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 2015 written by our sub-advisor MSA Capital.

Yours sincerely

Investmentaktiengesellschaft für langfristige Investoren TGV

Investmentaktiengesellschaft für langfristige Investoren TGV
Sub-Fund Partners Fund
FY-2015: Memo from the sub-advisor – MSA Capital, Dr. Mathias Saggau

Bonn, January 2016

Dear Investors,

The net asset value of the Teilgesellschaftsvermögen (TGV) Partners Fund was 101.48 Euros as of December 30, 2015. Since the first nine months from fund inception, the TGV has delivered a performance after all costs of 1.48%. In the same period the DAX has lost 10.22%. Thus, by January 01, 2016, the DAX would have needed an increase of 13.03% to catch up with the TGV's performance in 2015.

Even if this short-term outperformance looks satisfying, a qualitative statement about the performance in this period still makes little sense due to a period of only nine months cannot be considered a relevant touchstone for assessing an investment manager.

The companies in the TGV Partners Fund:

Of the 16 companies the TGV Partners Fund is invested in, I would like to list the ten largest positions in alphabetical order:

- Admiral Group
- Distribution NOW
- Google
- Leucadia
- National Oilwell Varco
- Amazon
- Fastenal
- Gruppo MutuiOnline
- Microsoft
- Rolls-Royce

These ten investments represent approximately 80% of the fund's assets. The biggest companies the TGV is invested in currently have a market capitalization of approximately 500 billion US Dollars each, the smallest of less than 10 million Euros. The TGV Partners Fund has no preference as to the size of companies, countries, currencies or industries. Potential investments are exclusively determined by 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 the company's stocks be purchased at a reasonable price?

All the companies in the TGV have in common that they are outstanding corporations whose long-term prospects I consider to be positive and which the TGV can purchase at a good price, considering the intrinsic value I have calculated for them.

Changes in the top 10:

Although **TGS Nopec** no longer appears in the top 10, its position within the TGV Partners Fund is unchanged. As the share price has fallen since first purchase, due to a decreased value of the position the TGV is holding, the company is no longer among the top ten. The crisis in the oil and gas industry continues and has developed into one of the hardest challenges for the industry since the 1970's. The prices of the companies the TGV is still holding in this field have continued to fall sharply since our purchase last year. In total, the investments in this field caused a negative contribution of nearly 10 % relative to the total value of the TGV. However, I remain confident that the selected companies can cope with the crisis and will be among the winners of the upswing once the mood is brightening in the market.

The shares of **Amazon** enjoyed a spectacular run in the past year. Since the company has announced details on his business Amazon Web Services (AWS) last summer, the shares have only known one direction: its price has risen around 80% (or in absolute terms by 140 billion USD) since the inception of the TGV. Apparently, some of the options I have introduced in the last semi-annual report are now being evaluated differently by the market than a year ago. Since, due to the very sharp price increase the attractiveness of the price and the resulting achievable yield has continued to decline and other excellent opportunities have opened up, the Amazon position has been reduced.

All shares of **Verisign** and **Dolby** have been sold. Both companies are still excellent businesses, but I came to the conclusion that there are much better alternatives, in which the funds freed by the sale could be invested.

In the last six months, shares of **Gruppo MutuiOnline**, **Rolls-Royce** and **Fastenal** were purchased, so that these companies are now included in the top ten.

Gruppo MutuiOnline:

In the summer of 2015, due to favourable prices, the opportunity opened up to acquire a stake in Gruppo MutuiOnline. As by the end of the year, this holding represents the second largest position in the TGV and I would like to explain the rationale behind this investment. The criteria we I am looking for in a recommendation for the TGV Partners Fund are perfectly demonstrated in the case of Gruppo MutuiOnline (MOL):

1) *Does the company have a reasonable business model?*

MOL operates in two different business segments. On the one hand, the company is operating various price comparison and brokerage websites in Italy. On the other hand, MOL supports financial institutions in multiple business processes, such as the processing of loans or insurance policies, so-called Business Process Outsourcing (BPO).

In the area of brokerage websites, MOL receives a commission in the event of a successful arrangement of a mortgage, signing an insurance contract or the referral of a user. In Germany, this business is conducted, for example, through websites such as www.interhyp.de (mortgage), www.check24.de (insurance, telephone, electricity and gas prices) or www.idealo.de (consumer goods). In other countries such as the USA, Great Britain, Spain or France, there are local and country-specific sites of companies that assume this function.

In the field of Business Process Outsourcing, MOL helps financial institutions to work more efficiently through the industrialization of process steps. Here MOL not only helps in the management of the physical loan file, but also provides assistance in the assessment of whether a credit decision can be justified at all.

2) Does the company have a lasting competitive advantage?

The competitive advantages are different in both business segments.

In the brokerage segment, the websites of MOL provide a comparison of offers available on the market and give the users greater transparency in order to make their decisions. MOL saves them money without the customers having to pay a direct fee for it.

For banks and insurance companies, such websites represent a relatively new and attractive sales channel of ever increasing importance, albeit unloved due to better transparency for the potential customer. It is the younger customers in particular, who are getting more and more accustomed to browsing the internet for prices and conditions before making a purchase decision. Even if the Internet has been ubiquitous for more than 15 years, despite their attractiveness, these platforms are still far from being the most important and highest-volume distribution channel for financial institutions. In addition, there are big differences in the market penetration and the search volume of comparison sites all over the world. Here Italy and Germany are still significantly behind the penetration of the pioneer markets such as Great Britain or Norway.

For the consumer, it is essential to be able to find the desired website. Once the consumer knows the website he is looking for, he can go there directly or enter the address in the browser. If the consumer doesn't know a specific site, then he usually begins his search using a search engine, usually Google, doing a so-called "organic search", or he is forwarded by clicking on internet advertising, such as Google AdWords, to a comparison website while e.g. looking for property or a mortgage online. Most hits are generated through organic search on Google and by direct access to the website.

For the organic search, Google favours those websites and results that are of high relevance for the searcher. The higher the user volume, the so-called "traffic" on a website, the more important, full of content and relevant the site is in its field, the higher up on the list of results the website will be displayed when searching on Google. This has huge implications: the higher the website is placed in the search, the more users will visit the site and the probability of a visit and thus of a successful brokerage of a contract increases. Therefore, the user traffic of first website displayed in the list of results on Google is average three times as high as the user traffic of the website ranking third on Google.

In 75% of all searches performed, a placement on the second page of the search result does not even get viewed at all, since the typical user does not even look at the second page. When a website is able to focus most of the organic searches on itself, it is very difficult for smaller or new competitors to break this virtuous cycle and take traffic away from the "bigger" website. This particularly applies when the content of the new website (prices and conditions) is the same as on the existing and already established site.

Once the user has landed on the website, transparency, completeness and reliability are of importance. What good is it to the customer, if he has no genuine and complete overview of all his possibilities or he realizes that more favourable offers are being withheld? It is therefore important that a comparison website presents all providers available on the market and actually displays the deals that are in fact the best ones for the customer. With satisfied customers, the probability of an actual conversion is much higher. The providers, in turn, want to and can only cooperate with those platforms that can deliver a correspondingly high traffic and conversion rate from interested customers to actual contracts. Therefore, they are not willing to cooperate with all comparison shopping sites, but focus on the biggest platforms.

Against this backdrop, over the last 15 years a pattern has developed, that in every country one or two websites make up the lion's share of all searches. Of course, the business is particularly profitable if there is only one website without significant competition in a country and thus less money has to be spent for the generation of users by investing in traffic and marketing. As soon as there are two websites competing in a country, the profitability of both websites decreases markedly. There is rarely ever a third or a fourth in a market, and if there is, they are usually hopelessly unprofitable and usually only a fraction of the size of the market leader. In the field of mortgage and credit brokerages, MOL is the undisputed number one in Italy, while there is another strong competitor in the insurance and product comparisons field.

In Business Process Outsourcing (BPO) MOL lives off the fact that it can offer the processes of financial institutions better and cheaper than many banks are able to generate them themselves. By now, MOL is the largest provider of this service in Italy and enjoys significant scale and quality advantages over other competitors and especially in direct comparison with internal departments at smaller banks.

Loan processing is a very labour-intensive, complex and local process. For a loan application, all relevant documents and certificates must be collected and assessed, any arising questions have to be clarified with the customer, and regulatory as well as bank- internal credit requirements examined and observed. Only beyond a certain number of credit cases does a bank benefit from implementing its own and specialized department or to develop its own software. This also manifests itself in fraud prevention in lending: of course the probability of detecting fraud is higher if you have seen a lot of tricks before, have processed countless credit cases, and can make regional interconnections.

Moreover, other banks typically will not consider a competitor for this service because what bank wants to give a competitor its own credit files and thus its own customer data for processing? For smaller, local banks, but also foreign banks, this type of outsourcing to a neutral third party a good opportunity to reduce their own processing cost, while at the same time, the high quality of the process is guaranteed. MOL has focused on this segment and built it with a lot of diligence and attention to detail into a powerful organization, which has grown to be one of the largest process providers Italy within just a few years.

3) *Does the management team act rationally, with integrity, and does it consider the shareholders to be partners?*

Gruppo MutuiOnline was established about 15 years ago by Marco Pescarmona and Alessandro Fracassi. They have met studying in the USA and after a while in their respective jobs, they decided that they wanted to become entrepreneurs together. Even today, they are still running the operation and are the largest owners of MOL. I know Marco and Alessandro for several years and I've had frequently the joy to touch ground with them.

Marco and Alessandro are a fantastic team; they complement each other wonderfully and in just a few years they have built a rapidly growing, highly profitable and above all sustainable company. The extent of their cost-consciousness, an excellent hand for the operational business and a brilliant understanding of strategy and capital allocation is rarely found in this combination. Even if they had to go through several major crises (2001, 2009 and 2011) together, they have always used them to systematically enhance and advance their own business.

I have no doubt, that all shareholders are seriously considered as partners and that shareholder's capital is in the best hands possible.

4) *Can the company's stocks be purchased at a reasonable price?*

I expect that Gruppo MutuiOnline has an excellent future ahead of them and that it will generate solid growth rates long-term. Part of this growth is the ever-growing market penetration and increased use of the Internet, without MOL having to invest a penny into this natural "tailwind". Another part of the growth is favoured by wise and far-sighted investment.

In light of this growth being highly profitable and Alessandro and Marco, as well as their team, are feverishly working to expand their own competitive advantages, I consider the price which was paid for the shares in the summer of 2015 as very compelling.

Value investors, technology and the Internet:

There is an iron-clad consensus among most value investors that is rapidly changing industries and short product life cycles are only poorly suited for a long-term investment. How are you supposed to determine the value of a company if you do not know whether the company is even going to still be there a few years from now? With this in mind, there are many investors who consider all companies that have emerged in the course of the past 15 years or conduct their business primarily on the Internet, un-investable. They prefer to invest in the "Old Economy".

The Internet, its use and its effects are seen as a lasting phenomenon, and that time cannot be easily turned back. Today, 15 years after the massive spread of Internet connections and only a few years after the first iPhone, there is hardly any business model which will not sooner or later be affected by the Internet. Be it as an alternative distribution channel, through greater transparency, better comparability of products and services, or through a changed customer and user behaviour. As an investor, you have to face this fact and accept these changes as a given.

Because even business models that have been considered absolutely safe and unaffected a few years ago (and perhaps still are), are going to experience major changes in the next few years: not only the automotive industry (self-driving electric cars), television and cable providers (Netflix, Amazon, Apple), traditional utilities (solar and battery technology) or all varieties of traditional retail (e-commerce) will be faced with these challenges in the coming years. And even if it is so obvious that these changes are pending, it is often unclear who – other than the consumers – will be the winners of this radical change.

Conversely, this is not to say that one should prefer only companies which are subject to strong technical changes or are active in the Internet. However, due to the changes brought forth by the Internet, a few highly profitable business models have emerged in recent years which have extremely excellent properties and can be very valuable should they last. Who would for example have thought a few years ago, that someone can build a company like WhatsApp with fewer than 50 employees, which is used by half a billion customers several times a day? The sticking point is whether one can judge at all, if these companies are really going to last.

Yet in my opinion it would be a big mistake to categorically exclude investing in these business models. My approach is therefore to select companies that, despite all these changes, have lasting competitive advantages, so they can still exist and still compete in the market ten years from now. Those companies with management teams who are aware of the challenges they are facing and capable of implementing the necessary changes in order to participate in shaping the future.

This is no guarantee of success, but it prevents the issues that will without doubt occur by burying one's head in the sand in ostrich-like fashion from happening rather sooner than later.

Oil and gas:

The developments in the oil and gas industry in recent months and the price have been spectacular and the price of crude oil has continued to decrease substantially. Now, in early 2016, it is around 70% below the price from mid-2014. Numerous partners and friends have been wondering whether an assessment of the oil price is not essential in order to be able to invest in this industry at all. Unfortunately, there is no simple answer to this question, and I'll try to illustrate the context that is relevant for us in a highly simplified manner:

The companies, in which the TGV Partners Fund is invested, are only indirectly affected by a falling oil price, as none of the companies is producing oil and gas. They act solely as suppliers to the industry. Hence why the companies the TGV Partners Fund is invested in it is mainly about the process of drilling, the producing wells, and the wear and tear of the equipment used for production and drilling, and less about the oil price itself. However, the oil price and the number of new drilling projects are at last indirectly related.

Since the oil has to be pumped and oil wells continue to dry up, this so-called decline rate has to be offset by finding and tapping ever new sources. On a global scale and as an average over all sources the best available estimates assume a global decline rate of around 4-6% per year.

More precisely spoken: of the total production 2015 of around 95 million barrels of oil per day (barrel per day or BPD) every year roughly 4-5 million BPD have to be replaced in order to maintain the supply. Year after year... The production shortfall is due to the law of physics and cannot be avoided. Without surveying any new wells, production will fall by 4-5% p.a. in the future. After only five years without any investment, this would result in a production shortfall of 20% or more than 20 million BPD. By way of comparison, Saudi Arabia as one of the world's largest producers had a production output of approximately 10-11 million BPD in 2015.

On the other hand, the demand for oil is at around 93-94 million BPD, which barely changes in the course of a recession and is slowly but steadily increasing, the production has to be renewed in the medium term to keep up with demand in the long run. But that in turn means that inevitably new oil wells have to be exploited if we want to keep driving our cars, flying our planes, and continue to produce plastics.

Now it is obvious that at a price of around 30 USD very few producers are exploiting new deposits - because for most producers this price is completely unprofitable considering all-in costs. This means that far fewer new projects are initiated for production and exploiting new wells. And this of course affects companies in the TGV Partners Fund directly. The implementation of a project and the time from the first discovery of oil to production takes years and cannot be achieved overnight.

This leads to the very real risk, that the more the oil price falls and the longer it remains low, more and more projects will be stopped. Then in turn, all the more unexpected and steeper the oil price will rise because supply cannot be expanded fast enough.

For the companies in the TGV Partners Fund the continuous decline rate is one of the main reasons to invest. It ensures that the big oil companies need to invest heavy and steadily, if they want to keep up their ability to deliver. Since it is becoming increasingly difficult and technically complex to produce the oil even if there is still an abundance of it, it is also more expensive to exploit the wells. Therefore, I consider permanently low oil prices to be unlikely. At today's price there are simply not enough new capacities developed to compensate for the steady decline rate.

Investor meeting:

The Investmentaktiengesellschaft für langfristige Investoren TGV will hold its annual investor meeting on Saturday, June 11, 2016 in Bonn - Bad Godesberg. As a partner in the TGV, you will receive an invitation shortly. If you have not participated yet, I would like to encourage you to take the trip. It is worth it! It is an excellent opportunity to meet the other partners and colleagues in the Investment-aktiengesellschaft für langfristige Investoren TGV.

Greetings from Bonn

Mathias Saggau