throughout history, we find multiple periods where stocks fall by more than 20% and almost always coincide with an economic slowdown. Even though stocks are the best long-term asset, the reality is that virtually no investor has a time horizon of 100 years and that a 50% drop only recover with a 100% rise.

Society, in general, takes out insurance to protect its most valuable assets (cars, houses, etc.) but instead, it does not do so with its portfolio of shares; why? Buying protection against a stock price drop is not too different from paying a premium for insurance without thinking that it is not a luxury but rather a necessity.

To build our tail risk strategy, we always use PUT options on indices and we reduce their cost by selling PUT options on shares that we want to have in our portfolio always without leveraging the fund, that is, we always have the cash to face the purchase of the shares if we were to execute the options.

Contrary to what many investors think, the tail risk strategy involves buying PUT options with long and not short maturities since it is impossible to determine the exact timing of when a recession will start. In our case, we use the leading indicators of the US Conference Board to try to determine when there is a certain probability that the economy could enter a recession or depression. It is only about seeking protection against a potentially large drop, not a correction (drop less than 20%) in the market like that of the fourth quarter of 2018. This option tail risk strategy is the result of a study and collaboration with an American company specialized in Tail Risk strategies. Some time ago, we bought a database with the price of all the options of the S & P 500 since 1994, and we calculate all possible combinations of expirations, strikes, and reel frequencies. Then we include our LEI leading indicator as a conditional on knowing when to activate the strategy and when not to. During this year, we will give more detail about the results of this study that we think is differential in Spain and perhaps also in Europe. The hedge activates for the first time at the end of 2018, and to this day, it is still in effect at a low cost, with almost no penalties for the fund's performance when equity markets rise. We will give more detail on the results of this study, which we think is differential in Spain and perhaps also in Europe.

Global MOI: *Tell us about one (or a couple) of your most significant investment mistakes. Any company that you have regretted not having bought?*

April: A recent mistake was not investing in XPEL [XPEL] in the middle of last year. XPEL is an American company that sells paint protection films for high and very high segment cars. To a lesser extent, it also sells to the residential and commercial sectors for window protection. We discovered this company in May 2019, when XPEL was trading at the US \$ 4.5 and had a market capitalization of US \$ 130 million.

It is a very scalable business. Grand View Research estimates a potential market to 2025 of US \$ 450 million growing at a CAGR of + 7%. The sectoral structure is also adequate because even though it is a fragmented market, within the automotive subsector, there is an oligopoly structure with 3M and XPEL dominating the market. Both XPEL and 3M sell their product to dealers and repair centers throughout the United States, and both different by being the "players" with the best product quality. Outside of the United States, XPEL also maintains a business model focused on franchises.

At the end of 2015, 3M denounced XPEL for patent infringement, causing a large drop in the price, although, in March 2017, both companies finally reached an agreement. The 3M demand created an incredible investment opportunity in XPEL because the listing did not rebound until well into the summer of 2018.

One of XPEL's main competitive advantages is its DAP software, which generates recurring income when sold under a subscription model and, at the same time, improves the efficiency and costs of dealers and installation centers (its customers). The other advantage is that this product sells at an average cost of US \$ 5,000, which is relatively low compared to the selling price of a very high-end car, about the US \$ 100,000, that is, no more than 5% of the total price.

Over the past five years, XPEL's earnings per share have grown at a CAGR of + 45%, very in line with its price (+ 40%). During the past summer, XPEL traded at a PER multiple of 15 times, which grew organically in sales at + 50%; therefore, we could buy growth at value prices.

As everything fit, both at a fundamental and valuation level, we decided to start our due diligence process, ruling out the possibility of meeting with accounting red flags and talking to their management team. This delayed our investment in XPEL, and the value went from \$ 5 to \$ 10 in a few months, so we finally decided not to invest.

Looking back, perhaps we were not agile enough because the stock has risen to US \$ 17.30, always accompanied by an excellent operating performance.

Global MOI: *What aspect do you pay most attention to when investing?*

April: Without a doubt, to know what are the risks of the companies that we have in our portfolio and especially in the smaller ones. To do this, we analyze in detail everything that can go wrong and calculate a fundamental valuation in an adverse scenario. Only when the price approaches that pessimistic scenario is when we decide to invest. In this way, we have a sufficient safety margin. For example, when the Cambridge Analytics scandal broke and the market consensus began to estimate a drop in advertisers and users on Facebook [FB], that was the time to analyze whether it was a real risk or just market noise. Analyzing the data coldly, FB was not losing either advertisers or users; what's more, the average ARPU in 3Q18 was \$ 6.10 and a year later \$ 7.26, a growth of almost + 20%. ARPU continues to grow, and according to our calculations for 3Q20, it could reach \$ 8.10, another + 11.5%. In users, FB has continued to grow in single digits throughout this period. Thanks to the craziness of Mr. Market, we bought FB at an average price of US \$ 134 while also selling PUTS. Today FB is still one of our central positions, and we estimate a target value for 2022 of \$ 275.

Another case could be Altigen Communications [OTCMKTS: ATGN], provider of cloud services. The company provides software and services for small and medium-sized businesses that require Voice over Internet Protocol (VoIP) telephone systems. Many of these companies use Microsoft Azure to equip themselves with cloud-based solutions. The real growth story is the revenue expected to come from the successful transformation from a license and hardware sales business to one of recurring revenue via monthly subscriptions. It is important to remember that the strengthening of current relationships with Microsoft and Fiserv provides you with exclusivity against your competition. To calculate our objective sales figure, we have estimated the number of subscribers and income per subscriber it could have during the next three years in a very conservative way. We have applied a multiple of 3.5 times sales, much lower than the multiple of its listed comparables. Today to 5 times sales.

Regarding the balance sheet, 85% of total assets are cash and deferred tax assets. There is a remainder of US \$ 60 million in "NOLs" (activatable deferred tax assets), which, when they can be activated, will cause ATGN does not pay taxes for many years. In other words, only cash plus deferred assets 85% of the total assets are cash and deferred tax assets, and there is a reminder of US \$ 60 million in "NOLs" (activatable deferred tax assets), which when they can be activated, will cause ATGN not to pay taxes during many years. In other words, only cash plus deferred assets 85% of the total assets are cash and deferred tax assets, and there is a reminder of US \$ 60 million in "NOLs" (activatable deferred tax assets), which when they can be activated, will cause ATGN not to pay taxes during many years. In other words, only cash plus deferred assets

They are almost 40% of the market capitalization. Our average purchase price is \$ 1.10, and we estimate it could be worth at least twice that.

IEH Corporation [OTCMKTS: IEHC] is the only independent manufacturer and distributor of hyperboloid connectors. These connectors join the poles of a cable and are used only in critical operations in the aerospace, medical, and military sectors.

We opened our position in IEHC during the summer of 2018 at an average purchase price of US \$ 10.5. At that time, we were buying a great company with substantial competitive advantages at PER 5, simply because it was unknown to the market. Even so, we did our analysis of red flags, especially in the inventory item—the most relevant article on the balance sheet inventories and, to a lesser extent, customer factoring. Regarding inventories, in recent years, IEHC has received large manufacturing orders from customers, and the company thinks that these will continue in the future (see last quarterly publication of results); therefore, it maintains high inventory levels to issue unexpected orders and to be able to offer better prices.

If we analyze the historical inventory mix, we observe as always raw materials represent 60% - 70% of the total. Changes in the inventory mix often suggest changes in the underlying business. Still, in this case, these were not increases in the finished product that could indicate a slowdown in demand. The percentage of raw material inventory over sales has always been between 25% -30%; therefore, we could estimate sales for the current year of about US \$ 30 million. In the last three years, the inventory of raw materials has almost doubled, not so in finished products; therefore, it seems clear that the increase is a consequence of higher production. Until 2016, IEHC valued raw material inventory using FIFO, but in 2017 it changed the accounting criteria to the weighted average price. This change, although necessary, does not worry us we would be concerned if it had been the other way around because during periods of price increase, with the FIFO method, the company obtains a more significant profit. After all, it is selling products that cost less when it bought the raw material. In short, we believe that the high weight of inventories is not a relevant problem, and today we are still IEHC shareholders, with a three-year target value of more than US \$ 32.

Global MOI: *Mention a couple of books you have read recently that have given you new knowledge to improve as an investor.*

April: The last book I have read is [Tail Risk Hedging](#) from Vineer Bhansali, former manager of PIMCO. It explains very well all the options that exist to cover the negative tails of the equity and debt market, especially in a scenario of recession or in a significant downturn. Another exciting book is [The Pink Sheets](#), which explains the operation of the OTC stock market in the USA; very popular for Leonardo's film DiCaprio but very interesting in my opinion, as long as you know how to separate the good from the bad.

Global MOI: *I understand that they do their research. Why?*

April: A differential factor in DRACO GLOBAL is that we carry out our research and publish it on our website, especially in micro and small caps. Most investment funds and hedge funds cannot invest in small or illiquid companies, and the MIFID II regulation has caused many research houses to stop covering small companies. We want to be the first to write about totally unknown companies without analyst coverage. If we get the investment thesis right, we can multiply our average purchase price by two or three times, a difficult task to achieve in companies with large market capitalization.

Global MOI: *Anything else you would like to add for our members?*

April: For the last three years, I have been the manager of the Global Quality Edge Fund, a vehicle created in the summer of 2017, with a concentrated portfolio of extraordinary businesses and with a global focus. But it was a product only for professional investors, domiciled in Malta and with a high TER, which had been making it difficult for the Spanish investor to contract. Hence, I have launched a new project, with a vehicle in SICAV and UCITS format by Gesiuris Asset Management in Barcelona. Now, as a manager and employee of Gesiuris, I have available an investment vehicle that can be easily contracted by the investor, since the SICAV trades on the Spanish MAB like a listed share.

Global MOI: *Thank you very much, Quim, for sharing your knowledge with us.*