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Quim Abril

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Global Quality Edge Fund

Mr. Quim Abril, served as Head of Equity Funds within BMN Asset Management from July 2004 to January 2015, where he developed the Earnings Quality framework analysis and Forensic Accounting. His flagship fund´s 5-year performance ranked Top 5 in the Spanish Equity Funds category, while also pushing Mr. Abril to the #429 (2° in Spain) among the top 1000 equity PMs in the world, according to Citywire. In addition, Mr. Abril has had active participation within the Spanish economic press, also appearing as a guest speaker in leading asset management conferences.

Can you tell our readers a bit about your background and the Global Quality Edge Fund?

Sure, in the last 15 years I've been working at different asset management firms in Spain; primarily investment arms within banking. Looking back, it was a great experience but I reached a point where the I realized I needed to set up my own investment vehicle and break away from the limitations that come with working in a bank. It has now been two years since I made that difficult decision of giving up the comfortable lifestyle I had in banking to create my own hedge fund.

Before all this happened, my background had mostly been in finance, particularly in accounting and auditing while also (more importantly) analyzing businesses from a qualitative and strategic perspective. Above all, though, what has really helped me out the most has been the experience I acquired from one-to-one conference calls with senior managers at companies in which we analyze and invest at the fund. My daily contact with other people within the same sector, their vast experience in strategic analysis has also been incredibly helpful. While I will not mention names, they know who they are!

Global Quality Edge Fund was officially launched in June 2017 with €1.5 million of AUM from a single investor. Today, we have grown the fund to €6 million from 15 investors and we hope to achieve the €10 million milestones by the end of this year.

The fund invests mostly in extraordinary companies with solid and sustainable long term competitive advantages, who are leaders in their niche markets, face low or null competition, have low broker analyst coverage, sound capital management, high ROIC across the business cycle, low correlation to equity market indices and visible interest alignment between shareholders and company management.

We generally invest in small and mid-cap size businesses. Our preference for this size range can be explained in 10 points:

1. 80% of the investable universe is made up of listed companies with less than €2.5 billion euros in market cap.

2. Their underlying businesses are easier to understand and study.
3. They focus on niche segments within their respective markets.
4. Their senior management is more accessible to contact and exchange insight.
5. They offer higher earnings growth potential and longer-term return, not always having to compromise on the increased volatility.
6. Low analyst coverage.
7. Lower correlation to market indices.
8. A higher percentage of insider ownership.
9. Higher chances of receiving take-over offers.
10. If in the U.S., favorably benefiting from the recent tax reform.

Whenever we feel the likelihood of a recession increasing, we apply tail-risk hedging strategies and protect our fund from significant losses, like those seen in 2000 and 2008.

You're looking only for "extraordinary companies." How would you define extraordinary? What qualities are you looking for in a business?

I think an extraordinary company is one that has very low or no competition thanks to one or more competitive advantages (structural characteristics attributable to their business), which translate into higher return on capital and margin.

For example, Victrex (VCT), a British Specialty Chemicals company and a global leader in engineering thermoplastics. Their signature polymer solution, PEEK, component for a number of industries. It has a 65% market share with only two direct competitors. Acerinox (ACX), on the other hand, a Spanish listed steel company, competes in price against a multitude of players globally where the only possible moat is to be the lowest cost structure.

Although both companies' products are key materials for other businesses, Victrex has a 4x higher return when compared to Acerinox. Is it reasonable to think that both companies will have qualified top senior management teams leading them; however, the main difference is the competitive advantage of Victrex, and the balance that exists between supply and demand, which is why Global Quality Edge Fund will and is always seeking markets where supply cannot always keep up with demand.

Another critical feature an extraordinary company must have is that they must cater to a niche market, where size matters in relative, not in absolute terms. If we take Holland Colours (HC), their total revenues were €84 million in 2017 within a potential global market of €11 billion in the coloring system business. However, if we study Holland Colours in greater detail, they actually have a 30% market share in a sub-segment of the colouring system business of €300 million. Is Holland Colours, then, a small or large company?

We try to understand the company from the perspective of the customers, as generally speaking the quality of their customers can also determine the quality of a company.

Happy customers also allow for better forecasting in future earnings. We could then ask ourselves, how dependent is the customer or client to the products or services offered by our case study company? What is their client retention rate? Is it easy to convince them to buy the products and services? Does the company in question have customer concentration? Tessi SA (TES), for example, is a market leader in document processing and payment services for the financial sector in France. In the last few years, they've achieved a 90% client retention rate. Similarly, Espey (ESP), a British manufacturing company that serves the military market and is largely protected by competition from its patents; has more than 50% of its sales come from its top 10 clients. If we look at Victrex again, it manufactures a polymer that is a critical supply material within the industrial sector, and its customers would not tolerate any error or settle for anything of lesser quality. To some extent, they're captive clients and switching costs to another competitor are incredibly high.

Lastly, we must ask ourselves the following: Is growth in earnings and profitability consistent or erratic? In the commodities space, for example, companies have no control on the pricing of the products they're selling, as the raw material it involves is directly linked to the cycle of the economy, there is exposure to price deflation and most of the companies destroy value for their shareholders. If we now think of software companies like Microsoft, where the user pays an average price and upfront fee of $100 for Office 365, generating a positive impact in working capital, visible and recurring earnings from their licensing, room for potential price increases and knowing switching costs are very high.

And another key part of your strategy is finding companies with a "low probability that an accounting problem could reduce the profit or cash flow." Can you tell us some more about this goal?

In the last 25 years, there have been many accounting fraud cases where senior management misled investors. Enron, Health South and Valeant in the U.S. and Gowex and Pescanova in Spain, to quote a few examples.

Most of the time, these situations are remote and hard to spot but what think are far easier to detect are the possible accounting practices that may put future earnings and cash flow generation at risk: accounting 'red flags'.

While it is always imperative to understand the business model of a company, their competitive position and their capital management, it is equally relevant to look for these 'red flags'; something we dedicate a lot of time in doing for our Global Quality Edge Fund.

To avoid falling victim to these mistakes we read annual filings in detail. These documents are not always easy to read and will change over time to reflect new accounting rules and guidelines; which is why a strong knowledge in accounting is necessary to understand them fully.

If we put these 'red flags' in context, I can maybe start off by saying - without running too big a risk - that the US economy is almost reaching its final economic stage and companies will begin to feel the strain to maintain or continue growing their earnings. In answer to that challenge, some senior management teams may start applying aggressive accounting practices to keep earnings growth, stable cash flow generation and a clean balance sheet. In the last 10 years, we have spent our time listing and classifying red flags according to their type which then help us identify possible accounting risks and understand how senior management think and act around them.

At Global Quality Edge Fund we prioritize time speaking to senior management. It is precisely on these calls where we get better insight to clarify and find answers to these possible accounting risks.

In one of his famous letters to shareholders, Warren Buffett once said "...trouble awaits managements that paper over operating problems with accounting manoeuvres. [They achieve] the same result as the seriously-ill patient who tells his doctor: "I can't afford the operation, but would you accept a small payment to touch up the x-rays?"

Another renowned American investor, Thornton O'Glove, would explain it through the following example: "If we assume that company reports earnings per share of $2, would there be a reason for the CEO to undervalue this number? Surely not but he could have inflated it from $1.5 to $2 to give the appearance that it is greater than is really is."

These two stories serve as a reminder to investors that companies massage their accounts, preferring in some cases illusion over reality.

Do you have an example of a business that initially looked interesting, but turned out to have accounting issues?

Yes, halfway through 2017 I came upon Mitie Group (MTO), a leading British outsourcing service company, which provides facilities management, office cleaning services, waste management, security and document management.

A typical and very boring business made interesting because of the specialist services they offered. Mitie managed almost always to renew all their service contracts, enjoyed high retention rate due to high switching costs, economies of scale and attractive returns on capital. Once I began to review their annual statements, I found what I had initially presumed would be a 'red flag' when they purchased Enara, a leading home care service provider in 2012. When analyzing the deal, I realized Mitie was assuming very high forecasts for their care service unit that could force a negative goodwill adjustment and subsequent losses on their P&L. Goodwill represented 45% of Mitie's market cap of which Enara contributed more than 20% to the total value. Under note 31 from the 2012 annual report, you could see how the amount paid to complete the acquisition was £115.7 million of which £94 million was allocated to Goodwill; in other words, more than 80%!

In addition to this, note 13 from the 2016 annual report showed how Mitie was aggressively forecasting total revenue growth rates of 20% when the underlying business was running on a loss. The years that followed, the pharmaceutical line of business began to deteriorate, and yet senior management chose not to write-off the goodwill although they did explain they would be open to it if the business did not improve. Eventually what I anticipated became a reality. Mitie announced their exit from the pharmaceutical business and recorded an impairment charge of goodwill, generation losses due to discontinued operations worth £132.4 million.

On 19th September 2016, after hosting an earnings call with analysts, the share price quickly dropped by 28.8%. Today, the stock is 50% below its year-end 2015 price.

In conclusion, whenever a company acquires and merges with another business, and the total value of the deal is significant, it is essential to analyze all of their accounting reports in greater detail.

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You also like to talk to management as part of your invest process. What qualities are you looking for in the management teams you invest alongside?

I can think of many but we generally begin by asking ourselves what type of manager leads the organization and what is his or her degree of independence when it comes to decision making.

(1) Bank of the Ozarks, now known as Bank OZK, is lead by Georg Gleason, CEO and founder of the company in 1979. The passion that George transmits when running the day to day business is undeniable and far-reaching throughout the entire company. All his decisions are long-term and never influenced by what the competitors may be doing, proved recently by giving up growth in his CR&E division to avoid compromising the quality of OZK's loan portfolio at a time when there is certain pricing pressure. In our teleconference calls with Tim Hicks (CFO), he told us that OZK only approves between 5-7% of applicants out of all the offers they study and will only do so when there is an imbalance between supply and demand.

Another important indicator to look out for is managers with low salaries, low stock-option compensation schemes and high stock ownership.

(2) Christian Canty is president and CEO of Installux, and his base salary is not even 0.5% of total sales, does not offer option linked compensation, and he's the owner of more than 50% of the company.

An interesting characteristic that's often not reflected in the market is how senior management values its employees.

(3) Employees of Holland Colours own 25% of the company, which impacts the profitability of the business both directly and indirectly.

In another conference call with Neurones (NRO) the company's CEO, Luc de Chammard, explained how their decentralized business model helps improve profit growth and retain talent. The company's level of talent retention is amongst the highest in the industry

It is also relevant to know if the CEO and CFO are making good decisions when allocating capital.

(4) Inchcape plc (INCH) is a good example. Their investments, working capital, M&A, dividend payments and timely share repurchasing programs have all added value for shareholders.

Share repurchase agreements are worth understanding and seeing if their timing is opportunistic or not.

(5) O'Reilly Automotive (ORLY) has a long history repurchasing shares. In May 2017 when the stock was trading at 15x earnings, O'Reilly announced it was boosting it by back facility by $1 billion raising the total to $9 billion, which represented 50% of its market cap.

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(6) Straco Corporation (S85) announced a share repurchase program last April of at least 10% of shares outstanding, at which point the stock price was close to SGD 0.75 with a cash P/E of 10.5x and an average daily volume of 100,000 shares.

Lastly, insider trading is a key indicator to buy stock whenever the CEO drastically increases his or her stake in the company.

(7) In June this year, Walgreens (WBA) CEO, Stefano Pessina, bought 1.7 million shares valued at $109 million, increasing his stake to 15%.

You also employ a tail risk strategy. Can you give us some insight into this strategy and why you've decided to implement it?

The idea behind hedging through options is to protect the tail-risk of the market, a practice that is also known as tail-hedging and was mainly developed by value investor Mark Spitznagel.

Throughout history, most drops in equity indices above 20% have been recorded when the economy enters into a recession. Our most recent evidence of this is the dot-com bubble in 2000 and the financial crisis in 2008. To avoid or diminish the drop, we buy out-of-the-money put options on market indices to protect our fund from market downturns greater than 20-25% whenever there is a significantly high chance of this occurring by closely monitoring Conference Board indicators (Leading, Coincident and Lagging indicators) for US and Europe.

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We classify the business cycle in four phases based on the rate of change of the US Conference Leading Indicator, on a year-on-year basis and year-on-year three month moving average. We believe the business cycle in the US is now in the expansion phase where (along with the recovery phase) is where we see higher returns for equities. We expect that towards the end of 2018, the business cycle in the US could move into the deceleration phase where stock returns will still be positive but not as high as the previous cycles.

Global Quality Edge: Stock Idea One

ITURAN LOCATION

Your first stock pick is Israeli company Ituran Location (ITRN). How did you first discover this business?

I discovered Ituran in a forum on American listings which I never miss; they are always a great place to learn about lesser known companies. Ituran was one of them and despite going public in Tel Aviv in 1998, it wasn't until 2005 that this Israeli-based company began trading on the Nasdaq. Even though it has several years of history behind it, it is largely unknown to American investors. Less than five analysts cover the stock; they're all local and the company itself never attends investor conferences.

What does the company do and what is its market size or potential for growth?

Ituran is a leading provider of location-based services, consisting primarily of stolen vehicle recovery (SVR-most important), fleet management services and tracking services. Ituran principally operates in Israel, Brazil and Argentina, has more than 1 million subscriptions.
The SVR business consists of locating, tracking and recovering stolen vehicles through a subscription fee service.

Ituran installs the AVL tracking unit in the car and has a network of transmission and reception stations for monitoring and a 24-hour control and customer service centre on standby. In the majority of countries in which it operates, the Ituran security staff is in direct communication and coordination with local police. Most of the company's customers are individuals, insurance companies and agents, OEMs (original equipment manufacturers) and industrial fleet management companies. Another line of business within Ituran is their Wireless Communication which encompasses all the AVL technology products, making up 25% of total sales.

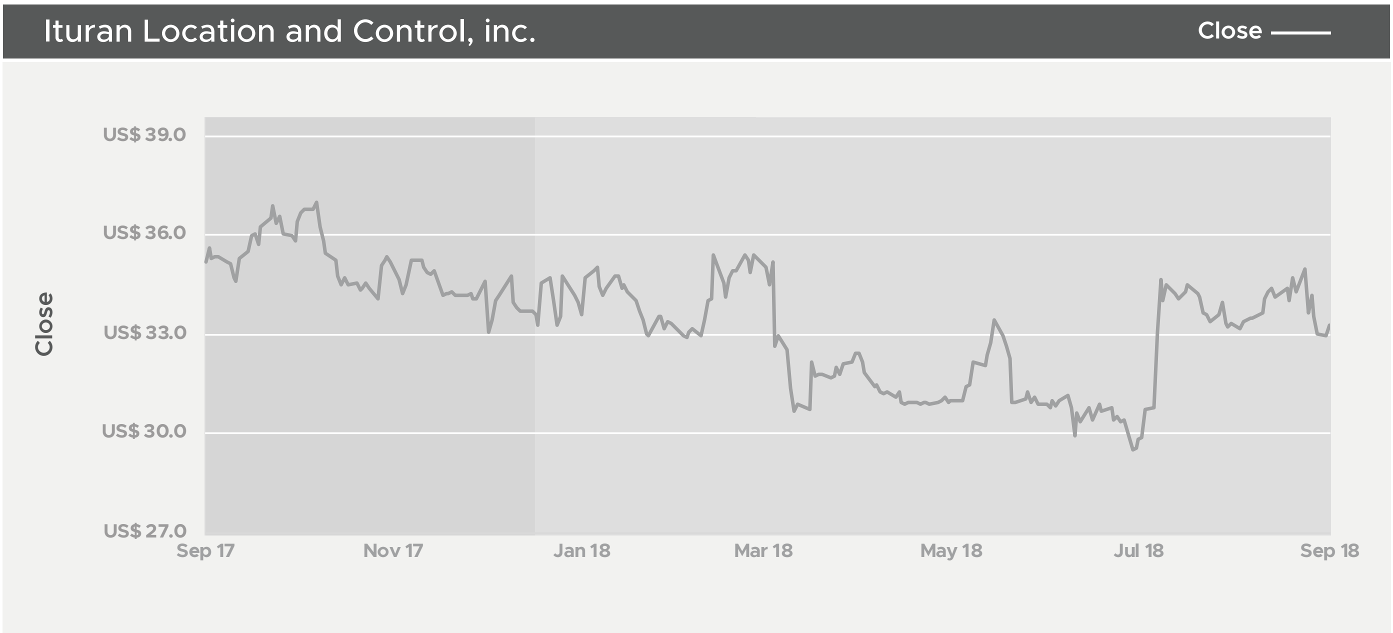
Demand for SVR products is strongly linked to crime and motor vehicle theft rates within a country. Brazil ranks at the very top in both categories. According to recent figures from Interpol, 557,000 vehicles were stolen in Brazil in 2017, of these case, 70% involved violence. The number of stolen vehicles secured by insurance companies is growing at a double-digit rate. Regardless of how you calculate it, this South American country is perhaps one of the worst places to own a car and the best for Ituran to do business. If the income per capita continues to increase among middle classes, demand for vehicles will rise, theft rates will also grow and demand for Ituran's services is almost guaranteed. We forecast a market share in Brazil of about 25% (precise figures are hard to come by) and believe it will continue growing in what we see as a fragmented market with tiny players and potential for future inorganic growth for Ituran.

What makes Ituran an "extraordinary" business in your view?

There are two reasons. Firstly, a competitive advantage in the form of a 'network effect' and the second one being its size or scale. In a rapidly growing market, like Brazil, its high market share allows it to have a higher degree of control on market trends.

A network effect exists when the value of a service is increased by the number of users who; in turn, attract more users, creating a virtuous cycle that displaces smaller networks giving way to more dominant ones. Over time, the increase in the user-base makes the marginal cost of adding one subscriber decrease and contributes to the overall sustainability of the network business model. In Ituran's case, their recurring sales (>80%) from their SVR line of business is one of their most exciting features. Their consistency in successfully increasing the number of subscribers year-on-year since going public 1998 is exemplary, leading them to surpass the one million subscriber milestone by the close of 2017. Most of the users are located in Israel and Brazil and pay an average $200 subscription fee.

One of the reasons why Ituran is unknown in the US market is because their total revenue figure is impacted by foreign exchange rates when converting sales from their local markets in Brazil and Israel to US Dollars. During 2015 and 2012, the Israeli Sequel and the Brazilian Real depreciated considerably against the US Dollar, giving the appearance of a drop in sales of 3 and 6%, despite the double-digit growth in the user base.



Share Information September 17,2018

Market Cap. $697.2m	**P/E (forward)** 15.8	**EV/EBITDA** 9.3	**Dividend Yield** 2.90%
Average Daily Volume 40,971	**P/B** 5.7	**ROIC** 38%	**Debt to Equity** N/A

Today, we're experiencing a similar environment to that of 2012 and 2015, where emerging market currencies are depreciating against the dollar but underlying growth without the FX effect remains strong.

This seems to be a unique business. Are there any threats to the business model? Is this a monopoly business?

Businesses with recurring revenues are the types of investments we like to look out for at Global Quality Edge Fund. They are more predictable when forecasting future performance and protect the company from changes in economic cycles.

However, Ituran does not come without its risks:

1. It has a high churn rate among users. 3% every month and 35% annually. It is worth noting that this loss in users is offset every year by the consistent and positive net annual growth rate of subscriptions has delivered since going public in 1998. In other words, it always manages to add more subscribers than those that have unsubscribed by year end.
2. Ituran has a monopoly in Israel. While it may be a concern in other markets, we don't see this as a significant threat for the time being, given the close relationship between Ituran and the government on Defence collaboration.
3. The FX effect, which we previously discussed, from their exposure to emerging market currencies.

What's management's background? How are they incentivized to grow the business?

Tadiran founded Ituran in 1994 and one year later, decided to sell the brand to a group of investors - led by Izzy Sheratzky - for $250,000. Since then, Ituran has grown organically and has made some small acquisitions along the way the most significant of which is Road Track (IRT), a telematics company operating in Brazil and Argentina that started off as a joint venture five years ago.

Ituran is jointly led by Izzy Sheratzky and Eyal Sheratzky with a 20% ownership under Izzy's Moked Ituran Lmt company. For both of these senior executives, their base salary is less than 30% of their total compensation package. The company's policy revises senior pay every three years, and its goals are set on expanding existing operations, conquering new markets leveraging in-house know-how and relying on customer relationships to sell services into fleet management and added value products.

This seems to be a highly profitable business with a strong balance sheet. How is management's record on capital allocation?

Ituran's 10-year average ROIC is 30%, and today this metric stands at 35%. This high rate of return has been achieved without compromising their balance sheet. The company has a healthy net cash position of $37 million.

Regarding their capital allocation since 1995, Ituran has paid more than $200 million in dividends (about a third of their market capitalization) with an average payout rate of 50%. It also repurchased 15% of its outstanding shares in 2008. On average during the past decade, capex spend has been 8% of sales with 2% of sales devoted to growth capex.

You mentioned the recent deal to acquire Road Track Holding S.L. Can you give us some more insight into how this deal will help the firm grow?

This deal is perhaps the most critical Ituran has completed until now, after a successful five-year joint venture. In the last investor conference call, Eyal Sheratzky said: "it will enable us to penetrate further major car manufacturers who will provide Ituran with a significant scale in the telematics industry and allow us to provide a broader service offering into new countries".

The deal struck will leave Ituran with a combined user base of 1.7 million, increasing its network effect and operating leverage. The pro-forma P&L suggests a combined total sales figure of $366 million, $98 million in EBITDA and $51 million in net profit. These economies of scale will allow the company to consolidate in other regions in Latin America, like Mexico.

Moving on to valuation, what's the current valuation and why do you believe this is attractive?

Ituran trades below 15x its earnings (adjusted for cash) or 11.2x EBIT for the last twelve-months. For the type of business and the financial profile Ituran has, it should be trading above 20x when compared against its peers (CalAmp, Mix Telematics, etc.) and current market valuations.

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A multiple of less than 15 times earnings for a business with a ROCE of 35% seems low. What do you think the market is missing?

I believe that Ituran's low valuation is a reflection of its small following among investors and FX fluctuations, which seem to be hiding underlying revenue growth.

What's your long-term price for the stocks and your bull and bear case for the stock?

To calculate Ituran's target price, we need to incorporate Road Track's consolidated P&L.

Eyal Sheratzky (CEO) indicated in the Road Track conference call last 25th July, a $96 million contribution to sales, a slight improvement in operating margin because Road Track has a higher margin (without revealing a figure), and an acquisition cost of $92 million through $76 million in debt and 12 million shares. They also agreed on a $4 million bonus over the course of three years and dependant on the company's performance.

To calculate the target price, we work on the basis of three scenarios; each with their own probability:

Base Scenario/80% probability: Double-digit subscriber growth continues, adding 100,000 users annually and paying an average subscription fee above $200. This translates into an 8% increase in sales. Even though this rate is below their long-term compound annual growth rate and their current reported figure, we still believe it's justified so long as the underlying business continues to grow at double-digits. The average operating margin in the long term (EBIT margin) would hover around 22.5%, but with Road Track's recent acquisition we see a potential for an increase to 24% as CEO said in the last conference call because Road Track itself has a higher margin, and there is potential for economies of scale.

Moving on, we assume an implied tax rate of 30%, and for working capital, we didn't account for any improvement. Despite this assumption, it is likely their purchasing power will rise due to their new bigger scale and should translate to lower cash cycles. Accrued Expense and unearned revenue would remain at 10% and 6% over total assets, in line with the observed rate of the last few years and capex over sales would level at 8% based on company guidance and a 2% growth capex. Lastly, Road Track's acquisition and its part funding through issued shares was also factored into this exercise. Given all the above, we arrive at a target price of $45 for 2018 and $51 and $56 by 2019 and 2020. The internal rate of return for the next 2-3 year horizon would be above 30% with the three-year upside higher than 70%.

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Comparable companies such as CalAmp or Mix Telematics currently trade at higher multiples vs. Ituran and offer lower profitability and lesser quality business models. For this reason, we find it reasonable to assume a 19-20x earnings multiple and 14-15x EBIT.

Bullish scenario/10% probability: Total turnover growth hits 10% per annum boosted by a tailwind of rising FX rates in emerging economies.

Bearish Scenario/10% probability: An extended currency depreciation of emerging market currencies against the dollar and a drop in the user-base due to increased competition or enhanced technology. Falling user numbers would drag down margins and profitability with the additional investment efforts. Sales would fall in 2018 by 5%, the number of users would remain the same or show a slight drop against current levels, and their operating margin would contract below 20% (lower than 2008 Credit Crunch figures). These assumptions would leave us with a target price of $34 or, in other words, today's current trading levels. Under this scenario, this would still allow us to fulfil our initial premise to investors to preserve their capital.

Global Quality Edge: Stock Idea Two

STRACO CORPORATION

Your second pick is Straco Corporation (S85). Let's start with the basics. What does this business do?

Straco Corporation (S85) is a leading leisure listed company that develops and manages tourism-related assets mainly in Singapore and China. Their businesses include: the Singapore Flyer (SF), the Shanghai Ocean Aquarium (SOA), Underwater World Xiamen (UWX), The Lixing Cable Service (LLC) in China among many others.

Straco was founded in 2002, listed on the Singapore stock exchange in February 2004 and now has a market cap. of SGD 632 million ($465 million).

Can you give a bit more detail on where the company makes its money and the potential for growth?

Their tourism and leisure business is straightforward and easy-to-understand. On one side, almost all its revenue comes from ticket sales, while their costs are mainly to upkeep and maintain their attractions and pay their employees' salaries. The increase in tourist visits drives Straco's organic growth while new tourist attractions they have acquired provides bolt-on growth. In August 2014, for example, a deal was struck to buy the well-known Singapore Flyer for $140 million. By June 2018, Straco had a total net cash position of SGD 140 million to fund new acquisitions (if it wants to).

What first attracted you to the business? What makes this an "extraordinary" business in your view?

Straco's competitive advantage lies in its unique regulated tourist attractions and site locations. The company faces very few to almost no competitors by operating tourist attractions that are hard to replicate and require hefty initial investments to build - the Singapore Flyer alone was $250 million. Strict licenses from government and local governing bodies can also act as barriers to entry. Their prime locations in popular and central areas for any visiting tourist in China and Singapore naturally guarantees high park attendance. In June 2016, Disneyland Shanghai opened their doors to the public in the same city as Straco's Ocean Aquarium, but instead of seeing it as a threat, I believe it only increases the number of tourists who are drawn to the area.

Management plays an important part in your strategy. What's management's background and do they have a record of creating value?

Mr. Wu Hsioh Kwang is the CEO of Straco since March 2003. He is a seasoned businessman having first invested in tourism infrastructure assets in the 1980s in China. In the years that followed, Mr. Wu partnered with State-run-company China Poly Group and constructed what would be one of his most important achievements: the Shanghai Ocean Aquarium (SOA).

In 2004, Straco began trading at Singapore stock exchange, and 10 years later, Straco acquired the iconic, but loss-making Singapore Flyer in a deal worth $140 million. After only a year in its possession, Straco was able to turn the business round to generate a profit.

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Mr. Wu himself defines his acquisition strategy in these words, "We believe there is a risk in every industry. The key is how you manage that risk. When investing in a tourism project, the success or failure is determined at the point when you build the asset. We often think like a craftsman, patiently gathering the best ideas and resources before we slowly shape the concept until it is close to the ideal we have in our minds."

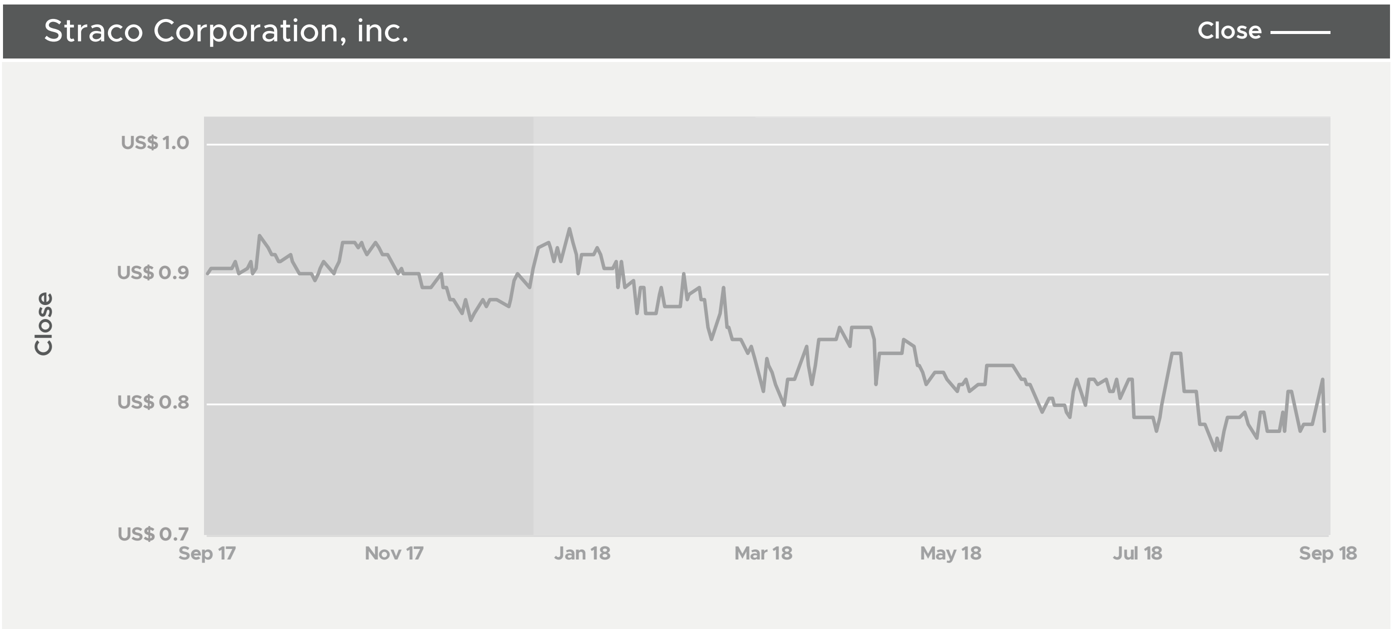
Does the management own a high percentage of the business? What is management's incentive structure?

Mr. Wu and his wife both hold more than 50% of Straco's outstanding shares; a stake which has remained mostly stable over the last few years.

The CEO's salary is, in my view, set at a reasonable level with an annual base of EUR 570,000 and a total compensation package of just under EUR 1 million (less than 0.25% of the company's market cap.). Despite noticing that both of his sons work at the company, it is important to note that their base pay is reported to be below EUR 100,000, which seems reasonable. Employees have access to share option schemes as part of their benefits programme capped at 15% of total shares outstanding. This benefit naturally incentivizes employees and aligns their interests with those of shareholders. In its recent history, Straco has rolled out two share option schemes: the first in 2004, the second in 2014 - when the first one expired. At December 2017 close, 2.8 million shares had been exercised and 20.1 million remain.

How does the management plan to grow the business?

The main performance driver is organic growth and the critical variable to look out for is the flow of tourists in China and Singapore. Domestic tourism has expanded at a rate above 8% per annum over the last 10 years and it's expected to continue doing so at a higher rate, according to the China National Tourism Administration (CNTA).



Share Information September 17,2018

Market Cap. $628m	**P/E (forward)** 14.9	**EV/EBITDA** 6	**Dividend Yield** 3.40%
Average Daily Volume 33,500	**P/B** 2.8	**ROIC** 15%	**Debt to Equity** 14%

China's change in economic model can partly explain this trend after it shifted from an exporting-driven country to a dynamic consumer economy. In terms of GDP, tourism in 2017 accounted for more than 2.5%, and the World Travel & Tourism Council hopes this figure will rise to 3.5% by 2027.

When it comes to the type of tourism behind this boom, it is estimated that only 20% of commerce comes from business travel while 80% stems from recreational tourists; most of which (80%) already live in China. Overseas tourists to this populous East Asian country totalled 137 million people and the number of park attendees to Straco tourist attractions (including the Singapore Flyer) was 5.9 million. In terms of growth, visits grew by more than 10% per annum in the last 10 years with only one year in the last 12 seeing a year-on-year decline in visitor numbers (2016 down -1.76%)

During the first semester of 2018, the CNTA stated that domestic tourism grew at a superior 15% rate and the number of trips by 13%. These figures only reinforce the Chinese domestic tourism trends seen in the last few years that benefit Straco business.

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If we look back at the company's finances in 2014, when Straco acquired the Singapore Flyer, its debt profile was similar to the one it has today, and the company traded within the same range as we see now. It took on SGD 94 million in debt (1.6x EBITDA), and I believe it could do so again to acquire a new tourist-related asset.

And my final question on management: What is its record of capital allocation?

Capital allocation can be explained in three points. Firstly, the group pays out 30% to 40% of earnings in dividends, increasing year-on-year; (except for 2015, after the Singapore Flyer acquisition) at a 10-year compound annual growth rate above 20%.

Second, debt repayments close to SGD 15 million on average every year

Third, share repurchase programmes to initially off-set or minimize the effect of their employee share option schemes and to also take advantage of share price drops when the company is perceived as undervalued.

Moving onto valuation, what's the current valuation? Why do you believe this is attractive?

The share price trades at 11.8x last twelve-month price to earnings. Its recent poor performance and can be explained in four points:

1. A technical fault on the Singapore Flyer that led to its closure for two months
2. The Government restriction on the number of visitors to Gulangyu island
3. The new Shanghai Aquarium opening
4. The Court ruling against Straco's insurance claim on Flyer's closure.

Although 2018 will not go down as the best year for Straco's performance, it offers us a good entry point to invest, leaving us with a wide enough margin of safety and knowing their structural competitive advantage is still sustainable in the long term. On a more positive note for Straco we have:

1. Adequate cash and cash equivalents for any further acquisitions they may wish to make.
2. The possibilities of a merger or delisting motivated by their main shareholders.
3. A better performance in the second half of the year now that the Singapore Flyer is up and running at full capacity.
4. The share repurchase programme announced earlier on in the year, involving up to 10% of its market cap; a move that would undoubtedly set a price floor.

What's your long-term price target for the stock?

To calculate our intrinsic value, we look at three possible scenarios with different probability outcomes:

1) Base Scenario/70% probability: Drop in park attendance rates in 2018 due to the temporary Flyer closure with a slow estimated recovery during 2019 and 2020 affecting sales and leaving them down by 10% in 2018 only to slightly recover in 2019 (+2.5%) and 2020 (5%). I expect the operating margin for 2018 to be around 49% (due to the Flyer closure) and will then rise to 50% as a conservative number (800-200bps lower than the last five-year average). I set the implied tax rate at 28%, capex at 2.5% of sales and share repurchases of 7.5% of the total market cap including the new share issue under the employee share option scheme. These estimates would lead us to an SGD 0.99 target for 2018, 1.06 for 2019 and 1.14 by 2020, applying a 15x earnings multiple. In other words, a potential three-year upside above 50% or a three-year IRR higher than 15%.

2) Bullish Scenario/20% probability: Strong recovery in park attendance in the second half of 2018 with 5% growth in 2019 and 10% in 2020; in line with Straco's historical growth rates. Operating margin closing at 50% for 2018 and increasing to 52% and 53% in the next two years, assuming an increase in tourists and a rise in prices. With these assumptions, our target would be SGD1.08 for 2018 and 1.23 and 1.39 for 2019 and 2020, applying the same 15x earnings multiple.

3) Bearish Scenario/10% probability: Park attendance continues to drop for the remainder of the year, leading to a downturn in sales equal or greater than 1H18's with an estimate for 2018 of 20% down and a further 2.5% decrease in 2019 and a flat recovery from there on. Operating margins would fall to 2012 levels, and there would be half a percentage increase in capex due to a rise in marketing spend. With the previous estimates, our target would be SGD 0.88 in 2018 using the same 15x earnings multiple. In other words, the stock price is unlikely to drop beyond this level in the mid-term.

If Chinese domestic tourism continues to grow at double digits, it's hard to see negative growth rates in Straco's sales. This is why we first believe we will preserve our capital with this investment and secondly, face a likely 50% upside.

Are there any key risks that could derail this thesis?

I think the most significant risk for Straco could be the newly built Shanghai aquarium, although we'll have to wait and see until we have more information on it.