Investmentaktiengesellschaft für langfristige Investoren TGV

Investmentaktiengesellschaft für langfristige Investoren TGV
Rüngsdorfer Str. 2 e · 53173 Bonn · Germany

Investmentaktiengesellschaft für langfristige Investoren TGV
Rüngsdorfer Straße 2e
53173 Bonn
Germany

Telefon: +49/228/368840
Telefax: +49/228/365875

E-Mail: info@langfrist.de

Dear Investors

We are enclosing the shareholder letter for our Teilgesellschaftsvermögen "Partners Fund" for the year 2019 written by our sub-advisor MSA Capital GmbH.

Yours sincerely

Investmentaktiengesellschaft für langfristige Investoren TGV

Investmentaktiengesellschaft für langfristige Investoren TGV
Sub-fund Partners Fund
FY-2019: Memo of the subadvisor – MSA Capital GmbH, Dr Mathias Saggau

Bonn January 2020

Dear investors,

The share price of the sub-fund (TGV) Partners Fund was EUR 147.18 as of December 30, 2019. The change in the value for 2019, including all costs was + 3.67%. The DAX achieved a performance of + 25.48 % in the same period.

Year	TGV Partners Fund (1)	DAX (2)	Difference Δ (1-2)
2015 (9 months)	+ 1,48 %	− 10,22 %	+ 11,70 %
2016	+ 16,27 %	+ 6,87 %	+ 9,40 %
2017	+ 20,24 %	+ 12,51 %	+ 7,73 %
2018	+ 0,76 %	− 18,26 %	+ 19,02 %
2019	+ 3,67 %	+ 25,48 %	− 21,81 %

Per annum	+ 8,63 %	+ 2,17 %	+ 6,46 %
Absolut	+ 48,20 %	+ 10,72 %	+ 37,48 %

After the weak year 2018, most indices showed very good results in 2019. The TGV Partners Fund was unable to achieve such a positive development. Due to a relatively high concentration on a few companies, the weak price performance of individual stocks had a substantial impact on the overall result.

Just as I have commented on individual years with an outperformance as not very meaningful, I now consider this phase of underperformance with calm. With the strategy chosen, such periods cannot be effectively prevented. I steer the recommendations for the composition of the portfolio with a longer timeframe in mind and let myself be measured by it.

While the prices of **Gruppo MutuiOnline** and **Alphabet** shares developed in a similarly positive way as the market, the price development of several companies (**Rolls-Royce, Interactive Brokers, Naked Wines, Grafenia, NOW Inc**.) was negative in the past year despite predominantly good operating results and beat down the overall result significantly.

The outlier was repeatedly the share price of **Amaysim**, which was downright catastrophic at −60% for the year. This position alone had a negative contribution of around −7% in relation to the entire TGV.

In my view, individual annual results are irrelevant. The reason why I emphasise this, again and again, is a purely pragmatic one: It should give you, as a partner in the TGV, the right mentality for investing in the fund and the goal is to simplify my work as well.

Most mutual funds must live with daily in- and outflows of their mostly anonymous investors. In good times, the fund volume fills up, in bad times everyone runs out through the same door. At the TGV Partners Fund, this is different due to the structure chosen upon inception with only quarterly liquidity. A calendar year that was obviously bad in comparison to the industry would lead to substantial outflows of capital for most funds and thus to many other undesirable side effects.

The right expectations of the invested partners allow me to focus on the essentials: Selecting and holding long-term oriented investments. The right attitude of the invested partners gives the TGV a tangible competitive advantage over many other market participants.

The fact that no partner has ended their engagement since the TGV started almost five years ago – meaning that there has never been a significant outflow – is extraordinary and a critical success factor for the strategy pursued. It also shows that the partners invested have the right mentality to invest in the TGV Partners Fund.

The companies in the TGV Partners Fund

Of the fourteen companies the TGV was invested in on December 31, 2019, I am listing the ten largest positions in alphabetical order:

- Admiral Group
- Amaysim
- Grafenia
- Interactive Brokers
- Rolls-Royce
- Alphabet
- Computer Modelling Group
- Gruppo MutuiOnline
- Naked Wines
- Tucows

These ten companies represent around 85% of the fund's assets. The largest company the TGV is involved in currently has a market capitalisation of around EUR 900 billion, the smallest of around EUR 15 million.

The central investment principles of the TGV Partners Fund have not changed and will not change in the future. When recommending potential investments, I remain committed to the following criteria:

1. Does the company have a reasonable business model?
2. Does the company have a lasting competitive advantage?
3. Does the management act rationally, with integrity, and does it consider the shareholders to be partners?
4. Can we purchase the company’s stocks at a reasonable price?

Changes in the top 10

There were only a few changes within the portfolio in 2019. **NOW Inc**. shares were sold in November. A rights issue was subscribed to at **Grafenia** in the second half of the year. The company is now back in the top 10 and has remained an integral part of the portfolio since spring 2018.[1] **Majestic Win**e has changed its name to **Naked Wines** in the past six months

[1] A detailed description of the business model of Grafenia can be found in the half-year 2018 report.

Operative development vs price development

Operationally, 2019 was a positive year for most companies in the TGV Partners Fund once again.

As also in terms of price development, **Gruppo MutuiOnline** and **Alphabet** were operationally the highlights of the portfolio. Both companies were able to significantly increase sales and profits in the past year. It is astonishing to see that even in the twentieth year of the proclamation of the "new economy" for Internet companies, such high, structurally driven growth is still possible. I assess the prospects of both companies to remain positive.

Tucows has had a mixed year 2019. The business segments with the domain and mobile communications business stagnated as expected, but delivered a good, above all stable, cash flow, which is used to build up the fibre optic business. In the domain business, a smaller company, Ascio Technologies, was acquired.

There were significant changes in the mobile communications business: Cooperation with one of the two partners by Ting, T-Mobile has been terminated with effect from the end of the year of 2019. At the same time, a long-standing collaboration with Verizon, another major network operator in the United States, began.

This change has both positive as well as negative effects: Firstly, the Ting customers who use the T-Mobile network will have to be migrated to the network of the new partner Verizon sooner or later. No matter how carefully and well planned such a process is carried out, some of the customers will definitely be lost. Furthermore, some extraordinary costs will arise and considerable human resources are tied up for this migration. On the other hand, the new contract with Verizon is cheaper and more attractive for Ting than the old contract with T-Mobile. In addition to cost savings, this results in greater flexibility for pricing strategies and a better network for customers. Whether the switch pays off in the long term, we will see in the coming years.

The business of Ting Internet, the fast fibre optic Internet connection in smaller cities in the United States, had its own difficulties. However, the list of new locations to which the company will expand fibre optics developed extremely positively: In 2019, the expansion of fibre optic Internet in several cities was announced, and with Cedar Holdings, a small network in Colorado was acquired. As expected, the desirable investments in this business field rose sharply. However, the connection of paying customers is going somewhat slower than I expected. Given the complexity of expanding a new local fibre network, I am hopeful that Ting will find its way. The Internet connection via fibre optic cable makes a lot of sense for customers – especially in the USA – and is inexpensive so that actually only the question of "when" and not the question of "if" customers are coming is to be answered.

For the other companies in the TGV Partners Fund, the key figures that indicate healthy and sustainable business have improved within a reasonable range in the past year.

The king is dead, long live the king

In contrast to the French hereditary monarchy, companies the TGV Partners Fund is invested in have no succession by birthright.

When selecting the companies, the TGV Partners Fund invests in, I attach great importance to the ownership structure and the people who have a decisive influence on the company. As a rule, the CEO and his management team play a large part in the strategic vision, the essential strategic decisions and the culture that shape a company.

There are particularly strong business models in which weak management can do little damage in the short term. The framework conditions and tailwind of an industry can be so strong for a while that weak decisions do not carry weight at first. In the medium term, however, it is almost always the case that the negligence accumulates and the company loses its outstanding position.

On the other hand, a bad business model in a challenging industry is rarely steered for the better by good management.

In the third variation, however, when excellent management comes to a fundamentally sound business model, real miracles of change can be brought about.

Examples of the positive effects of a change in management are countless and exciting. For example, Satya Nadella at **Microsoft** or Steve Jobs at **Apple** are examples of a comprehensive renewal. What would have happened to the **Berkshire Hathaway** textile factory without Warren Buffett's leadership? And in Germany, the success of **United Internet** without Ralph Dommermuth or the resurrection of **WashTec** without Dr Günter Blaschke are hardly imaginable.

The investment in **Rolls-Royce** in the second half of 2015, for example, was based on the appointment of Warren East as CEO of the engine manufacturer. Rolls-Royce has always had an excellent business model with literally sky-high entry barriers and a strong market position. At the same time, the company's reputation was affected by internal quarrels and past mistakes. Since the appointment of Warren East, Rolls-Royce has gone through a comprehensive transformation, the first successes of which are slowly but clearly becoming apparent.

Precisely because management is central to the long-term development of a company, I regularly take a closer look when top management changes.

This year there was an unusually high fluctuation in leadership figures in the companies the TGV Partners Fund was and is involved in. At four companies (**Alphabet, Interactive Brokers, Naked Wines** and **NOW**) the baton was passed to a new company manager. While this was not unexpected at Interactive Brokers and Alphabet, I did not expect the changes at Naked Wines and NOW in this form.

On his 75th birthday in autumn 2019, the founder of **Interactive Brokers**, Thomas Peterffy, handed over his office and life's work to his successor. As founder and owner of around 75% of Interactive Brokers' shares, Peterffy will continue to closely follow the company as Chairman. In his wake, the continuity is maintained by Milan Galik, who has been with Interactive Brokers for almost three decades. I believe the company is in excellent hands.

Not at an advanced age, but at the tender age of 46, the two founders of Google, Larry Page and Sergey Brin stepped down from their posts as CEO and President of **Alphabet** in early December 2019. This step had been hinted at for several years and was therefore not particularly surprising. First with the creation of the holding structure Alphabet and subsequently with fewer public appearances by Page and Brin. In fact, Sundar Pichai, the long-time CEO of the subsidiary Google, is now also taking on the role of CEO at the parent company Alphabet. In my view, it is more of a formal act than an actual change in operational circumstances.

At **Naked Wines**, with the release of the half-year figures in November, it was announced that Rowan Gormley will hand over his role to Nick Devlin after the 2019 Christmas season. Even if the announcement came unexpected for me at that moment, Rowan had given hints in earlier conversations that he would not stick to his post forever and that he could well imagine early retirement.

I have a positive outlook for the future of Naked Wines: I met Nick, who was responsible for developing the critical US business, during a visit to the USA in 2018. I am convinced that Naked Wines is not a "one-man show", even though the company loses a real entrepreneur type and extraordinarily charismatic leader. I sincerely wish Rowan all the best and I am curious whether we might hear from him in the future, given his youthful mid-50s. Especially if he gets bored with retirement at some point.

At **NOW** the announcement of Robert Workman's dismissal came as suddenly as it was unexpected. I took this unforeseen development as an opportunity to start the whole case again from scratch. A fresh look on a white sheet of paper often shakes up previous findings. After this exercise, I decided to recommend selling NOW Inc.

Although I am still convinced that NOW is an excellent company at heart, Robert Workman, who is now no longer in the picture, was one of several essential building blocks of my investment thesis. It is necessary to revise assessment if facts change.

When is a mistake a mistake?

The case of Now Inc. shows that an error and cause analysis in investing is not always easy. The difficulty lies in distinguishing between mistakes in the investment process and deliberately taken risks.

Nobody would think of attributing a sustainable and sensible strategy to a lottery player. The house has a structural advantage, and the longer the game, the higher the loss. Thus, based on a single investment without understanding the background, it is impossible to appreciate whether it is a sensible and sustainable overall strategy or not.

The TGV Partners Fund has been invested in NOW for several years since its launch in 2015. The investment generated a minimal loss for the TGV and thus diluted the positive overall result of the TGV in this period. In retrospect, it would obviously have been better not to invest. A mistake?

NOW has developed in such a way that the company's operating results were within the scope of my expectations. Of course, I was expecting a more favourable scenario with significantly better operating results. But the operational development that has occurred to date is not entirely surprising. It was considered as part of a possible adverse scenario.

No investment in stocks of a company is risk-free. The core question to answer is always whether the sum of the existing opportunities outweighs the risks, coupled with a healthy safety margin. It is in the nature of things that undesirable events occur when taking risks.

At NOW, I saw the industrial crisis not just as a risk, but also as an excellent opportunity for the company. It was the company's stated goal to consolidate the market through acquisitions that were favourable due to the crisis and to expand the business in the direction of a system integrator. Good companies can often emerge stronger from crises. After several sensible acquisitions in 2015 and 2016, however, things got very quiet and no major acquisitions have been carried out to date, despite considerable financial leeway. Another vital component of the investment thesis, which did not materialise as hoped.

At the same time, business picked up only slightly. Technological progress in the field of shale oil production has increased production in the United States as a whole, but there has been no real upturn in NOW's operating business to date. Adjusted for the acquired sales, NOW still only makes around 60% of pre-crisis sales. Since the business has a high share of fixed costs, caused by the distribution network of branches and warehouses, poor profitability is the logical consequence.

A central part of the investment logic was that this fixed cost basis, driven by acquisitions and/or an organic stimulation of the business – would sooner or later be put to much better use. Both inputs largely failed to materialise. Although I still assume that this upturn in sales will eventually occur, driven by the steady reduction in production, only a weak and slow growth scenario has come true. At the same time, the originally postulated idea has undergone a sudden and clear change due to the departure of Robert Workman and other employees from the management team.

In the case of NOW, I do not see any structural mistakes in the investment process from today's perspective. The possibility of an operationally prolonged slump for oil service companies was taken into account in the risk assessment at the time. Should there be a significant upturn in sales, I continue to expect disproportionately better results. But the execution of potential growth and the strategy of value-adding acquisitions are less clear today than they appeared at the time of the investment. This accumulation of several factors is the main reason to recommend selling the shares.

One of the central questions that I ask myself in my own regular error analysis is whether I would "*make the same decisions based I made at the time of the original decision given present facts.*" I can still answer this with a definite "yes" today, even though the investment as such was not successful.

These remarks show that the price performance of individual investments and a long-term investment over a period of a few years is not a sufficient criterion to finally differentiate between good and bad investment processes, or right or wrong.

The price of Enron had multiplied over a few years before the collapse in 2001, only to implode to 0. Gruppo MutuiOnline fell by almost 60% during the Italian crisis in 2012 to a price of around EUR 2.50. Today, the company is quoting around EUR 20. Was holding on to the stocks through the crisis a mistake? It certainly felt like it during the crisis, but the real mistake would have been a sale.

This leads us back to **Amaysim**. The price of Amaysim has fallen by around 75% since the first investment in 2016. By subscribing to a rights issue at a significant discount, the loss for the TGV Partners Fund is lower overall. Nevertheless, the investment has had a negative impact of around 15% on the performance of the entire assets of the TGV Partners Fund over time. Opportunity costs are not even taken into account here. A catastrophic mistake?

At the moment, it is too early for me to make a final judgement. It is uncertain how stable and robust the intrinsic value of the customer base really is. The telecommunications market in Australia has gone through a serious crisis over the past two years and many of the developments that have occurred have not been in the hands of management. Operationally, it is nowhere near as dramatically bad as the high loss suggests.

Nevertheless, the company is still in the middle of restructuring its own business. The management around Peter O'Connell tackles the right issues quickly and decisively, took advantage of the crisis and, for example, acquired a smaller competitor at a reasonable price in the second half of 2019.

The Investmentaktiengesellschaft für langfristige Investoren TGV is currently the largest shareholder of the company, and there is a close and positive communication about its future strategy. I am excited to see how the company will develop. In due course, I will conduct a full review of this investment, for which it is too early at this point.

Investor meeting

Investmentaktiengesellschaft für langfristige Investoren TGV will hold its annual investor meeting on June 6, 2020, in Bonn-Bad Godesberg. As a partner in the TGV, you will receive an invitation shortly.

It is fantastic to see that the number of participants increases every year and that the meeting has a fixed place in the schedule of many of you. If you have never participated before, I would like to encourage you to come to Bad Godesberg.

The meeting is an excellent opportunity to get to know the other partners and colleagues of the Investmentaktiengesellschaft für langfristige Investoren TGV and to get a first-hand picture of the people involved.

Kind regards from Bonn,

Yours Mathias Saggau