Investmentaktiengesellschaft für langfristige Investoren TGV

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Dear investors

Attached, you will find the annual report for the year 2019 provided by our sub-advisor JMX Capital GmbH for the sub-fund „Truffle“.

Yours sincerely

Investmentaktiengesellschaft für langfristige Investoren TGV

Annual Report 2019 of the Sub-Advisor

Dear investors,

The overall price development of TGV Truffle was roughly unchanged compared to the previous year. However, there were very high price fluctuations in the individual shares over the course of the year.

As stated in the semi-annual report, the 2019 operational development of the companies behind the shares was entirely in line with expectations. This development continued in the second half of the year. 2019 was a good year to illustrate the occasional divergence of courses and underlying values.

Nowhere is this more evident than with the largest position in TGV Truffle: Tucows. The organisation of Tucows was undoubtedly working to capacity with various internal projects in 2019 (in particular the upcoming change of the network provider in the mobile communications segment entails considerable IT development tasks). However, the company simply did exactly what it has been saying for a long time and achieved figures that corresponded to this operational development and are in line with previous years. Even though 2019 did not bring about exciting headlines, the company did use the year to lay the foundation for future growth.

However, the company's price went crazy: starting the year at USD 61, the price temporarily climbed to over USD 90 and then plummeted to USD 45. They closed the year – curiously enough – at just over USD 61! In summer, I used the weak phase below USD 50 to recommend expanding the position.

An informed, rational, and long-term investor of the entire company would even consider a price well above USD 90 per share to be appropriate, especially when consulting the ratings of comparable companies. Indeed, stock market investors should always keep an eye on the real economic value of a company. Stock prices are just expressions of temporary opinions of market participants – and they fluctuate erratically in some cases.

Measuring and Weighing

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

Portfolio-Fakten:	
NAV as of 12/30/2019 in EUR	120,30
Total number of investments	12
Weighting largest investment	23.8%
Weighting Top-5 investments	67.6%
Weighting cash / fixed deposit	3.7%

Alphabetical Listing of Top-5 Investments:
Alphabet
Cincinnati Bell
Rolls-Royce
Scout24
Tucows

Period	TGV Truffle	Berkshire[1]	*(Difference)*[2]	6% p.a. Benchmark	*(Difference)*[2]
2015[3]	-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%)*
2018	-1.9%	+7.5%	*(-9.4%)*	+6.0%	*(-7.9%)*
2019	+1.3%	+13.6%	*(-12.2%)*	+6.0%	*(-4.7%)*
Since Inception[4]	+20.3%	+49.7%	*(-29.4%)*	+31.9%	*(-11.6%)*

Sense and Nonsense of Share Prices

The portfolio of TGV Truffle only includes companies whose market price is significantly below the conservatively determined value of the operational business that I assess. In 2019, some companies experienced some downright absurd distortions of price and value. The most extreme examples are amaysim, Naked Wines, and System1. The current prices of these companies are many times lower than the earnings potential of the companies would suggest or what could be achieved in a sales process.

[1] in EUR
[2] Rundungsdifferenzen sind möglich.
[3] 31.03.2015 – 31.12.2015
[4] Seit 31.03.2015

Of course, I am therefore in contact with the supervisory boards and executive boards of these companies to recommend the use of such undervaluations – for example, by using excess funds for share buybacks.

Had this annual report not been created on December 31, but two weeks earlier, the companies Scout24 and Cincinnati Bell would also be on the list of the most drastic mispricing. Both companies had bids from financial investors before Christmas that lowered to price-to-value gap.

In the case of Scout24, there was a bid for the Autoscout24 segment, and for Cincinnati Bell a takeover bid for the entire company. At Scout24, the management team around CEO Tobias Hartmann and CFO Dr Dirk Schmelzer skilfully optimised the value for the shareholders in the sale of Autoscout24 through clever communication and careful consideration of the courses of action.

In the case of Cincinnati Bell, it appears that a financial investor used the low prices in autumn to launch an opportunistic bid – apparently with a lack of opposition from the supervisory board.

The Cincinnati Bell case is well suited to classify the sense and nonsense of share prices. But let me say one thing first: the company developed operationally without any surprise. Generally speaking, a provider of Internet connections does not change much within a year anyway. It provides infrastructure technology that continues to evolve in generations. Cincinnati Bell is particularly active in the field of fibre optic Internet: a technology for the provision of Internet access that is better in the long term than telephone or TV cables and will be the winner for decades to come – more on this later in this letter. Hence it is nonsense to measure developments in quarters. But the stock market does just that: starting at slightly over USD 8.00, the price dropped to USD 3.20 over the course of the year and then recovered to USD 7.70 towards the end of the year. On December 23, 2019, a financial investor offered to buy the entire company for USD 10.50 – for a 36% premium on the last market price. Has the price of Cincinnati Bell increased by 36% on this trading day? Not at all! There was just one new incremental buyer – by the way, not a strategic buyer with possible synergy potential, but just a financial investor "like you and me" – who wanted to use the short-term irrationality of the stock market and the low prices to secure the entire cake right away. Chapeau for the necessary chutzpah!

In the end, however, the shareholders decide whether this bid will be accepted and it is now up to investors like TGV Truffle with their long-term perspective to ask for a reasonable purchase price or to show alternatives to the bid of the financial investor. Here it becomes clear that takeover offers for entire companies are not always fair or desirable. Of course, financial investors also try to pick up a bargain. But here too, price and value can be completely different things. However, being forced to sell at a lower price as a shareholder is problematic, and so the current situation at Cincinnati Bell is a threefold warning:

First of all, it is my duty to inform you as an investor in TGV Truffle about the relationship between price and value for the shares contained in the TGV. You only see a NAV every two weeks and a letter from me twice a year. My job is to relieve you of the problem of individual stock selection. It is entirely understandable if temporarily high TGV prices (such as in spring 2019) suggest that "something good has happened" and low prices that "it is not going so well". In terms of the Cincinnati Bell portfolio position: nothing went worse in July (price at USD 3.60) than on December 23, 2019 (price at USD 10.50) – only the perception of the capital market has changed.

My main task is to enable you to make an informed decision as to whether the changes in the price of TGV Truffle are factual changes in the company ("has become more or less valuable according to objective standards") or simply fluctuations in the prices ("the capital market evaluates the company differently").

Secondly, the Cincinnati Bell case shows the importance of either being the largest shareholder in a company or having a capable large shareholder as a co-investor who acts rationally and respects the rights of minority shareholders. The countless examples of acquisitions of listed companies by financial investors in recent years show that many management teams are succumbing to the sweet poison of the charge of a financial investor. Less annoying shareholders, less in the public eye, often better remuneration options – who can blame them? And my negative attitude to a takeover may sound strange – because should not all shareholders be happy about more than 30% premium as in the case of Cincinnati Bell?

I think this view is entirely wrong and characterised by a short-term approach to the stock exchange. In my Cincinnati Bell valuation models, the conservative case is worth a lot more than USD 10.50. Selling at USD 10.50 is a nuisance. Apparently high premium on the last price or not. Fortunately, in the case of Cincinnati Bell, there are now some larger shareholders who can also oppose the takeover offer[5]. This is important and confirms my view that TGV Truffle should appear as a large and visible shareholder in our invested companies if possible. It is a stroke of luck that TGV Truffle was launched by the Investmentaktiengesellschaft für langfristige Investoren TGV since it has built up a reputation for being a responsible and, if necessary, assertive stakeholder for long-term minority shareholders.

Thirdly, I have further developed my assessment of whether the management should attach importance to the share price of its own company. The common belief is that this must obviously be the case. After all, prices express whether a company is doing well, or do they not?

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[5] Just before this letter was published, a competing offer at an improved price materialised from another bidder. This provides additional support for the thesis that the value of Cincinnati Bell is in excess of USD 10.50 – now a bidding war could possibly start. More in the next report!

Socialised as a value investor, I oppose this opinion in essence, since current prices say nothing about the development of a company's underlying business.

In many conversations with the main actors in companies, I appealed to patience and said things like "don't let low prices drive you crazy, at some point the market will attribute the right value to your company". I still have this fundamental attitude. However, I am now convinced that management teams have an obligation to courageously use excessive negative market prices of their company to its benefit. For example, because a competitor could otherwise buy the company; the company holds a lot of excess liquidity and could buy back shares at a cheap price, or the employees are paid at the company's shares.

In autumn 2019, for instance, I had a conversation with a CFO who had far more free liquidity (i.e. bank balances and open lines of credit) than the company's market capitalisation at that time. There was also no medium-term use for this liquidity – something the management confirmed to me. Whether due to sluggishness or institutional slowness, they could not bring themselves to buy back shares. "The market will fix it" is simply an insufficient answer if you have the chance to pay back the entire shareholder's equity.

We are fortunate that the board members of the very important portfolio positions Alphabet, Scout24 and Tucows used excess funds for meaningful share buybacks in 2019.

Portfolio Changes

Two changes in TGV Truffle were noteworthy:

On the one hand, the position in NOW Inc that has existed since the inception of the TGV was sold. The original idea was that this distributor in the oil and gas industry could consolidate the industry. The management team had previously demonstrated this in the case of another company. This strategy was implemented swiftly at first but has continuously stalled in recent years. At the same time, the oil and gas industry has been characterised by brutal changes and fluctuations. To this day, it seems that the team at NOW gave their best – they were just in the wrong industry at the wrong time. Recently there were some changes in management, and the original team, on which my investment assessment was based, was no longer on board. The position was therefore recommended for sale towards the end of the year, and TGV Truffle divested itself of the position with no significant gain or loss. However, our investment would have yielded much better results in the same period in other portfolio companies.

Given the same information, I would probably make the same decision today as I did then; therefore, I do not consider the investment a mistake. This is an example of how a good investment thesis does not necessarily have to lead to a profitable investment.

On a different note, I recommend building a smaller position in Metro Bank plc in autumn. It is a young bank in Great Britain, which gains new business through customer-friendly branch concepts. An account is opened within a few minutes, the prices are fair and transparent, and the customer is welcomed in the branches as if by a hotel concierge

It should be noted that the British banking market is highly consolidated and that long-established banks like Lloyds or Barclays do not distinguish themselves by their service or low prices.

This has opened up a wide gap for a customer-friendly concept like Metro Bank, and the disruptive trend will continue here. Initially driven by the founder's admirable energy, Metro Bank built more than GBP 10bn in deposits and operated dozens of branches in and around London.

Unfortunately, the bank made some severe errors in risk assessment at the beginning of 2019 – something that a serious bank simply cannot afford. Hence 2019 became Metro Bank's annus horriblis. A massive loss of trust followed.

The equity book value is the North Star for the stock market valuation of every bank, and while Metro Bank was still valued at multiples of its equity in 2017, the price is now quoted at only 20% of its equity book value. A price drop of over 90% in a few months! After the founder withdrew, the CEO also left and, to make matters worse, Metro Bank had to raise new capital at a very inconvenient time to comply with the British regulatory requirements. Metro Bank was probably the most hated company on the British stock exchange in autumn 2019.

I have been following the bank's history with strong, albeit uninvolved, interest since the IPO. After the fog cleared in autumn – an experienced restructurer became the new CEO and the necessary new equity capital was raised – I spent a little more time analysing the operational development.

I found a bank whose concept seems healthy at its core. Customers were still raving about the service in the branches, the deposits rose again, and employees left rather positive ratings on online employer portals. Service and pricing at the established British banks are not getting any better in the short term. Metro Bank received subsidies from the English government to expand into the Northern UK. New top-class executives from competitors were hired and shortly before Christmas a new supervisory board member was announced, who previously headed the regulatory compliance department at Barclays.

Metro Bank has left a lot of scorched earth with shareholders, but there seems to be hope in the engine room. I do not want to put my head too high above the parapet as to whether Metro Bank can build an extensive and profitable branch network. The probability of this is considerably high, but it is certainly not a sure-fire success. If it succeeds, the share is probably worth ten times the current price and I would like to be a shareholder for years to participate in this development.

However, the reason for the investment of TGV Truffle is that the capital market is implicitly pricing in the total dismantling of the business. Valued at circa 20% of equity book value (incidentally, with a loan book that has been running exceptionally well up to now), even the liquidation of the business should realise considerably more capital than the current market capitalisation.

For other credit institutions in the UK – especially those that want to differentiate on the credit side and not like Metro Bank on the deposit side – a merger with Metro Bank should be a good deal even at twice the price. Another advantage of the investment thesis are the shareholders, which consist primarily of committed and long-term investors, who I believe will protect minority interests and at the same time will work proactively on a solution for the future of Metro Bank.

It looks as if the more likely scenarios at Metro Bank suggest higher or much higher valuations than today's prices and only a drastic deterioration from the current situation will lead to losses. Reason enough that an investment by TGV Truffle seems sensible.

"Lighting up the World"

I would like to address an investment topic that is important for the TGV, which always raises further questions. If a technical discussion of the American Internet infrastructure is too dull for you, feel free to skip straight to the end of this letter.

Through the investments in Tucows and Cincinnati Bell (of which we hope that we can retain it and will not be forced to sell), one of the central investment priorities of TGV Truffle is the implementation and expansion of fibre optic internet infrastructure in the USA. The positive development of this investment will play a decisive role in the long-term performance of the TGV.

With the invention and dissemination of the telephone by Alexander Bell at the beginning of the 20th century, thin copper cables were laid in streets, canals, bridges, detached houses and high-rise buildings everywhere in Europe and the USA. Virtually every place is connected to every other location by means of thin copper wire.

Just imagine how revolutionary it was that someone in Hamburg could have a clear conversation over the phone with someone in Munich. For many decades, the telephone was the crucial communication channel, supplemented by a handful of TV and radio signals via radio waves.

Since the 1970s, it became possible to send more information using thicker copper cables. This allowed for cable TV get established and helped this new medium to make its breakthrough. People could now watch hundreds of channels in colour and were willing to pay monthly subscription fees for this

revolutionary product. Everywhere there were resourceful entrepreneurs who set up huge satellite dishes (to receive the TV signal) and fed this signal locally to the households using a thick copper cable.

The new cultural movement TV spawned gigantic business models such as the movie broadcaster HBO or the sports channel ESPN in the USA. Similar to the self-reinforcing symbiosis of the military, armaments, and mining industries found in Western Europe and the USA in the early Cold War, a symbiosis of TV channels, TV content (e.g. Hollywood movies, news channels, or sports reporting), and advertisers formed in the 1970s. The more dramatic the sporting event, the more important it was to be able to watch the sports channel, and the more beneficial it was to have advertising space there. This quasi-cartel favoured large companies in particular, which were able to produce or distribute relevant content nationwide or sold products nationwide through tv advertising. Hundreds of billions of US dollars in value were thus generated within 40 years by TV stations, professional athletes, and clubs on the one hand, and consumer goods manufacturers on the other.

In the mid-1990s, the most important innovation in modern history was born: The Internet. Without going too much into the technical details, it was clear from the start that the transmission of data using the TCP/IP internet protocol shooting light through glass fibre optic cable is the most efficient and stable way of transmission.

However, what helped the Internet to achieve a mass breakthrough was the possibility of using a modem over the – in part 100 years old! – telephone copper wires to send an internet signal. What a stroke of luck! Now finally, a creaking modem could be plugged into every telephone device (which was factually available to 100% of the population in Europe and the United States at the end of the 1990s). The Internet spread through AOL email, Altavista search engines and eBay auction fever.

Since the birth of the Internet, the amount of data accessed by people has increased rapidly every year. It was and is a phenomenon that telecommunications experts keep underestimating the necessary Internet capacity, as new applications are continually being developed on the Internet protocol. Fortunately, new technologies allowed for the expansion of the data capacity of phone cables, allowing more and more data to be transmitted. It also became technically possible to use the thicker and therefore higher-capacity TV cables for the Internet protocol and to continuously optimise them for better data throughput. However, both are and remain technologies that were not initially designed for the transmission of Internet data and can only transmit higher amounts of data with considerable hardware and software modifications.

We are now at a turning point where the technical limits of the converted copper technologies are becoming increasingly evident and, at the same time, the demand for high-speed Internet continues to

increase among the population every year. DSL Internet via telephone cable is simply out of date and even the best TV cables reach their limits at peak times.

The network operators' answer is to always develop just enough infrastructure that customers do not revolt. However, keep in mind that the telephone and TV cable providers are almost always monopolies or duopolies.

Take the street we live on in Hamburg-Eimsbüttel, for example: no matter how angry and frustrated I am with Deutsche Telekom (DSL via telephone line) or Vodafone, formerly Kabel Deutschland (Internet via TV cable) – there are no other options. This fundamental market structure has played out differently in different places around the globe.

In the United States, TV cable providers practically won the race. They invested just enough to have a clear technical lead over DSL providers. The latter have quit (with very few exceptions, like Cincinnati Bell) to maintain their network and basically try to somehow get their junk cars through the next inspection. It is amazing how many households still use DSL. Whoever decided to lay a telephone cable in the prairie in the 1920s: They certainly did not expect that this investment would generate cash flows for more than 100 years!

The TV providers, on the other hand, played their cards perfectly and won customers from the DSL providers through a technology standard that was always slightly better. There were brilliant entrepreneurs in the TV cable network market, who – through acquisitions and, above all, cleverly implemented price increases – were able to maximise the value of their networks.

The situation in many (not all!) US markets in 2020, however, is that end customers can now choose between very poor DSL lines and half-heartedly developed TV cables at ridiculous prices. This point is central and crucial for the German reader: Good Internet is easily 2-3 times as expensive in many cities in the USA as in Germany. At the same time, network providers have almost always skimped on service quality. It is worth talking to American acquaintances about their experience with Comcast or Spectrum (two of these TV cable providers). The frustration expressed is often not suitable for polite company.

In many places, the construction of a new fibre optic network and the provision of fast internet will allow end customers to a product that is better and cheaper at the same time. Ting also has a drastically better brand and service perception among customers, expressed by extremely high Net Promoter scores . At the same time, the price to be achieved in the market for an Internet connection still allows for adequate revenue to ensure a good return relative to the necessary infrastructure investment.

By now, there are numerous examples of companies that have successfully “overbuilt” cities in the US with fibre optic connections. I measure construction activity in the United States in a database and in

fact, the appeal seems to be getting around: there has been a significant increase in fibre optic projects in the past 18 months.

Now, the question naturally arises as to why the established network providers do not selectively offer fibre access at the locations where there are fibre optic startups and thus nip the market entrants in the bud. In fact, this happens regularly. However, one has to bear in mind the overall situation of these companies in the relevant markets. Especially for the often heavily indebted TV cable providers, it can be an entirely rational strategy not to invest, but to "milk" those customers for whom the Internet via TV cable is still good enough.

Even in a successful fibre optic project, the customers will only be won over several years – ergo remain on the network of the old provider for some time on average. For many cable companies, the decision to commit to construction costs and risks to perhaps keep some of the customers longer is not easy. Furthermore, it is often not possible for providers to compete 1: 1 with an Internet-only provider, because in addition to the Internet product, a TV product must be cross-subsidized.

The product and service world would have to be revised entirely, instead of merely incremental changes being noticed by the customer. We also see e.g. in retail compared to e-commerce and for automobile manufacturers in case of electromobility, how difficult it is for established players to deal with disruptions. The TV cable providers are slaves to their own success: Over the years, the price increases have made it possible to increase profits and, above all, debt levels. The shareholders are spoiled and have benefited from low investments, rising prices, and the associated high cash flows. It is much easier for these companies to milk their remaining customers in the markets with fibreglass superstructure just a little more. Since the time horizon of these corporations ticks in quarters instead of decades, this could be considered quite rational. The further expansion of fibre optic superstructure in the USA will take decades (just like the construction of the TV cable networks back in the day) and for the large cable companies, the fibre optic startups in the periphery are like a single bark beetle nibbling on a 100-year-old oak tree, especially since, cynically speaking, similar to their networks, many CEOs and owners of these companies have reached their technical lifespan. So why invest with the next 25 years in mind?

Tucows, as the largest investment within TGV Truffle, is now investing very selectively in attractive geographies and expanding fibre optic networks there. It manages them with the service platform established and tried and tested from the other segments of the company. So far, they are active in 10 cities, and I expect them to announce various other places in the coming years. Based on the previous figures and numerous benchmarks of similar projects, this investment should, when viewed as a whole, bring excellent returns on capital invested.

Many private infrastructure investors are currently investing considerable sums globally in the expansion of fibre optic networks, and the attractiveness of these projects is therefore well understood in private markets. On the other hand, in the stock market, fibre optic investments are currently viewed with scepticism. In my opinion, this is because, based on the decades of success of TV cable companies, many investors believe in their infallibility and thus the imminent failure of fibre optics.

It is no coincidence that one of these infrastructure funds now believes in using Cincinnati Bell's vast fibre network to take advantage of the valuation difference between the stock market and the private capital market. It should be noted that in the stock market, facts are often only believed once they are apparent in highly aggregated and simple numbers (e.g. earnings per share). In the case of Tucows, however, it still takes about 18-24 months until the fibre optic business figures become apparent that way. Believe it or not, the only thing that matters to the stock market is what happens in the coming quarter.

No discussion of wireless technologies should be left out of any debate on fibre optics. First of all: the technical performance of no mobile network (buzzword "5G" or not) comes even close to fibre optics. Furthermore, the bandwidth of a cellular network standard is related to the frequency of this standard. The higher the frequency, the more capacity the radio wave has. The problem with high frequencies, however, is that they are easily disturbed by rain, windows, trees etc. and only bridge limited distances. For a 5G network to replace a fibre optic connection in a house, the transmission tower has to be built extremely close to the house, thus increasing the required number of these transmission towers, and related investment requirements, rapidly. This standard is no longer about just a few hundred transmission points per city, but about thousands of micro-cells that literally require fibre backhaul at every corner. 5G would actually have various applications (e.g. making vast amounts of data available at a live event) – however, disruption of the new fibre optic cables in living or office environments seems extremely unlikely. It is clear that an urban fibre optic network such as that from Cincinnati Bell or Tucows not only represents an immediate business case due to the number of connected households but also offers considerable options in the medium to long term for applications not yet in use today.

Recommended Reading

I can strongly recommend "Being Mortal" by Atul Gawande: fewer books have opened my eyes to a topic that was previously locked to me. The author is an American medical doctor and medical journalist who has already written successful books on medical procedures and their relevance in the world outside the hospital. One of the defining features for me was "Checklist Manifesto", in which he describes the development of checklists in operating theatres and explains the importance of checklists

in many areas of life. He has also recently become the CEO of a health insurance company Berkshire Hathaway, J.P. Morgan, and Amazon have jointly established. In "Being Mortal" he gives laymen like me an insight into the medical care of people shortly before their death. Health systems in the Western world are designed to prolong life at all costs – even if that does not improve the quality of the remaining life. Despite the sad topic, the book gives a lot of hope and positive energy, because the author encourages the reader to ask the really relevant question, how much life can actually be in added lifetime. Highly recommended!

Outlook

As every year, I look forward to seeing you at the investors' meeting on June 6, 2020, in Bonn. Please bring your family and ask any questions you may have. The event has grown very nicely in the past few years and the weather has always played along too!

Kind regards

Jan-Hendrik Mohr