Investmentaktiengesellschaft für langfristige Investoren TGV

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Dear investors

Attached, you will find the annual report for the year 2017 provided by our sub-advisor JMX Capital GmbH for the sub-fund „Truffle“.

Yours sincerely

Investmentaktiengesellschaft für langfristige Investoren TGV

Dear Investors,

TGV Truffle can be considered a success, if the performance in the long term is not only higher than 6% per year but also outperforms the Berkshire Hathaway A share (measured in euros). Every investor in TGV Truffle could make a liquid, cost-effective, diversified, and well-managed investment through an investment in Berkshire Hathaway. At the same time, significant returns have to be made in absolute terms to increase the purchasing power of the invested capital.

So far, TGV Truffle has surpassed the 6% per year while slightly missing the Berkshire benchmark. Congratulations Warren! However, the insights gained from those results are limited, since TGV Truffle has not been on the market that long. I am not quite sure when it is going to make sense to announce a representative intermediate status based on the performance figures. Maybe after five years, by the end of 2020? Perhaps later? In any case, at least one significant capital market correction should have fallen into this period, as such a correction often reveals the weaknesses of a strategy.

In the short term, however, it is worth to compare the price development of the portfolio companies with their operating performance. For the year 2017, I am pleased that my assessment of the fundamental value of the portfolio companies has risen significantly more than the prices of the companies. In this respect, despite the already pleasing price performance in 2017, I am optimistic about the future return of the TGV Truffle portfolio.

Measuring and weighing

As always, please find the most important portfolio and performance data of TGV Truffle in the following table.

NAV as of 12/31/2017 in EUR	120.96
Total number of investments	9
Weighting largest investment	26.6%
Weighting Top-5 investments	78.3%
Weighting cash / fixed deposit	0.4%

Alphabetical Listing of Top 5 Investments:

Amaysim

Microsoft

Now

Tripadvisor

Tucows

Period	TGV Truffle (in EUR)	Berkshire (in EUR)	*(Difference)*[1]	6% p.a. Benchmark	*(Difference)*[1]
2015[2]	-12.5%	-10.0%	*(-2.5%)*	+4.5%	*(-17.0%)*
2016	+18.1%	+27.5%	*(-9.4%)*	+6.0%	*(+12.1%)*
2017	+17.0%	+6.9%	*(+10.1%)*	+6.0%	*(+11.0%)*
Since inception[3]	+21.0%	+22.6%	*(-1.6%)*	+17.4%	*(+3.5%)*

Portfolio changes

The most significant change in the TGV Truffle portfolio over the past six months has been the purchase of Tripadvisor. The business model is easy to explain: The company provides a platform on which people can post reviews of hotels, restaurants, and activities. The website is an excellent resource for many travelers, especially when it comes to planning trips to unknown places. For hoteliers and restaurateurs, Tripadvisor is a vital customer acquisition channel, and good reviews on Tripadvisor are often used for advertisements. The company makes money by getting a commission for forwarding customers from the website (or app) to booking sites, hotels, or table reservation providers. This business model is highly profitable and allows for growth without the investment of additional capital. The online travel market is highly competitive, and Internet giants such as Google are trying their hand at cutting the ground from under the feet of companies like Tripadvisor with their local advertising products and map apps. Still, in the third quarter of 2017, visiting Tripadvisor seemed worthwhile for 455 million unique users. Furthermore, the number of these users is growing at a rate of approximately 16% per year and the number of reviews on the platform at a rate of more than 40% per year.

[1] Rounding can lead to minor deviations in the differences.
[2] 03/31/2015 – 12/31/2015
[3] Since 03/31/2015

I have been following Tripadvisor since its spin-off from Expedia more than five years ago. An experience from that time remains in my head until today: I traveled to Cambodia and drove eight hours from Phnom Penh to Kratie to see an endangered species of river dolphins there. Arriving in the quite rural Kratie, I found our hotelier with a bucket of paint, painting the front door. He tried to paint a colorful owl (the logo of Tripadvisor) because, on Tripadvisor, his hotel had recently been rated the best hotel in Kratie. Tripadvisor sends out stickers with the words “Tripadvisor Traveler’s Choice”, but our host did not want to wait for the stickers to arrive. His standing on Tripadvisor was too important for him! Since then, I have experienced countless similar stories in different places around the world. The rating on TripAdvisor is by far the most important quality seal for the global travel industry.

So far, I lacked clarity in two aspects to make an investment recommendation. First, how much does Tripadvisor have to invest for users coming to the site through the Google search engine? Second, can Tripadvisor convert even more users into revenue, especially on mobile devices?

As far as question one is concerned, just a few years ago, it was a profitable business model to bid on the general terms such as “hotel in New York” in the Google search engine. Tripadvisor was able to acquire customers, inform them about a hotel, and still generate a margin by forwarding them to a booking page. This Google keywords auction has become more efficient (meaning more expensive) over time. Today, the relatively clumsy acquisition of users by bidding on generic keywords is no longer profitable. For a long time, it was unclear how high the share of the profit from this user group in the total profit of Tripadvisor was. Since this profit contribution was likely to erode further, for a long time I did had no way of reliably estimating the earning power of Tripadvisor within the business valuation. However, this has been considerably clarified over the past few months as both Tripadvisor, and numerous competitors significantly reduced their advertising on Google – without any impact on profits. This suggests that the auction prices for keywords in the travel market have reached the break-even. Therefore, this channel generates only a small contribution to the overall profit of Tripadvisor.

The second previously unclear point – the future increase in revenue per user – has also become much clearer lately. It seems that Tripadvisor has substantially increased its ability to motivate users researching on mobile devices to book a service. Especially when it comes to reviewing and researching restaurants – which often takes place on the smartphone – there is much tailwind. Users are more and more willing to reserve a table directly on their mobile app, and more and more restaurants are offering this service. Tripadvisor should, therefore, be in a position to charge considerably more for the advertising value it provides to the restaurant.

Tripadvisor has a good chance of generating 300 million USD a year in free cash flow in the medium term. Based on the current market capitalization, this represents a return of around 6%. Furthermore, approximately 10% of the market capitalization is surplus liquidity on the balance sheet, which is likely to be distributed to the shareholders following the most recent US tax reform. Tripadvisor's management expects double-digit revenue growth in the long term. Given the current growth in the number of users and the potential to increase revenue per user, I am convinced that this is, in fact, achievable. At the same time, Tripadvisor's cost base is more or less fixed and an increase in sales of, e.g., 10% should be reflected in an operating profit increase of more than 15%. At the current price level, this combination of growth and return should allow for attractive returns over the coming years.

A word about the management: CEO and founder Steve Kaufer impresses me as an entrepreneur who deliberately makes painful short-term investments to achieve a good long-term return. This is easy to say, but in the extremely short-lived world of investors in big technology companies, such behavior is rare and unpopular. The Tripadvisor management team increases the fundamental value of the company while accepting a sometimes extremely volatile company valuation on the capital market. Only a small portion of the world's managed assets can accept such brutal short-term price swings in exchange for long-term performance, as poor performance in one quarter usually means the loss of customers and/or jobs.

In the context of the long-term investor base of TGV Truffle and the non-institutional decision-making processes, I consider cases such as Tripadvisor to be the absolute "sweet spot" of the truffle search.

India

As announced in the semi-annual letter, I lived in India from September to December to better acquaint myself with the local market. I have been following a handful of Indian companies for several years, and the purpose of the trip was to develop my knowledge of these companies. Furthermore, I wanted to get some new, exciting companies on my radar. All in all, the trip was a complete success, and I highly recommend India as a travel destination. A particular highlight of the trip was the interaction with local investors. With the help of some Truffle investors, I had been in contact with some excellent local investors already before the trip. They all took much time to take the young German investor by the hand and guide him past the most dangerous shoals of the market. I am grateful for these encounters and learned a lot.

I would like to share some investment-related impressions from India:

1. Automation

   One of the success stories of the Indian export industry has been the growth of the IT outsourcing industry over the past 20 years. One driver is the high number of well-educated, young English-speaking workers. This army of workers can offer standardized processes – from accounting to programming to hotlines – at significantly lower unit labor costs than in the

Western world. This resulted in a win-win-win situation over decades. Western companies were able to buy services at a lower cost, an oligopoly of large Indian outsourcing providers earned margins of up to 40%, and young people were able to find jobs directly after graduation, some of which paying ten times their parents' wages.

The sticking point is that many manual tasks (especially in the IT sector) will be taken over by machines in the next ten years. This development is not limited to the IT industry: The proportion of manual labor in India is incredibly high. From a certain income level, it is, for example, unusual to drive yourself to work. You treat yourself to a driver. Every elevator in better hotels is operated by an elevator operator. Some of these jobs are utterly pointless and redundant. To illustrate this redundancy, it is not unusual for a ticket to be checked three or four times between scanning of the boarding pass and actually boarding the plane.

However, it seems that the provision of a great many simple jobs is an important part of the Indian social contract. Unlike in Western Europe, there is hardly anything that could be called a national social security system. By offering many simple jobs, Indian society avoids too much unemployment and social discontent. It is therefore uncertain how automation will change the Indian society. Can the current social contract persist if millions of people are replaced by machines?

2. Entrepreneurship

As much as the previous point worries me, I am impressed by the resourcefulness and entrepreneurial spirit of the Indians. The majority of jobs in India are in the so-called informal sector. Tour guides, engineers, or artisans are usually self-employed or pseudo-self-employed. Of course, this entails various problems. For example, less than 5% of Indians pay income tax. Another consequence of the high proportion of self-employment is high resilience to changes and the pronounced efficiency of these many hundreds of millions of small-scale entrepreneurs (and especially the women among them). As a result, more jobs are likely to be threatened by increasing levels of automation in India than in other countries, but at the same time, the entrepreneurial flexibility of many Indians makes me optimistic about the ability of the country to be antifragile to change.

3. Change through reforms

The reforms India has initiated over the last five years are impressive. The most significant measures are (1) the biometric recording of all citizens, (2) the harmonization of the different federal value added tax rates to one uniform national value added tax, and (3) the abolition of two cash lot sizes to combat corruption with a simultaneous regulatory strengthening of electronic payment methods. In daily business life, these three measures result in a significant increase in efficiency. Before those reforms, a delivery between Indian states, for example, required an import declaration or customs duty had to be paid, which not only incurred costs but also led to delays.

The aggregate economic effect of the reforms should be unequivocally positive.

However, I wonder how far the competitive advantages of many Indian business models over the past few decades are simply due to the shrewd tactics of coping with local regulation. It is striking that some companies in India are showing significantly higher returns on capital than similar business models in other countries. On closer inspection, it appears that the high returns on capital can be explained in particular by distribution channels that are very difficult to replicate. In India, it is often difficult for incoming competitors to copy supply chain logistics that have been calibrated over many years. It may very well be that this competitive advantage is rather a symptom of the pre-reform India and that some companies' high return on investment that has previously been achieved this way will sooner or later erode.

4. Attitude

The most positive impression was left by the Indians' attitude towards progress. Across the board, I saw a desire for growth and social advancement. The conviction that this (social) advancement is possible on one's own accord and also *locally* in India is particularly impressive. The often-described advancement of families into the growing middle class and the interest in participation in the economic ascent of India is palpable everywhere. Status symbols (certain brands of motorcycles, clothes, and cell phones) are extremely important to people, and the motivation to achieve more material wealth is seldom lacking. I was a little surprised that there was hardly any talk of emigrating from India. Although my interlocutors have occasionally studied abroad or have been able to travel to other countries, they always considered the center of their lives and the future of their careers to be in India. This is remarkable, especially in the context of a vast global Indian diaspora and growing mobility options.

5. Limits of research

Immediately after returning to Germany, I began intensive research of a company with business activities in the UK and Germany. I have known the company for a long time, but due to recent changes, I suspect that the value of the business may be significantly higher than previously assumed. As a secondary finding, it became clear to me how much easier and more direct the analysis of a company is when you are based in the same country. You can call the hotline, make test purchases, conveniently talk to a number of customers and assay various competitors.

Of course, this is per se also possible for Indian companies. However, humility towards local characteristics is important, and there are many business models that an Indian investor can assess much better. There is only a small group of Indian companies for which I dare to assess customer benefit, competitive situation, and management from afar and through regular visits. However, this group of companies is smaller than initially thought and has changed quite a bit because of my extended stay in India. Yet I feel very comfortable with this handpicked group of companies, and maybe one day there will be an investment recommendation.

Recommended reads

It is nearly impossible to travel India for several months without experiencing long hours of train travel. Shortly before one of these trips, a friend suggested that I should browse "The Long Read" segment on the online presence of "The Guardian". These articles were wonderful companions on the subsequent journeys and opened up many new perspectives for me. The "Long Reads" are excellently researched articles on mostly contemporary social topics. Little is better than reading dozens of "Long Reads" on a ride in a sleeping compartment in India. By now, there are many of these articles online, and often the content does not lose importance over time. To maintain my reading habits of this genre, I have adapted them to my travel habits at home: The time that passes on a short-haul flight from sitting down to the beginning of the onboard service, is enough for reading one "Long Read". Give it a try, it is worth it!

Outlook

On behalf of the Investmentaktiengesellschaft für langfristige Investoren TGV, I would like to cordially invite you to our annual investor meeting on 06/16/2018 in Bonn. Come to Bonn in June to learn more about the Investmentaktiengesellschaft and get to know the team behind the scenes! An official invitation will be sent to you in the coming weeks.

Until then, I wish you a great spring and thank you for the continued trust.

Kind regards,

Jan-Hendrik Mohr

JMX Capital GmbH