Investmentaktiengesellschaft für langfristige Investoren TGV

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Dear Investors

We are enclosing the shareholder letter for our Teilgesellschaftsvermögen "Partners Fund" for the first half of 2022 written by our sub-advisor MSA Capital GmbH.

Yours sincerely

Investmentaktiengesellschaft für langfristige Investoren TGV

Vorstand: Jens Große-Allermann, Waldemar Lokotsch
Aufsichtsrat: Dr. Maximilian Zimmerer (Vors.), Wolfgang Fritz Driese (stv. Vors.), Alexander Pichler (stv. Vors.)
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Investmentvermögen mit veränderlichem Gesellschaftskapital

Investmentaktiengesellschaft für langfristige Investoren TGV
Sub-Fund Partners Fund
H1-2022: Memo of the sub-advisor – MSA Capital, Dr Mathias Saggau

Bonn, July 2022

Dear investors,

the share price of the sub-fund (TGV) Partners Fund was EUR 176.58 as of June 30, 2022. The change in value for the first half of 2022 was -33.47% including all costs.[1] The DAX achieved a performance of -19.52% 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 %
2020	+ 30.47 %	+ 3.54 %	+ 26.93 %
2021	+ 38.21 %	+ 15.79 %	+ 22.42 %
2022	- 33.47 %	- 19.52 %	- 13.95 %

per annum	+ 8.26 %	+ 0.92 %	+ 7.34 %
total	+ 77.81 %	+ 6.83 %	+ 70.98 %

What a difference a few months can make: Shocked by the sudden war in Ukraine and rapidly rising interest rates, the prices of most stocks have only known one direction in recent months: "down", and many of them dramatically so.

At this point, a little over a year ago, I was still talking about red hot valuations and absurd excesses on the broad market, but this phenomenon has completely dissipated over the past twelve months and has given way to a widespread hangover mood in recent quarters. In the meantime, the economic situation has deteriorated significantly. Stocks of many companies that were particularly highly praised during the Corona crisis have lost all the gains from that period, many even more. Many companies lost significantly more than 50% of their value.

The companies in which the TGV Partners Fund was and is invested were also affected by these tumbling prices. There isn't one particular culprit for the poor performance over the past six months. It's rather that several companies have suffered sharp price losses since the beginning of the year: **Naked Wines (-75 %), JustEat Takeaway (-69 %), Tucows (-47 %), MutuiOnline (-45 %), Ferguson (- 39 %), Interactive Brokers (-30 %).** In a concentrated portfolio, where the capital is

[1] Since the 2018 annual report, the performance calculation for the TGV Partners Fund has been based on the so-called BVI method. The differences in the percentage return and the fund price change can be explained by payments in connection with taxes.

invested in a manageable number of companies, these price losses strongly impact overall performance.

In the past, I have repeatedly emphasized that, in my opinion, short-term forecasts about the price development of stocks are impossible. For this reason, I do not try to anticipate such market movements or hedge the portfolio against falling prices. For example, in March 2020, in the midst of the crash at the beginning of the corona pandemic, who would have thought that company prices would recover so quickly within a few weeks?

The portfolio is secured exclusively through the quality of the company selection. In particular, I assume that the selected companies will do much better in the future and, at the same time, already have reasonable valuations today. Unfortunately, an inevitable reality of this approach to entrepreneurial investing is that there are good and bad years when it comes to returns and that cheap valuations can intermittently become much cheaper. The important thing is that you get where you want to go. As Charles Schwab aptly put it: „***It's not about timing the market, it's about time in the market.***"

In my view, the companies in the portfolio as a whole are defensively oriented, and so I said in January: *„In my opinion, the portfolio should rather behave in such a way that it is less affected than the market as a whole in the event of general price drops, while it should also rise less sharply with generally rising prices. On average, the companies in the portfolio have no net debt, often crisis-resistant business models, and thus should be more defensive. But the result of the last 24 months was different."*

This statement was brutally confronted by reality just a few months later. Because a phase in which the fund developed significantly better than the broader market was now followed by a phase with a much worse result than expected. And that even though the financial results of the last few quarters have been very solid for many of the companies in the TGV Partners Fund and for them, there is no sign of an economic slowdown or even a depression. On the contrary, there are numerous examples in the portfolio where the situation is getting better operationally rather than worse in the current environment.

Nothing has changed in my assessment of the quality of the companies either. I'm in a positive mood despite or perhaps because of the turbulences: because really excellent companies manage to create and add value – especially in economically challenging times – and often emerge from a crisis stronger.

Above all, this shows why investing in shares, as I have repeatedly emphasized, only makes sense over a longer term. If you needed the capital in the TGV Partners Fund in this situation, you would now be forced to sell at depressed prices. However, the longer the period that an investor can plan for any stock investment, the higher the probability of a positive return.

Against this backdrop, I am enthusiastic about the composition of the investors in the TGV. It is a steady competitive advantage that significantly influences and supports investing for the TGV. Despite the sharp decline, there have been no outflows in recent quarters and few concerned calls. The sharply falling prices were often seen as an enticement to make additional investments. Regardless of an investment in the TGV Partners Fund, this is the right reflex for a prudent and long-term capital investment.

The companies in the TGV Partners Fund

Of the fourteen companies the TGV was invested in as of June 30, 2022, I will list the ten largest positions in alphabetical order as usual:

- Associated British Foods
- Ferguson
- Interactive Brokers
- Lanxess
- System1 Group
- DCC
- Gruppo MutuiOnline
- Just Eat Takeaway.com
- MEDIQON Group
- Tucows

These ten companies represent around 95% of the fund's assets. The largest company in which TGV is currently invested has a market capitalization of around EUR 30 billion, the smallest around EUR 10 million. Most companies have been part of the TGV portfolio for years.

The key investment principles of the TGV Partners Fund have not changed and will not change in the foreseeable 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

In the wake of the market turmoil, the TGV Partners Fund bought shares in two companies (**Ferguson** and **Lanxess**). This purchase was financed by the sale of stocks in the oil and gas sector (**TGS** and **Computer Modelling Group**) and the gradual reduction of some existing positions. The shares of **Naked Wines** are still part of the portfolio but are not represented in the top ten after falling sharply in recent months.

Even if, in retrospect, the sale of the stocks in the oil and gas sector turned out to be extremely unfortunate timing-wise due to the sharp rise in oil prices since the beginning of the war, I am convinced that the shares of the two newly acquired companies have a better long-term risk-reward ratio and are therefore better suited for the composition of the portfolio.

The two new positions, Lanxess and Ferguson, both emerged from a historical transformation of their own businesses and are now significantly better companies than just a few years ago. While it is obvious that the future of these two companies looks a lot brighter than the past, the market doesn't seem to share that view. They are valued as if they were still mediocre or even bad companies.

Take **Ferguson,** for example: founded as Wolseley Sheep Shearing Machinery in 1887, the company has acquired various businesses over the years and has been one of the great British conglomerates for decades. In 1982, Ferguson Enterprises, a regional distributor for plumbing supplies in the USA, was acquired, which formed one of Wolseley's 32 different divisions at its peak. A dreadful hodgepodge

without a clear focus. Then came the financial crisis in 2008, and Wolseley, shaken by high debts, was on the verge of bankruptcy and barely survived.

After this near-death experience, they decided to focus on their best business domains. In the following years, the debt was drastically reduced, and the company focused on one operating division, the wholesale of plumbing and waterworks-related supplies in the USA. In 2017, the company was finally renamed Ferguson Plc.

Today, with nearly $30 billion in US sales, Ferguson is the largest professional trade supplier in the US. The company has achieved excellent operational development in the past twelve years since the financial crisis.

As Wolseley was historically based in the UK and listed in London, it was virtually ignored by US-analysts. As a result, the company was perceived as more "European" than "American". The result was a much lower valuation compared to competitors in the US market. Even today, there are few US investors and practically no US index funds in the shareholder structure, although it is now a very large and purely American company.

The neglect goes so far that in a recently published 66-page study by Barclays Bank assessing all the companies under the umbrella of *"U.S. Homebuilding & Building Products"*, Ferguson is mentioned only once in a footnote. And that despite the fact that it plays a vital role as one of the largest companies in this field.

Therefore, as one of the last necessary measures, it was decided in March 2022 to move the stock exchange listing from Great Britain to the USA to obtain a place in the important S&P500 index in the medium term. The goal is to solicit the interest of American investors and index funds and to make up the valuation difference.

This valuation difference is huge. Distributors, in general, are a great business model. They are regularly characterized by stable organic growth, crisis resistance, and high returns on capital employed. Accordingly, these companies are regularly traded on the stock exchange with high valuations. **Fastenal**, **Watsco**, or **Pool Corporation**: several representatives of this sector have been spectacular investments and fantastic companies over the past 25 years. However, they are also regularly rated very highly. 25x or 30x annual profit as valuation is not uncommon.

Ferguson has enjoyed a similarly positive operational trajectory over the past years. Operating income has increased by more than 15% p.a. in the last ten years. Unlike the distributors mentioned above, it currently trades at about 10 times its 2022 after-tax profits. At the same time, Ferguson has a consistent history of value-adding acquisitions and aggressively buys back its own stock when prices are low. From my point of view, this is an excellent use of their earnings.

Index funds and shareholder structure

Index funds, so-called ETFs (exchange-traded funds), have experienced an unprecedented rise in the last thirty years. As a particularly inexpensive alternative compared to actively managed funds, they replicate a specific index and make automatic buy or sell decisions based on set rules. The great advantage of index funds is obvious and undisputed: they often have lower costs than actively managed funds.

One of the reasons why I believe Ferguson is valued so much cheaper than comparable US competitors is its history as a European company and the listing in London. Therefore, it also has to do with the structure of ETFs.

Historically, Ferguson has no owner and virtually no permanent anchor shareholder. Index funds focusing on British or European stocks and British-oriented funds are the dominant shareholders today. Notably, Ferguson today has almost no US shareholders.

With the relocation of the stock exchange listing to the US in March 2022, the European-oriented index funds no longer have any reason for holding the shares. By definition, Ferguson is no longer a European company. The US index funds, on the other hand, cannot invest in the company yet, since Ferguson has not yet published an annual report with the SEC. This so-called 10-K is one of the necessary conditions to be included in the S&P 500. This is expected to happen later this year.

A significant change in the shareholder structure triggered by a change in the listing has extensive consequences. Normally, this process would be reasonably orderly, especially for such a large company. However, the situation in the broader overall market is anything but orderly at the moment.

This, in turn, allows the TGV Partners Fund to invest in a situation where the near-term prospects for equities in general and Ferguson shares, in particular, are highly uncertain but reasonably unrelated to its operations and the company's intrinsic value.

The value of a company and the price of its shares are not always closely related. The price of shares can deviate significantly from the company's actual value, especially in stressful (market) situations. And in such a market phase, the shareholder structure can be the reason for significant price changes. Suppose individual larger shareholders are forced by external circumstances to sell their shares regardless of the price. In that case, this leads to further turbulences in an environment like the current one.

A good example of shareholder structure turbulence is **Naked Wines**. After the sale of the former "Majestic Wine" retail shops, there was an almost complete change in the shareholder structure.[2] Many new shareholders became aware of Naked Wines during the Corona pandemic and hoped for permanently bright prospects.

As a Corona winner and e-commerce company, the shares have developed particularly poorly in recent months. Modest annual results for 2021 and a poor outlook for the year ahead led to a crash, with shares losing around 60% of their value in just two days. A deep sense of insecurity spread.

In just a few months, it fell from darling of the market (lauded as "the Netflix of wine") with a decent valuation to the valuation level at which the company was acquired by Majestic Wine as a start-up in 2015. However, the difference is that Naked Wines now has more than four times as many customers and sales than it had seven years ago.

The past three years have produced numerous aberrations that would probably not have occurred in "normal" times. Negative interest rates, a negative oil price, utterly insane valuations in some parts of

[2] A detailed description of the business model of "Majestic Wine" and the transformation to today's "Naked Wines" are included in the annual report 2018 and the first semi-annual report of 2019.

the stock market, and a gold rush in so-called digital assets ("crypto assets"). Followed by soaring interest rates and runaway inflation, followed by a crash in tech stocks.

The chance that all these changes will pass in a brief period and without friction or failures among all market participants and generally without collateral damage is close to zero. I, therefore, assume that there will certainly be more of these turbulences in the coming quarters. In the meantime, however, these technical effects, such as liquidations by investors, could prove to be opportunities for prudent and long-term investors. Unfortunately, we will only know in hindsight when the bottom was actually hit.

For the TGV Partners Fund, this has not exclusively negative effects. The intrinsic value of companies, the fixed star by which we navigate, is normally not affected by such turbulences. In the long run, it is actually the other way around: the greater the stress and fluctuations, the more likely it is that there will be high levels of inefficiency in certain corners of the market. If properly identified, the ability to exploit these inefficiencies will add value to the long-term value of the TGV Partners Fund.

Unfortunately, those inefficiencies inevitably come in tandem with periods of uncertainty and high market volatility.

Where are we now, and what's next?

When investing in stocks, there are two ways to permanently lose capital. The first is being unable to sit out a crisis, generally selling at low prices, or worse, being forced to sell. The second is that the invested companies need capital and permanently dilute the shareholder structure by issuing new shares at rock-bottom prices. As an investor in the TGV, you have control over the first decision. The second is in my hands by recommending the right companies.

In the 2020 Annual Report, on the occasion of the fifth anniversary of the TGV Partners Fund, I introduced the concept of sustainable earning power to you. I mentioned that I will address it in longer intervals in the annual report. This sustainable earning power is a component of assessing the various companies in the TGV Partners Fund, and I regularly compare them to the available alternatives. Given the occasion, I would like to give you an insight into the values I use – and thus, an important glimpse into how I view the portfolio in its entirety.

The sustainable earning power *is an estimate on my part and is based on data and assumptions as to what income a company would achieve today if it no longer invested in future growth from this point on. In theory, it could then distribute the sustainable income as a dividend, but conversely, it would no longer be able to grow. Sustainable earning power and the price development of company shares should go hand in hand over a longer time.*

In my estimation, the sustainable earnings of the companies in the TGV Partners Fund at the inception of the TGV were around 6.50 euros per share for a little more than seven years. According to my estimate, the sustainable earning power has grown by approximately 13% annually to around 16 euros per fund share in the summer of 2022. If this sustainable earning power within the companies in the TGV Partners Fund can be increased at a similar pace in the future, this will inevitably be reflected in a further increase in the price of the shares and a positive return for the TGV.

Two key conclusions can be drawn from these data points: Firstly, the sustainable earning power has risen more strongly over time than the price of the TGV Partners Fund. In my opinion, the price development of the TGV Partners Fund in recent years can therefore be attributed primarily to an operational increase in the income generated by the companies and not to a change in the valuation of the companies in the TGV – an indicator of sustainable organic development.

On the other hand, the valuation per share of the TGV has become more favourable over the past few years. Based on this fact, I am positive about the future: In my opinion, the valuation of the companies in the portfolio is overall lower today than at any point in the past seven years, including the Corona crisis.

If you put these facts in relation to an uncertain world, in which interest rates are still at historically low levels despite a significant rise in recent weeks, and many companies are facing major structural challenges, I can look forward to the years ahead with confidence.

With this in mind, I wish you a great summer and thank you for trusting us.

Kindest regards from Bonn,

Mathias Saggau