Investmentaktiengesellschaft für langfristige Investoren TGV

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Dear investors

We are enclosing the shareholder letter for our Teilgesellschaftsvermögen "Truffle" concerning the first half of 2015 written by our sub-advisor JMX Capital GmbH.

Yours sincerely

Investmentaktiengesellschaft für langfristige Investoren TGV

Report of the Sub-Advisor for the first six months 2015

Dear investors,

The TGV Truffle has been launched in April 2015 and I am delighted to submit this first investor letter to you.

What is the actual purpose of an investor letter?

In my mind, a good investor letter does three things:

First, it is designed to inform the readers about the performance and activities within the portfolio. This is particularly important in the case of TGV Truffle, because I do not intend to make comments using other channels (such as interviews in magazines or a blog). This is due to my firm goal to provide a trouble-free and independent environment for my work. Particularly current political or macroeconomic issues attract enormous interest in business papers or on stock market TV, yet they have little impact on the long-term value of companies. Avoiding these everyday influences means that I do not necessarily have to have an opinion on each and every one of these issues. In the investor letters I would much rather like to inform you about the topics that are actually relevant for our investments.

Second, you, the readers, should enjoy my investor letters and perhaps even draw some inspiration from it. Unprecedented example of an inspirational investor letter is Warren Buffett’s annual letter to the shareholders of Berkshire Hathaway. Since as a teenager I first found out about this letter, reading it on the Saturday morning after its publication has become a beautiful ritual for me. You can tell Buffett's letter was written over several months and was proofread and edited by one of America’s best business journalists. I do not dare to claim that I will ever reach Buffet’s literary quality, but my goal is to write letters that you enjoy reading and that will not just end up in your desk drawer.

Third, my clearly worded and content-wise focused investor letter helps me to structure my thoughts and submit my conclusions to a good reality check. Since my letter is not primarily aimed at professional colleagues with financial background, I want to explain all the ideas in and understandable way and without jargon or too much complexity. However, I can only succeed if I can sort out my thoughts before writing them down and recognize the essential core of each analysis.

Consequently the question arises how frequently the investor letter is going to be issued in the future. I would like to explore this empirically and start with the initial hypothesis of a semiannual letter. The formulation of my thoughts (third article above) would speak for issuing numerous letters, since that way I would get to examine my ideas more frequently. On the other hand most of the time there is simply not a lot of exciting news to report about my work (other than reading and analyzing the umpteenth business report – and I definitely don’t want to bore you with that!). Therefore it is an important part of success to know when it’s best to do nothing.
Let's start with a semiannual letter and in case I realize that the letters turn into fluff pieces or there are simply no new ideas to report, I might extend the intervals.

Measuring and weighing

I consider it particularly important to present the results and portfolio investments of TGV Truffle in a consistent and transparent manner. Therefore I chose a way of illustrating it to you, the readers, that allows for an easy overview of any changes (or lack thereof) at first glance:

NAV as of 06/30/2015 in EUR	96.95
Total number of investments	9
Weighting largest investment	14.5%
Weighting of the top-5 Investments	54.4%
Weighting cash / fixed deposit	23.5%

Alphabetical Listing of Top 5 Investments:
Aggreko
Google
Leucadia
Microsoft
National Oilwell Varco

Period	TGV Truffle	Berkshire (in EUR)	*Difference*	6% p.a. Benchmark	*Difference*
Since 04/01/2015	-3.05 %	-9.20 %	*6.15 %*	1.50 %	*(-4.55%)*

An interesting question in monitoring the performance is which benchmark to actually choose, since in the financial industry the paradigm of the benchmark has prevailed. Many funds compare their results with an index, e.g. the DAX or Euro Stoxx 50, with indices being accepted as a given representation of the stock market in recent years. The following applies: better than the index = good fund, worse than the index = poor fund. I wish my performance evaluation to be more sophisticated; a look into the history of the indices will help to understand my intention.

The oldest stock market index in the world - the Dow Jones Industrial Average - was created in 1884. The founding father of the Dow Jones, Charles Dow wanted to create an indicator, which provided a quick and clear picture of the fluctuations of the US stock market. So initially the index consisted primarily of railway companies, precisely because they were representative of the US economy at that time. Even today, the components of the Dow Jones are selected based on subjective criteria by Wall Street Journal journalists.

The idea behind this concept is that the Dow Jones should always represent a cross-section of American industry. A lot has happened since 1884 and over time "investment suitability" of the index has become more and more important. Especially large institutional investors such as pension funds have been looking for easy ways to invest large amounts of money in certain countries or sectors.

Old indices like the Dow Jones, however, were difficult to invest in because the original purpose of the calculation was purely informational and Charles Dow had certainly never imagined that one day large investors would want to invest trillions of dollars in the Dow Jones index as such. The high demand for investments directly into the indices has over time led to a weighting of indices for possible investment volume.

Thus the German DAX 30 does not contain the most representative companies in Germany, but the 30 companies in which you could invest the most money. This is due to the so-called weighting by free float, i.e.

the market capitalization of those shares, which are not in the hands of major shareholders (the criterion "major shareholder" is chosen rather arbitrarily). In Germany for example this results to the fact that E.On and Continental currently have both the same DAX weighting of approximately 2.60%. However, since Continental is controlled to almost 50% by the Schaeffler family, only half of the market capitalization is considered in the calculation basis - the fact that the entire market capitalization of Continental is twice as high as that of E.On is completely ignored!

It is a common argument that the comparison of an "active" fund with a standardized benchmark is necessary, since a "passive" investment in the benchmark would be the next best alternative to "active" stock-picking. I consider this argument a misconception. Although the purchase of an index (e.g. by means of an ETF) is often the most convenient alternative to investment funds such as the TGV Truffle, it does not necessarily reflect the investor’s actual opportunity cost.

The crux of the matter is that a lot of the actors on the capital market do not really care about the available market liquidity. Even very large investors are highly unlikely to have a major problem purchasing enough Continental shares instead of E.On shares. As I select the shares for TGV Truffle based on relative opportunity costs ("why buy a twelfth position when I can invest more capital in my largest position?"), investors in TGV Truffle should not forget to consider the opportunity costs as well. But what is the logical alternative investment to the TGV Truffle, which any long-term investor could choose virtually unquestioningly?

For me the answer is clear: Berkshire Hathaway, the investment holding of Warren Buffett. Led by a team surrounding the best investor of our time, diversified by investments in many different countries and all that with daily liquidity through its listing at the stock market. When someone asks me for my "stock picks", the best answer would most probably be Berkshire Hathaway, because the stock could actually be an ideal investment for long-term asset accumulation for many people.

Should I for a long period of time not be able to beat the benchmark Berkshire Hathaway with TGV Truffle, I should rather invest all my money in Berkshire Hathaway stocks and find a new job. This applies even more to my investors: given such an attractive investment alternative as Berkshire Hathaway TGV Truffle has to create real added value to justify the investment.

Nevertheless I also measure myself using an absolute benchmark, which is also the basis for calculating the performance fee of the fund. This benchmark is set at 6% p.a. and should represent a robust estimate of the long term return of an investment in the stock market. Numbers crunchers may be puzzled here, since the return (in particular in the US equity market) a lot of times is significantly higher than 6%. But here it is to be noted that these historical figures originated mostly in the context of very positive economic trends – 40 years post-war boom of the United States for example – or significant inflation. Looking at the long-term performance of stock markets in a less rosy context (e.g. United States before the WWII!) leads me to express somewhat dampened expectations.

Let’s look at it from another point of view: should the current inflation (or rather deflation in Europe) last, 6% p.a. nominal return should lead to a doubling of purchasing power every 12 years. For me as a 26-year-old investor in the TGV Truffle this would mean that every Euro I invest today would have eight times the purchasing power on my 60th birthday. There are less appealing outlooks than this, aren’t there?

Big truffles

TGV Truffle is named after the Tuberaceae family within the Ascomycota division of the Fungi kingdom because my goal is to identify high quality companies which have gone undetected or are currently covered with "dirt" - as an analogy for truffle hunting. As successful truffle hunter one has to understand two things: First, what is a good truffle? Second, where to go hunting for those truffles?
Many market participants uphold the opinion that you can find better chances in the stock market the smaller and more obscure the companies you look at are. Argument is that the inefficiencies of the capital market are greater there, since fewer professionals would even bother looking at the respective companies. The classic

question is: "what can you analyze better than the many dozen Wall Street analysts covering that particular stock?" My answer: maybe I cannot analyze it better, but I can take a long-term perspective and above all I am independent!

As an example I would like to compare an investment in a German small or midcap with an investment in Microsoft (the ultimate "large cap"). When looking at the investor base of most small or midcap stocks in Germany (and probably worldwide), you will likely find a mix of founders / management, private shareholders who appreciate the dividend, and perhaps a handful of specialized small caps funds. The stock is probably relatively illiquid; shareholders are holding their shares long-term and there is often a close bond (pun intended!) between companies and shareholders. A lot of time the management delivers information pro-actively, is highly responsive to shareholders and you will always see the same faces at the annual general meeting.

If an investor buys or sells a stock, then the counterparty is likely an investor who had been – figuratively speaking – sitting three rows down at the annual general meeting. It is also likely that this counterparty has in one way or another actively considered the outlook of the company. Maybe not with the quantitative knowledge of a Wall Street analyst, but possibly as a supplier, employee or pensioner with knowledge that is likely to be crucial for the long-term future of the company. In summary, my counterparties are probably investors who are – just like me – looking for truffles in similar places and in a similar way.

With Microsoft this is different .The currently largest four shareholders of Microsoft are all rule-based funds, which aim to replicate the entire US market. If I buy or sell Microsoft today, my counterparty is probably not another investor but a computer. Of course, there are many analysts who focus on Microsoft as well and these analysts are all intelligent people who have better access to the management of Microsoft than me.

The only problem is that the clients of the analysts are large active investment funds whose fund managers are not investors but salaried managers. These managers have to consider not only the actual investment risk, but also the career risk, should their own performance deviate too much from the benchmark. As a fund manager of a large investment company you can simply not afford trailing behind the market for a year or two (and heaven forbid if this is the case for an even longer period of time!).

Consequence is a quite short-sighted focus on quarters, frequent trading to limit losses and making at best marginal decisions that deviate from the benchmark. Yet fund managers have a symbiotic relationship with analysts, because the latter are usually paid by the trading commissions of the fund. The more trades are made before and after the quarterly figures the better. For Microsoft, this means that every year as many shares are traded as the company has issued. If you deduct the important long-term shareholders (e.g. founder Bill Gates, not to mention the Government Pension Fund of Norway and the TGV Truffle), the free float is likely to change hands several times a year.

Therefore it is hardly surprising how few questions the CEO of Microsoft gets actually asked about to long-term outlook of the company in the quarterly teleconferences. Granted, the analysts frequently ask for the expected tax rate for the next quarter – but given that focus, do they have a better understanding of the long-term value of the company than me? This analysis published last April by a US investment bank makes me doubt that:

Microsoft Corp. (MSFT)

BUILD/FAB Takeaways – Long-term Story Sounds Promising; Near-term Path Unclear

Sell	**3**
Price (29 Apr 15)	US$49.06
Target price	US$37.00

- **Very positive long-term picture painted** — At today's Financial Analyst Briefing, management further focused communication around three strategic imperatives including more personal computing, reinventing productivity and building the

"Long-term story sounds promising; near-term unclear: Sell!"

In my advice for TGV Truffle I am perfectly fine to live with this short-term uncertainty. Perhaps we have even bought our Microsoft shares from the bank that issued this analysis.
As a real long-term investor, I can use the short-term nature of the marginal buyer or seller and deliberately choose places for our truffle hunt, where competitors have a very different perspective than I do. This does not mean that I want to exclude investments in small companies (on the contrary) - but I think it is just not a necessary precondition to recommend solely small, seemingly undiscovered companies.

An example

In this letter I would like to explain an investment of TGV Truffle in some detail, because it is a fine example of a truffle hunt.

For several weeks the TGV Truffle has continuously been building up a position of Rolls-Royce plc. The British company comprises a mix of various industrial sectors, with the largest part of its profitability coming from the construction and maintenance of aircraft turbines. Along with GE Rolls-Royce holds a duopoly in the field of long-range aircraft engines. For the A380 for example, there are only engines of either GE or Rolls-Royce available. The new Airbus A350 XWB is exclusively equipped with Rolls-Royce engines.

The entry barrier in the field of aircraft engines is extremely high, because the development of a new engine will take many years and can easily cost billions of Euros. Furthermore, the industry is highly regulated and airlines as well as aircraft companies have no interest in experimenting with new competitors. It is now quite common for airlines to no longer buy the engines but to lease them from the manufacturer. The leasing payments are agreed upon as a fixed amount per flight hour, this means sales for Rolls-Royce engines are increasing and decreasing quite precisely with the global long-range flight volume.

Herein lies the appeal of the business model, because it is very likely that the volume of air traffic will continue to grow in the coming decades. Due to a worldwide growing middle class more and more people can afford to fly. Europe has a 17-times higher flight volume per capita than India for example. Given India's economic development, this gap will close little by little in the years to come and the growth of the industry is likely to be secured for decades.

In a 2013 market survey Airbus assumes an annual increase of 5% in air traffic by 2033, which approximately corresponds with the absolute growth over the past 30 years. In my view, the growth assumptions for the number of long-distance flights are particularly robust, as they are subject to much lower technology risks.

There is for example a scenario that in China more and more medium-range travel will be shifted to rail, since trains are a much more energy-efficient means of transport than aircraft (especially on relatively short distances). In the field of long-range travel, however, there is no alternative technology to the aircraft.

There are relatively few industries which benefit from such robust, long-term and strong growth trends such as the aircraft industry. Even more rare, however, are companies that are experiencing this kind of growth in a market where they are relatively protected from competition and can thus achieve a high return on their invested capital.

Rolls-Royce is such a company. Given the high durability of the product (a turbine is used 30-40 years), the contractual obligation of airlines to lease the turbines or to buy spare parts, and the exclusive right to sell turbines for certain aircraft types, the growth in long-range air traffic should prove to be beneficial to Rolls-Royce. So we should bear in mind that each long-range aircraft, which is flying right now or will be built by 2020 (at least), will either be equipped with GE or Rolls-Royce engines and those engines will remain on the aircraft for 30-40 years!

From 2020 the new Boeing 777x (equipped with GE engines) will go into production. It is currently the only foreseeable competitor to existing long-range platforms. Within this context we have to note that the previous efficiency results of the 787 Dreamliner (60% market share Rolls-Royce engines) and the A350 XWB (100% market share Rolls-Royce engines) are excellent and these aircraft are experiencing outstanding sales. As a once sold aircraft will remain in service for decades, the results for Rolls-Royce are highly likely to experience a robust growth.

The legendary investor Peter Lynch once said “I like buying companies that can be run by monkeys - because one day they will be”. This offhand remark is quite fitting when we take a look at the past ten years of Rolls-Royce company history. Yes, management has furthered the company's growth and the development of new products excellently. But unfortunately also a number of serious mistakes in the allocation of capital and the financial management of Rolls-Royce have become evident.

In recent years large amounts of money have been invested to "diversify" Rolls-Royce and to reduce its dependence on aircraft turbines. Why anybody would favor business models that are at best average (construction of diesel generators, maintenance of nuclear power plants) over one of the best business models of all times remains incomprehensible to me.

Luckily, those miserable management decisions had little impact on the operating performance or the price of the Rolls-Royce share (hence the reference to the quote!). Despite the weakness in recent months, the share price has tripled since 2005 and the sales have increased by about 9% per year. I have been following Rolls-Royce and other companies in the industry for several years.

Apparently under pressure from other shareholders, a large part of the Rolls-Royce management team has been replaced in the past 18 months. So when the CEO resigned in April 2015 and was replaced by an apparently capable successor, I decided to begin buying.

What makes Rolls-Royce a good investment?

In the last ten years Rolls-Royce increased its profitability before taxes and interest by 8% per annum. This growth has been financed purely internally, the number of shares and net debt remained stable. Based on the underlying growth trends I see little reason that this growth over the next ten years should be structurally higher or lower. Rolls-Royce is therefore likely to increase the company's value by around 8% per year.

Even with its investment in growth, in the last ten years the company was able to rake in about 5% of the annual turnover as a free cash flow. This cash flow constitutes the money that was left for shareholders after all investments and acquisitions and was distributed primarily as a dividend. Adapted to today's fiscal and financial situation and adjusted by the underfunded pension liabilities the currently available free cash flow amounts to approximately 4-5% of the market capitalization. In other words, the value of Rolls-Royce is expected to grow not only about 8% per year, but the company can even give us an annual dividend of 4-5%.

Around 12% in growth and dividend already make for an attractive long-term return outlook. But what really excites me about Rolls-Royce is the prospect of a significantly improved capital allocation and profitability. It is indeed surprising that a company with the competitive strength of Rolls-Royce only achieves a 5% sales margin (on a cash basis) in the high-tech field.

I know many companies with fewer competitive advantages that achieve significantly higher margins. Part of this low margin can be explained by relatively high start-up costs and investments for new engine types, which are partly non-recurring. In the current earnings estimates for instance, management assumes decreasing research spending and capital investment. In fact, some evidence suggests that the allocation of capital (which includes the decision how research is being conducted and where that next factory should be built) was made only in part based on economic considerations.

The new management has a variety of approaches to increase the margin of Rolls-Royce. By no means I consider a sales margin (on a cash basis) of approximately 10% in ten years to be far-fetched. Should this become reality the return of our Rolls-Royce Investments is likely to increase significantly beyond 12% p.a.

How come?

In my eyes, Rolls-Royce is once again the example of one of these truffles that goes unnoticed because many truffle hunters have a different perspective than I do.

As an example I would like to mention that recent "sell" analysis about Rolls-Royce issued by a large German bank. In said study the analyst theorizes a brilliant model for the profit trend until 2017. I would be surprised if the Rolls-Royce management gave such a detailed estimate of the company's profitability in the coming quarters. In his theory the analyst foresees lower profits for the near future than his colleagues and therefore concludes that Rolls-Royce is "likely to deliver a negative surprise".

I often see this kind of short-term approach in the evaluation of companies: very few market participants are concerned about the company's real long-term growth trends. A lot of times the coming three years are projected at an extreme level of detail, while the next seven years are only approximated, and pretty much everything beyond a time horizon of ten years gets assigned a standardized growth rate (usually 1% or 2% per year).

My goal as an analyst is to find companies for which I have structurally higher expectations for the long-term growth rate to avoid that the company might disappear from the market within the next ten years. My assessment of Rolls-Royce is that they are likely to grow strongly for a long time.

Outlook

As already explained in the "Investor's Manual," I intend to run a marathon with my recommendations for TGV Truffle and not a sprint. It's a privileged situation to recommend investments for a fund with an investor base which has such a long-term perspective. I have always sought such a structure and partnership and I am grateful that it has now become reality.

With this in mind I want to thank you again for the great confidence in my work.

Yours,

Jan-Hendrik Mohr
JMX Capital GmbH