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 2020 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
H1-2020: Memo of the sub-advisor – MSA Capital, Dr Mathias Saggau

Bonn, July 2020

Dear investors,

The share price of the Sub-Fund (TGV) Partners Fund was EUR 148.51 on June 30, 2020. The change in the value for the first half of 2020 including all costs was + 0.90%.[1] The DAX achieved a negative performance of −7.08% over 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 (6 months)	+ 0,90 %	− 7,08 %	+ 7,98 %

Per annum	+ 7,96 %	+ 0,54 %	+ 7,42 %
Absolut	+ 49,54 %	+ 2,88 %	+ 46,66 %

What a difference a couple of weeks make. Even if the result of the TGV at the end of the half-year is practically unchanged: the way there was turbulent.

Who would have thought that the world would come to a near-standstill within a few days and that drastic changes triggered by the coronavirus would occur in a very short time? While we may have sneered at face masks in Asia in the beginning, they have now become an integral part of public life in Germany too.

Had anyone predicted in January that a novel virus would cast a spell on the world, brought various industries to a standstill and at the same time drive millions of people out of work, the catastrophically gloomy outlook would have seemed ludicrous. Had I also predicted abstruse fantasies such as a negative oil price or the near-complete halt of global air traffic: you would have questioned my mental health. We would have, however, agreed on one thing: that a major stock market crash would be the inevitable consequence.

It is all the more astonishing that the prices of many stocks in the markets jumped back to their levels from the beginning of the year only a few weeks after a slump in March following massive interventions

[1] Since the 2018 annual report, the performance calculation for the TGV Partners Fund has been expressed using the BVI method. The differences in the yield and the NAV change can be explained by tax-related payments.

by governments and central banks. Yet another example that it is impossible to predict short-term developments in the stock market.

Fortunately for us all, the medical impact seems to have been relatively mild so far, especially in Germany. It looks as if the augurs' worst fears, which were outdoing themselves with ever bleaker forecasts at the beginning of the crisis, have so far not materialised. Unfortunately, however, a concrete end is not yet in sight.

The prices of the shares in the TGV Partners Fund were – as they tend to be – spread across the board from catastrophic (**Computer Modeling Group, Grafenia**) to excellent (**Naked Wines, Admiral Group**), breaking even across the entire portfolio. Operationally, the effects for most companies seem far less dramatic than the price fluctuations would suggest.

The companies in the TGV Partners Fund

Of the sixteen companies the TGV was invested in on June 30, 2030, as usual, I am listing the ten largest positions in alphabetical order:

- Alphabet
- Amaysim
- Computer Modelling Group
- DCC
- Gruppo MutuiOnline
- Interactive Brokers
- MEDIQON Group
- Naked Wines
- TGS-NOPEC
- Tucows

These ten companies represent around 85% of the fund's assets. The largest company the TGV is invested in currently has a market capitalisation of around EUR 900 billion, the smallest of around EUR 10 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

Due to the corona crisis in the first half of 2020, there were some minor changes within the portfolio. **Rolls-Royce** and **Admiral Group** shares were sold. The funds realised were invested in shares of **TGS-NOPEC** and **DCC**.

Grafenia shares continue to be part of the TGV Partners Fund portfolio. Due to a sharp price slump, they dropped out of the top 10.

The shares of **MEDIQON Group AG** have been in the portfolio for over five years since the inception of the TGV Partners Fund. At that time, the company was still named as **Medical Columbus AG** with a market capitalisation so small and so few shares to buy that it had never been enough to reach the top 10.

Over time, close support as a shareholder turned into an active role in shaping the company, resulting in me becoming a member of its supervisory board in 2018. The company has taken its first new steps in a new direction after selling its original core business in 2018 and changing its name to MEDIQON Group AG. Hopefully, there are many steps to follow. In any case, we have put together a great team so far and injected some capital for further growth.

Since I am also responsible in an official company role, this letter is not the right context for in-depth reporting on MEDIQON Group AG or to elaborate on future plans. I would, therefore, like to refer to the company's annual report and shareholder letter 2019. [2]

The reasons for the sale of **Rolls**-**Royce** and **Admiral Group** could not be more different. One company (Admiral Group) will soon be better off than planned due to the crisis. The other (Rolls-Royce) is facing very difficult times.

Admiral Group, as a car insurance company, is expected to achieve a spectacularly positive result in 2020. Insurance premiums are typically calculated and paid in advance. When calculating the amount of the premium, the amount of damages is projected for "normal" traffic. Nobody could have factored in that traffic came to a near-complete halt. Less traffic means fewer accidents and fewer accidents mean fewer insurance claims. Against this backdrop, Admiral will have to pay out far fewer claims in 2020 than it would have under normal circumstances. If everyone stays at home, nobody has accidents.

An extraordinary income that is unlikely to incur again in the next few years. The company's shares held up very well during the Corona crisis due to this generally well-understood dynamic and, unlike most shares, rose even in the turbulent month of February. Given the wide range of alternatives, I recommended to sell it to free up funds.

Due to the complete halt of air traffic, the turnaround of Rolls-Royce initiated in 2015 was set back by years. The new Trent XWB engine generation is decisive for the successful continuation of the transformation. Without the sale of a sufficient number of these new engines, the costs associated with the development cannot be recovered, and the expected scaling of the business will not materialise. Since almost all potential customers are currently struggling with existential problems, it is unclear how and when the business will recover. No airline manager considers purchasing new engines while all the planes are on the ground. What is certain, however, is that Rolls-Royce's once very clear and positive outlook has become more than uncertain. In this regard, the coronavirus completely changes the business environment for Rolls-Royce. I, therefore, recommended selling the investment despite a bitter loss after a holding period of almost five years.

Triggered by the renewed sharp drop in oil prices in March this year, with **TGS-NOPEC**, an "old acquaintance", has once again been added to the portfolio.[3] The TGV Partners Fund has been invested in TGS-NOPEC in the past. The company has developed solidly despite the monumental crisis in oil and gas and is one of the best business models in the industry. Since we first sold our investment, Kristian

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[2] English Version at: https://www.mediqon-group.de/wp-content/uploads/2020/05/Mediqon_Group_annual-report-2019.pdf
[3] Please review letter of H1/2015 for a full description of TGS Nopecs business model.

Johansen and his team have consolidated numerous competitors and kept on track. After the company's shares have dropped by −65% since the beginning of the year, the valuation was so extraordinarily favourable that the TGV Partners Fund gladly took this opportunity to buy TGS-NOPEC again.

I have a long and special relationship with the second newly acquired company **DCC** from Ireland. During the period of the European crisis in 2010/11, stocks and bonds in the so-called PIIGS countries (Portugal, Italy, Ireland, Greece and Spain) came under great pressure in a short time. I remember that in a bank around this time, customers were actively approached, whether they in all seriousness wanted to own shares and bonds from these countries in the future. This warning regularly led to the sale of all relevant papers regardless of the underlying circumstances.

At that time I was hired as an analyst at Investmentaktiengesellschaft für langfristige Investoren TGV in Bonn. What banks branded as a risk was seen as an opportunity here. One of my first tasks for the CEO Jens Große-Allermann was to find healthy and interesting companies that were based in these countries but generated a large part of their sales and earnings in other countries. Perhaps the prices of these companies were unjustifiably under pressure? Based on this preliminary work, we travelled to Ireland in the late summer of 2011.

At the same time, guided by the brilliant recommendation by Don Fitzgerald, an Irish investor friend, we visited DCC, among others, and met the then-CEO of DCC, Tommy Breen, and CFO Fergal O'Dwyer. We loved it! Hat tip to Don! It was one of the first purchases I contributed to working for Investmentaktiengesellschaft für langfristige Investoren TGV. Since then, I have visited the company several times and have been able to build up a positive relationship and understanding of the people in charge today.

DCC, founded as **D**evelopment **C**apital **C**orporation, was originally focused on providing needed capital for young companies in Ireland. Over time, the company developed into a decentralised industrial holding with various business areas.

In DCC's two largest business segments (DCC LPG and DCC Oil), over one million customers are supplied with almost 2 million tons of liquid gas and 12 billion litres of oil per year. These two business segments now account for three-quarters of the holding's earnings. DCC is now mainly active in the UK and continental Europe and has a huge distribution network of almost 3,000 tanker trucks. The company earns a small and stable amount per ton of liquefied gas or litre of oil delivered. A typical distributor.

DCC has made several hundred mostly smaller acquisitions over the past 25 years and has continuously expanded and consolidated its own distribution network. The company is very accomplished and disciplined when it comes to acquisitions. They always focused on achieving a reasonable return and keeping indebtedness within reasonable limits. The result of this series of acquisitions is flawless; the journey has been spectacular. Since going public in 1994, operating profit has increased by almost 15% annually from GBP 15MM to nearly GBP 500MM.

In recent years, DCC was able to increasingly internationalise its business. Driven by the crisis in the industry, many multinational oil companies began to scrutinise and sell their own distribution network as "outside of the core business" to free up the capital needed for dividends, for example. This allowed DCC to benefit from the crisis in the industry and systematically bought good assets from willing sellers.

From the crisis in 2011 until 2016, DCC's share price has developed splendidly and far better than the operating results. I follow the company on a regular basis and have had great sympathy since my first visit. However, I was not prepared to pay a high price for a great business. The share price has been weakening slightly in the past four years, although the business developed very well. The valuation got better and better over time.

Driven by the corona crisis and the oil price crash, DCC's share price plunged sharply in March this year, at times even disproportionately to the overall market. This is even though the oil price has practically no influence on the actual business, and the business model itself is very stable and extremely resistant to the economic cycle. An excellent opportunity to finally recommend buying DCC for the TGV Partners Fund.

I expect that the worsening crisis in the oil and gas industry will continue to be positive for DCC. The central part of DCC's compounding engine is to make numerous good and affordable acquisitions in this area. The more willing sellers and offers, and the fewer potential buyers, the better for DCC.

Five years of TGV Partners Fund

Beyond the Corona crisis, there actually *were* positive news in this first half of the year. At the end of March 2020, the TGV Partners Fund celebrated its 5th anniversary. The time since the inception passed in a flash. In the past, I emphasised several times that I do not attach any importance to short-term price development. I stand by that. An investor should only be assessed after a minimum of five years, the longer the period, the better. The assessment should include times of rising markets and especially times of falling markets.

Now that five years have passed, I should be assessed based on my words. For this purpose, I would like to provide you with some data points beyond the mere price performance, which I consider important for an assessment. I plan to continue these data points every five years.

The TGV Partners Fund has achieved a return of approximately +50% or around +8% p.a. over the past five years. Solid, but far from exceptional. A bit better than most broad indices, but admittedly a little worse than I had secretly hoped for.

If you compare the result with different indices, it becomes clear that there has been a large spread of results in the markets over the past five years. The sun did not shine everywhere. In short: Everything that has included a lot of technology, especially in the USA has developed excellently over the past five years: Nasdaq: +134%, S&P 500: +57%. The rest of the world was sluggish: MSCI World: +34%, Eurostoxx50: +3%, MSCI Emerging Markets: +7%. Some sectors were downright catastrophic: European banks: around −50%, energy worldwide: −39%.[4]

[4] Examples of some Exchange Traded Funds (ETFs) that reflect these developments: (Nasdaq100: IE00B53SZB19, S&P500: IE00B5BMR087, MSCI World IE00B4L5Y983 Eurostoxx50 IE00B53L3W79, MSCI EM: IE00BKM4GZ66, Stoxx Europe Banken: DE000A0F5UJ7, and MSCI World Energy ELU0533032420).

Price-performance vs operational performance:

I consider the long-term and substantial development of sustainable profitability to be much more important than rising prices alone. Sustainable earning power is one of the key parameters by which I evaluate the various companies in the TGV Partners Fund and compare them with alternatives.

It 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 frame.

In my opinion, the sustainable return of the companies in the TGV Partners Fund at the inception of the TGV five years ago was around EUR 6.50 per share. To date, this amount has grown by around 10% annually to approximately EUR 11 per share. If the sustainable profitability within the companies in the TGV Partners Fund can continue to be increased, this will almost inevitably be reflected in a further increase in the share price and a positive return for the TGV.

It should be noted once again that this key figure is a robust but also a theoretical construct. On the one hand, I adjust, normalise, and estimate influencing factors for the result. On the other, I have no control over the investment behaviour of companies. I have rarely seen the assumption that a company “stops investing from now on” in practice.

Nevertheless, this methodology serves me as a basis and is part of a broader philosophy to consider the valuation and above all, the reinvestment opportunities of the companies in question. The combination of today’s profitability and future growth determines the value of a company. Growth requires investment. These investments are then not available for distribution as a dividend.

Fact is that the companies in the TGV Partners Fund have distributed about 20% of the sustainable earnings I have estimated over the past five years as dividends or share buybacks. The remaining 80% of the funds have been reinvested in the form of investments in future growth and have strengthened sustainable profitability.

That this sustainable profitability has only grown around 10% p.a. over the past five years and thus less than I had hoped for, was because the TGV, beyond the share of excellent investments that were able to increase their profitability extraordinarily (Tucows, Gruppo MutuiOnline, Alphabet), also held a not negligible share of investments that developed significantly worse than expected. To date, these investments have not been able to increase their sustainable earning power, or have increased it only marginally, and have diminished the portfolio average. The goal for the future must be to reduce such poorly performing investments for the next five years. Of course, this is easier said than done.

Based on the available data, I am optimistic: In my opinion, the valuation of the companies in the portfolio today is overall somewhat lower than it was five years ago. On average, the companies in the TGV Partners Fund have practically no debt, are moderately valued and have structurally excellent growth prospects. If you put these facts in relation to a world in which interest rates remain at zero and many companies are facing major structural challenges at the same time, this makes me extremely optimistic about the years ahead.

Interest rate level and valuations

Todays' historically low interest rate level will be a challenge in the coming years or even decades. Based loosely on Newton's apple and gravity: There is no gravity without interest. Asset prices become weightless and rise. Due to the historically sharply dropped interest rates in the past years, future growth has become increasingly valuable, and the prices of many assets have risen significantly.

Many companies that are likely to grow strongly are now given historically high ratings. Revenue multiples of 20 or 30, formerly a rare occurrence, are the order of the day. If these companies stopped growing today, many would hardly have sustainable profitability and thus little value. The total value depends on positive future development.

This enthusiasm for "safe growth", which has rallied in recent years, can be seen particularly impressively in the composition of the large indices. The five largest companies in the S&P 500 and MSCI World (Microsoft, Apple, Amazon, Alphabet, and Facebook) are all companies that, according to consensus, are heading towards a bright future. The operating results of these companies have been excellent over the past five years, and the share price development has been spectacular.

In retrospect, the right strategy over the past five or even ten years would have been to focus solely on profitability in the distant future. Nevertheless, I was never able to jump my own shadow and never completely detach myself from today's profitability with my methodology. Especially since in the past, there have been numerous times during which you did not have to make this compromise. In the first bi-annual letter of the TGV Partners Fund in 2015, I wrote: "*Under these circumstances, some of these large "mega caps" and "internet companies" like Google or Microsoft are very attractive in the long run because they are currently priced in accordance with the overall market, but have a structurally very different outlook than the average companies."*

The prices of these companies have risen much faster than the underlying operating results in the past five years. "Safe growth" is the hottest thing on the market. The price of Microsoft shares, for example, has increased fivefold during this time, that of Amazon sixfold - while the sales of Microsoft during this time have increased by +50% and those of Amazon by almost +300%. The valuation of these companies has increased in recent years, and today they are no longer valued "similar to the overall market".

Five years ago, the five companies mentioned above were still weighted with around 10% in the S&P 500, today they have a share of around 22%. Almost a quarter of the index! A similar effect exists, albeit in a weaker form, in the MSCI World – evidence of the fantastic price development these companies have achieved. And even though they are excellent companies with excellent prospects, much more of this "safe growth" is priced in today than five years ago. This massive tailwind has made the S&P 500 one of the best indices in the world in recent years. Without these stocks, the S&P 500 would have performed significantly worse. A portfolio without technology stocks at all has certainly had difficulties compared to the broad market.

The problem of expanding the valuation this way is that it usually does not go on forever and is not as sustainable as a persistent increase in profitability. If, for example, the earnings multiple doubles from 17x to 34x within five years, it is, of course, possible that the valuation will increase to 70x within the next five years. But it is unlikely.

A word of warning is in order: it can sometimes take many years for this premature praise to be supported by operating results. For example, when Microsoft was last regarded as a "sure-fire investment" in 2000 and was awarded an extraordinarily high valuation with a earnings multiple of around 70x, it took sixteen long years – supported by excellent operating results – until the share was finally able to reach new heights from 2016.

With this, I don't intend to predict that the future looks bleak for markets in general or Microsoft in particular. By no means! My message is rather that with very high valuations, operationally excellent results must follow so that these valuations make sense afterwards. For those companies that do not deliver outstanding results in the years that follow – naturally, there will be many of them – great pain is inevitable.

Although I understand the great value, some of these rapidly growing companies can have, being too dependent on future growth and paying a very high price for it today goes against my concept. I am very aware that profitable future growth is particularly valuable in a time of extremely low interest rates. But I shy away from relying solely on future profitability and always look at the profitability that can be achieved today.

Corona's influence on the portfolio

Of course, you are wondering what impact the Corona crisis will have on the companies in the TGV Partners Fund: There is no easy answer here, especially since we are still in the thick of it.

In my estimation, Corona will leave little structural change in people's behaviour. Especially if a vaccine and/or a cure for COVID-19 is found in the near future. Humans are creatures of habit who find it difficult to break with old habits. However, I assume that Corona has drastically accelerated existing trends. Although these trends were recognisable beforehand, they would not have accelerated as quickly without a crisis. I lost track of how many times have I heard from older friends and acquaintances in the past few weeks that *"Netflix is really convenient without advertising, on-demand viewing, and a huge selection."*

We were able to observe this influence in some companies in our portfolio: **Naked Wines**, **Interactive Brokers**, or **YouTube**, for example, the subsidiary of **Alphabet**, could hardly cope with the rush of new customers during the first months of the crisis. These companies were able to record a multiple of the normally expected new customers. With regard to the portfolio, let's hope that these new customers will permanently include the goods and services on offer in their everyday lives and thus replace old shopping and usage habits.

Overall, more than half of the portfolio is active in areas that are directly or indirectly related to, and benefit from, greater use of the Internet in all areas of life in the future, which is extremely positive, as it ensures structural growth for the companies concerned. This fact, combined with the reasonable valuation and financial stability of the companies mentioned above, is an excellent combination for withering a storm on the high (investment) seas.

Investor meeting

Due to the corona crisis, the annual meeting of investors of the Investmentaktiengesellschaft für langfristige Investoren TGV that was planned for June 6, 2020, in Bonn-Bad Godesberg had to be cancelled. There will be a virtual meeting on September 5, 2020, to make up for it. Of course, nothing can replace the personal contact – but hopefully, it will only be a temporary solution until next year.

As a TGV partner, you will, of course, receive an invitation. As always, please feel free to contact me with questions at any time.

Stay safe and healthy!

Kindest regards,

Mathias Saggau