Dear shareholder, 04/13/2021

The returns of DRACO GLOBAL SICAV during 1Q21 was + 6.7%, and since the beginning, it was + 8%. The official new Management began in September last year, with exposure to equities of 19%. Throughout the fourth quarter of 2020, we increased our exposure to 45%, and at the end of March 21, we are at 65%. The main reason for not completing the portfolio is why we do not like to go behind the market. We will find better prices during the following months.

As you well know, we communicate much information through the following channels: 1) Website (www.dracoglobal.es/en), 2) Newsletter (newsletter), 3) Twitter (https://twitter.com/AbrilQuim) and 4) our YouTube channel “Invertir como un professional – DRACO TV”.

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MARKET ENVIRONMENT

We expect a strong global economic recovery with greater strength in the US thanks to Biden's huge fiscal plan ($ 1.9tr). The Biden’s fiscal plan will have a significant impact for the next two years, and then, the economy will return to its low growth path. Suppose we combine low-interest rates with a still expansionary monetary policy. In that case, we find the perfect breeding ground for the excellent performance of equities, small companies. Here are some reasons why you should invest a portion of your savings in small businesses:

1. Biden's fiscal plan ($ 1.9tr) has a substantial impact on the real economy.
2. Micro & Small caps represent 80% of the entire global investment universe.
3. Greater alignment of interests due to more significant business ownership.
4. Greater probability of receiving an offer to purchase (OPA).
5. Greater access to the owner, CEO, and CFO.
6. Lower analyst coverage and lower pricing efficiency.
7. More significant long-term profitability potential.
8. Simpler to understand businesses.
9. Greater capacity for growth in sales and profits in the medium and long term.

We think that the global economy has started another bullish cycle, led by the US and China. Although we will see corrections, these will be clear buying opportunities. If so, we see no need to hedge (purchase OTM PUT options on equity underlying) as leading indicators (LEI) will continue to

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recover. Our tail risk strategy is very opportunistic. We implement a tail risk strategy when there is a high probability that the economy will enter a recession or depression, a scenario that we will not see in the next two or three years. If you're interested in how this opportunistic strategy works, please check this video.

Click on the image to open the video

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📊 PORTFOLIO SITUATION.

The first ten positions represent 45% of equity assets, and the first twenty more than 81%. The geographical distribution by sales figure is made up of 65% USA & Australia, 24% Europe, 8% China and the rest Global. By size, 80% are small companies, and 20% are large companies. On average, five analysts follow our companies. The split between Growth companies and Value companies is 55/45. The fund has a three-year upward potential of more than 45% or an IRR for the same term of 12%. The average ownership percentage of the portfolio is 65%. The average insider trading is higher than 20%. More than 15% of the companies in the portfolio are repurchasing their shares for an amount close to 10% of their market capitalization.

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The most relevant movements in price in the first quarter were:

✔ + 70% MamaMancini's Holdings, Inc. (MMMB), + 48% ChannelAdvisor Corporation (ECOM), + 41.5% LGI Homes, Inc. (LGIH), + 23% G5 Entertainment AB (publ). (G5EN) and + 21.9% Hanza Holding AB (publ) (HANZA).

✘ -41.51% Repro Med Systems, Inc. (KRMD), -12% Altigen Communications (ATGN), -9.5% Palo Alto Networkds (PANW) and -8.6% Jumbo Interactive (JIN) and -6, 75% Ekinops (EKI).

PORTFOLIO OF SHARES.

During the past quarter, DRACO GLOBAL SICAV has received the first takeover bid since its start with the new Management. Receiving a takeover offer is not a matter of luck. Still, it is intrinsically related to the search for quality companies, with some competitive advantage or in the formation of one. Receiving a purchase offer for one of our companies is part of the investment philosophy at DRACO GLOBAL. In fact, from June 2017 to September 2020, we received 4 OPAs through our previous investment vehicle, Global Quality Edge Fund.

Enlabs (NLAB) is a Swedish micro-cap that operates online games in the B2C segment under the Optibet brand. In the Baltic countries (Latvia represents 75% of sales). Online gambling was already growing before COVID-19, but the pandemic has accelerated the growth rate of online gambling to the detriment of land-based casinos. We know that this secular growth trend will continue in the coming years. NLAB offers us strong growth in high-growth countries, stable regulation, and a high market share that functions as a barrier to entry to the competition. There are other exciting companies in this sector, such as Evolution Gaming (EVO), Kambi Group (KAMBI), or NetEase (NTES), and it was an apparent mistake not to invest in them in the recent falls,

Last Thursday, January 7, Entai plc launched a purchase offer for 100% of Enlabs. The purchase price offered a premium of + 1.5% (40 SEK) compared to the closing price of the previous day and a premium of + 42.3% compared to its average price during the last 180 days, valuing the company at $ 342m. We thought it was a ridiculous purchase offer. Although it had the consent of the company management (42% of the capital), it was not enough. After the Entain submission, relevant shareholders began to appear, stating that they were not going to sell the shares at this price, a statement with which we fully agreed.

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Several American hedge funds, relevant shareholders, and other funds got together to exceed 10% and paralyze the takeover bid. This blockade forced Entain to improve its purchase offer, and finally, on March 1, it improved the price from SEK 40 to SEK 53. This new valuation was closer to our intrinsic value calculation (SEK 57). We decided to sell the shares on the same day. Eventually, Entain secured more than 90% of the shares. The NLAB was listing out from the market.

We have taken advantage of the past quarter to continue building the DRACO GLOBAL stock portfolio, great companies, growing, with an attractive sector structure and a sufficient margin of safety. We will see below all the new additions in the portfolio briefly.

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New ideas in portfolio.

LGI Holmes Inc. (LGIH).

LGIH is the 10th real estate developer in the US ($ 3,237m) and specializes in selling first homes with an average unit price 20% below its closest competitor.

The current macro environment of strong economic recovery and low-interest rates in the US is very conducive to encouraging the change from rent to property. The COVID-19 pandemic has also changed work habits, and now the citizen stays longer at home or works from home. Although vaccination advances faster, it will return a bit to the pre-pandemic situation. We think that the changes have come to stay. According to Global Workplace Analytics, 70% of workers in the service sector will do it remotely from home until 2025.

On April 6, LGIH announced that it had closed 2,561 sales transactions vs. 1,835 last year, representing an increase of + 40%. Regarding new communities, LGIH is present today in 110. For 2021, LGIH gives us the following guidelines: 1) Close sales operations between 9,200 and 9,800, 2) 112 to 120 communities, 3) average unit price of sale between $ 260 ky $ 270k, and 4) a gross margin between 24% and 25%.

Our valuation implies a target price for 2023e of $ 185 per share, with home closings of 9,526 in 2021, growth of + 2% in the future, and an average unit sales price of 269k growing at low single digits. Our average purchase price is $ 110 per share, therefore, upside potential in the medium term of more than 68%.

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Kitron ASA (KIT).

KIT is the leading company (EUR 399M) in solutions for manufacturing electronic products (EMS) in the Nordic countries. KIT focuses on niche products without the competition of the mass market. The products are highly complex, and the geographic scope is regional. KIT's clients recognize companies such as Thales, ABB, Elekta, Atlas Copco, Tomra or SAAB.

The TAM in Europe is € 32bn and is expected to grow to € 37bn by 2025, with strong demand in verticals such as cybersecurity, sustainability, electrification, medical devices, defense, and aerospace. These verticals are growth markets, with average CAGR rates of + 12% and high-profit potential via increased market share.

Last year was very good, with sales growth of more than + 20%, operating margin close to 8% and an order book growing by + 6.5%. KIT expects to reach NOK 6,000, and an operating margin of 8% in 2025 (vs. a pre-pandemic operating margin of 7%) and will maintain a payout of 50%. According to Management, the expected sales growth will achieve as + 10% organic plus opportunistic M&A operations.

We believe KIT is present in high growth markets (electrification and connectivity), with a high customer retention rate and generates economies of scale.

We calculate a target price for 2023e of NOK 25 per share, which, compared to our average purchase price of NOK 17, represents a potential upside in the medium term, close to + 50%.

G5 Entertainment AB (publ) (G5EN).

G5EN (460m EUR) develops and sells games for mobiles and tablets and the IOS environment. G5EN has developed a successful and scalable business model, which benefits from the current trend in the mobile video game industry. G5EN has more than 30 video games, and most importantly, 13 video games are new and have been developed internally by the R&D team. These new video games generated 1m SEK in 2Q19, and at the end of 2020, they contributed 133m SEK. This growth is entirely organic and develops from scratch.

The mobile videogames segment has a highly competitive market structure, and there are influential players. However, G5EN operates in a niche market. The target audience for this niche is women over 35 years old, in the US, and with an IOS operating system. G5EN has different video game formats: object search and puzzles (main segment).

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G5EN continues in a good moment thanks to the contribution of its video games, which today account for 60% of sales. In USD currency, sales grew by + 16% in 2020. During the release of 4Q20 results, the Management anticipated more than + 25% growth during January and an operating margin of 20%.

We calculate a target price of SEK 800 to 2023, which offers an upside potential of + 52% and an IRR of 15%. Our average purchase price is 450 SEK per share.

Hanza Holding AB (HANZA).

HANZA (EUR 59m) specializes in manufacturing all kinds of electronic and mechanical products for clients who want to outsource their manufacturing process. It has 16 manufacturing plants divided into five clusters with local proximity to the customer. A typical company maintains several suppliers distributed globally but bears high logistics and transport costs. HANZA offers proximity, efficiency, speed of delivery, and cost reduction by working with a single supplier. Under the "all you need is one" format.

According to E2open, manufacturers see many benefits of outsourcing the manufacturing process mainly due to better logistics, reliability, security, reduced costs and investments, access to a qualified workforce, third-party experience in design and manufacturing, and the capacity to be able to scale production rapidly. It seems clear that there is a secular trend towards outsourcing products and services, and HANZA is and will be a beneficiary company.

Although it is not easy to estimate HANZA's TAM, the company indicates that the global electronic component manufacturing outsourcing market is EUR 395m. Europe represents 8% and expects to grow single digits in the next five years. Regarding its customer base, even being a small company, the concentration per customer seems reasonable and acceptable to us.

We calculate a 2023e target value of SEK 27.6 per share, upside potential at the current price of + 53%, and an IRR of 15.4%. Our average purchase price is SEK 14.6 per share.

Mastech Digital Inc. (MHH)

MHH (169m EUR) is a provider of IT employment services and analytical services in the financial, government, pharmacy, and retail sectors. Its founders Sunil Wadhwani and Ashok Trivedi, still control 60% of the company's ownership. Its clients are mainly in the US.

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The IT segment represents 86% of sales. Although it is a highly competitive business, the expected economic recovery should be a tailwind for the entire sector. The data and analytics segment presents higher growth and margin than IT and represents the remaining 14% sales. The gross margin in this segment is 50%, well above the 21% in IT. Management expects this segment to grow very strongly in the future and its share of sales to grow to 40%.

The key in this business is having a high retention rate, a light cost structure, experience, and technological leadership. MHH has grown at a CAGR of + 10%, + 21%, and + 24% in sales, Ebit, and net profit in the last ten years. This growth is organic but also inorganic with selective purchases whenever exciting opportunities present themselves.

In 2023 we would be paying 8x profits or 6x Ebit, with an upside potential of + 63% and an IRR of 17.5%. Our average purchase price is $ 16.68 per share.

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S&T (SANT)

SANT (EUR 1,445m) is an IoT and Industry 4.0 services company and an IT service provider. SANT has its software, but it also sells third-party hardware and software such as Microsoft, Cisco, SAP, or HP. SANT has grown at very high rates in the last ten years, with a CAGR of + 30%, + 34% in Ebit, and + 37% in net profit. This growth has been possible thanks to the effort in acquisitions, which we think will continue in the future.

SANT has solid exposure to the German economy, with more than 60% of sales. SANT offers us exciting growth potential in Eastern Europe, a market that we could not reach before with our French IT small caps investments.

Its primary shareholder is Ennoconnn corporation, a subsidiary of Foxconn Technology, which controls 27% of the shares and strengthens the strategic and business relationships between SANT and Foxconn.

The IT sector is a highly fragmented, competitive sector where prominent players play a leading role. Still, SANT offers us exposure to growth markets and sectors, such as Eastern Europe and China, as well as medicine and transport. We hope that SANT will carry out its strategic plan and increase its operating margin through investment in the most profitable IT segments.

In 2023 we would be paying 12x profits or 11x Ebit, with an upside potential of + 25% and an IRR of 7.6%. Our average purchase price is € 20.5 per share.

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SEI Investment company (SEIC).

SEIC (EUR 7,573m) is a financial company that offers asset management, back and midlle office services mainly to banks, insurers, fund managers, investment advisers, and family offices. Its competitive advantage comes from its software and its platform through a SaSS business via subscriptions that provide recurring income.

SEIC managed more than $ 786m and collected $ 370 at the end of 2020 (before LSV). Since it charges a fee on the assets managed and administered, part of the sales presents a high recurring revenue.

In essence, SEIC helps its clients with accounting, reporting, regulatory and CRM tasks all through its proprietary platform. Once the customer integrates into the SEIC interface, there is a high changeover cost that provides high customer retention.

We believe that the outsourcing of fund management presents a good business opportunity for SEIC. A more demanding regulatory environment and the needs of Capex in technology and people make outsourcing a structural trend of long-term growth in the sector. The expansionary policies of central banks also benefit the appreciation of financial assets, attracting higher assets under Management that increase future commissions.

We calculate a 2023e target value of $ 80 per share, upside potential at the current price of + 25%, and an IRR of 7%. Our average purchase price is $ 60 per share.

Media (ILM1)

ILM1 (EUR 565m) is one of the leading providers in pharmaceutical specialties focused on niche therapies (40%) and OTC drug sales (60%). The main areas of indication are oncology, neurology, autoimmune deficiency, ophthalmology, infections and hemophilia. ILM1 has generated a 5-year CAGR of + 45% and + 40% for both business segments.

We estimate that its potential market (TAM) is over € 17bn. There are more than 1.6m patients with some type of cancer in Germany that require infusions with an annual cost per patient of 160k. Also, there are 6,600 nursing homes in Germany alone in need of individualized medication worth 900 EUR per year per patient. The specialty drug market has doubled vs. traditional medicines for the last eight years, and we expect this trend to continue. From our experience as shareholders of Grifols, PaySign, or Repro Med Systems, we know that more strange diseases require treatment.

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Democracy exerts a tailwind for the sector because it increases the demand for personalized medical treatments.

With the recent purchase of Cranach Pharma GmbH, its turnover will exceed EUR 1,000m this year. However, IL1M's ambition goes much further. Its strategic objectives are: 1) Coverage in more than 1,000 pharmacies vs. the current 500 (with Cranach), 2) cross-selling of products, 3) sale of more than 1,000 medicines, 4) expansion of margins increasing the capacity used with 10m EUR of additional Capex, 5) reach 300k prescriptions for patients and 6) continue with inorganic growth thanks to its strong balance.

We calculate a 2023e target value of EUR 50 per share, upside potential at the current price of + 35%, and an IRR of 10.7%. Our average purchase price is € 36.78 per share.

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Jumbo Interactive Limited (JIN)

JIN (EUR 543m) is Australia's largest online lottery reseller. In 2013 began its international expansion mainly in the US and the UK. The COVID-19 pandemic has benefited JIN's business, increasing online purchases and the volume of prizes to distributes. Also, personnel costs have reduced as employees work from home. The company recently reorganized its business segments, now reporting under three parts: 1) Lottery retailing, 2) SaaS business, and 3) managed services. The best way to follow the evolution of the business is through the TTV metric (company total transactional value).

During 1H21, the total volume traded increased by + 26% to 233 AUD, although the number of Jackpots (grand prizes) fell by 35%. Still, JIN achieved sales growth of + 9%. Both the SaSS and service management businesses have contributed very positively to revenue growth.

JIN's business model has switching costs due to long-term contracts that ensure its turnover and recurring income from its subscription and service management business. JIN renewed its large contracts that provide sales growth during June and August for the next ten years. There is a secular trend of a structural change on the online channel, reaching 40% in 2025 vs. the current 28%—an estimated TAM of $ 25bn and service management with an opportunity exceeding $ 40bn. There is an excellent opportunity in the US since online penetration is still low versus countries such as Finland or the United Kingdom that double the ratio of Australia.

We calculate a 2023e target value of AUD 18 per share, with an upside potential of 40% at the current price and an average purchase price of AUD 13.25 per share.

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Legal warning

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