

Investmentaktiengesellschaft für langfristige Investoren TGV

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Dear Investors

We are enclosing the shareholder letter for our Teilgesellschaftsvermögen “Falkenstein Fonds” for the first half of 2020 written by our sub-advisor Falkenstein Management 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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TGV Falkenstein Fonds – 1st half-year 2020



LETTER TO THE INVESTORS OF THE TGV FALKEINSTEIN FUND

Dear investors,

After almost ten years at Falkenstein Nebenwerte AG and another ten years at Sparta AG, we are meeting again here. In addition to many old friends of our investment philosophy, which we will refer to as Falkenstein philosophy below, we are delighted to welcome some new members to the family.

In the past, we have invested out of listed investment companies. Today we advise a fund – the TGV Falkenstein Fund (TGV Falkenstein), set up as a sub-fund of the Investmentaktiengesellschaft für langfristige Investoren TGV (*Langfrist*). In this first half-year letter, we, therefore, delve a little deeper into the Falkenstein philosophy, our history, and also the differences between sub-funds and listed investment companies. A major difference is that we used to directly invest the capital of the company as members of the executive board. In the new set-up, we act as a consultant or so-called “sub-advisor” of the portfolio manager (Fiducia Treuhand AG) of the TGV Falkenstein. So when we talk about advisors in this letter, we mean ourselves.

However, much has remained unchanged. The same team – consisting of Traute Kuhlmann, Martin Possienke, and Christoph Schäfers – still sits in the same offices, uses the same computers, and above all follows the same investment approach that has been tried and tested over many years. We are still convinced that a mix of value investments and special situations leads to above-average returns and allows for a peaceful sleep.

Falkenstein philosophy

We assess companies according to the basic principles of value investing. The focus is on concepts such as sustainable competitive advantages and margin of safety. In addition to the value component, the “ideal” Falkenstein investment is characterised by a special situation – or such a special situation could potentially develop in the not too distant future. A crucial aspect of special situations is that they often offer an additional safety net, such as payments related to domination and profit transfer agreements. However, special situations can also be events that resolve an existing undervaluation or trigger a revaluation. Company takeovers or changes in the shareholder structure are examples of such settings.

The portfolio allocation in terms of value investments on the one hand and special situations on the other changes over time and is somewhat opportunistic. Typically, we are 30-70% invested in value stocks, which are – compared to the special situations – more closely linked to the fluctuation of the general stock market. However, it is often difficult to determine whether an investment is still close to the market or is already a special situation.

The time horizon of the value investments is long-term. The time horizon of the special situations can also be several years but is usually much shorter compared to the value investments.

Usually, our target portfolio is concentrated and rarely consists of more than 20 to 25 positions. Often, the five largest investments account for more than half of the total assets.

In particular, on the special situation side, we focus on investments in German-speaking Europe, which is primarily due to a better understanding of the German capital market legislation.

We have successfully and independently implemented this strategy briefly outlined here at Sparta AG (Sparta) for more than ten years. In 2019, Sparta was taken over by a competitor with different strategic objectives. After we left, the task arose to set up an investment vehicle to continue the previous investment philosophy. As a result, we developed a concept together with *Langfrist*, whose representatives were on Sparta's supervisory board for years and left the company at the same time we did.

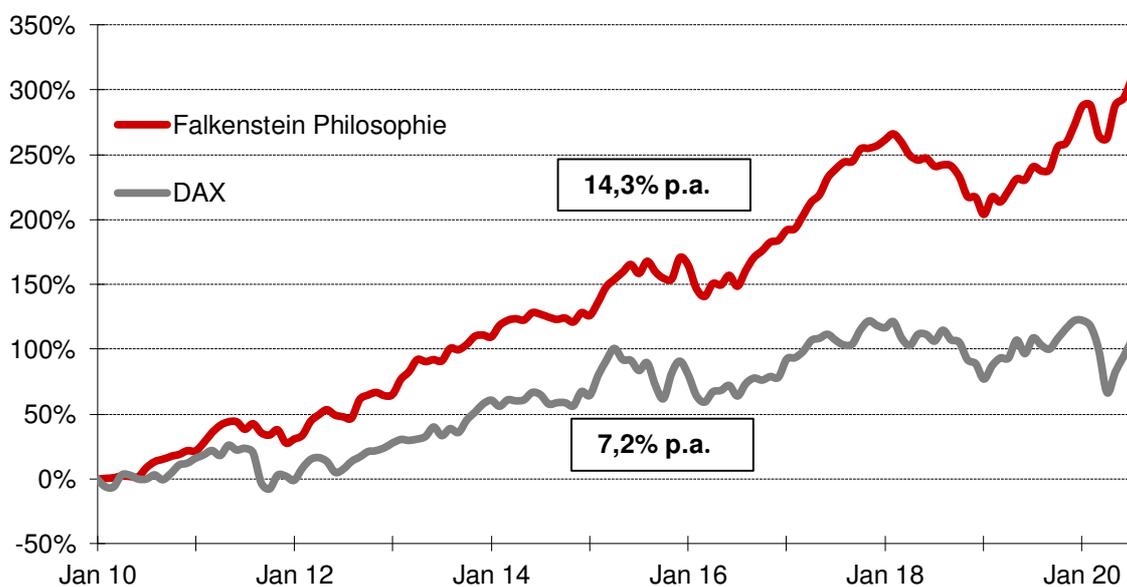
Compared to a listed investment company, an investment fund has a number of advantages, which can be seen primarily on the tax side. It is also much easier to raise capital in an open-ended fund than in a listed company. However, at the same time, it creates the potential problem of cash outflows at inopportune moments, which are, in our opinion, the greatest disadvantage of open-ended funds. During periods of calm on the stock market, an outflow of funds is not a problem. Only when stocks appear cheap and worth buying because there is yet another crisis, and the market is going crazy, an outflow of funds can be a disadvantage for those investors who remain invested. Suddenly the fund cannot buy or – in a worst-case scenario – must even sell stocks that would be worth buying to cover the outflow of funds. Another aspect is that special situations in the end game often require quite large position sizes in relatively illiquid stocks. Such positions are also much more comfortable if the capital invested is “safe”.

When designing the TGV Falkenstein, we attempted to largely eliminate this general disadvantage of funds. In particular, a three-month notice period to the end of the quarter was introduced. In the event that investors need their money without prior notice, the potential disadvantage that co-investors suffer from the outflow of liquidity is offset by a 5% discount on the NAV of the returned assets. This discount is credited to the fund assets (not to the advisor or the fund company). We hope that with this design, we were able to combine the best of both worlds – the fund and the investment company – and we firmly believe that the Falkenstein philosophy can be successfully implemented in this new setting.

Track record of the Falkenstein philosophy

Since the beginning of 2010 – the first full year in the then revitalised Sparta – until the summer of 2020, the Falkenstein philosophy has achieved an annual return of 14.3% p.a. We are aware that the combination of historical returns that have been achieved with different vehicles is subject to challenge. However, we believe that the chart below illustrates well the return that has been achievable with our mix of value and special situation investments in the past. Yet we are also of the opinion that the historically achieved return cannot be projected into the future.

Falkenstein Philosophie* vs. DAX



* Estimated historical return on the Falkenstein philosophy, derived from January 2010 to April 2019 based on the development of the net assets of Sparta AG with invested equity between EUR 25m and EUR 100m. May 2019 - December 2019 based on the development of a portfolio in the single-digit EUR m range. From January 2020 based on the development of the TGV Falkenstein Fund.

As at Sparta, our long-term target return is 10% p.a. based on a five-year average. Against the backdrop of constant interest rate cuts and various “quantitative easing programs” from the world’s central banks, this goal is much more ambitious today than it was ten years ago. Feel free to draw parallels between the cover image of this letter with central bank policies of recent years.

The considerations behind the long-term target return are as follows: With “normal” investments in German stocks, long-term average returns of around 7% to 8% p.a. should be achievable – or at least that was the case in the past. We estimate the return of German special situations at 4% to 5% p.a. With a 50:50 weighting of the portfolio, our approach would have to average around 6% p.a. before costs and taxes. After costs and taxes a “market return” around 4% to 5% p.a. can be expected as a long-term average.

With our long-term target return of 10% p.a. we want to achieve around twice the “market return”. We are aware that this is quite an ambitious goal, even without the zero interest issue mentioned above. In our view, however, it could still be possible to achieve double-digit returns with the Falkenstein philosophy on a long-term average. A supportive factor is the focus on small- and mid-caps. Likely due to lower market efficiency, they have often performed better than standard values in the past. We believe that on the special situation side, the markets are even less efficient, so that here, too, it seems possible to achieve excess returns compared to the broad stock market. Unfortunately, special situation investments are not getting easier either, as other market participants, including some with impressive financial firepower, are entering this segment. But that’s probably the problem with every successful niche, whether on the stock markets or elsewhere – it will get crowded at some point.

We like to compare our long-term average return with the overall development of German stocks (e.g. measured by the DAX or CDAX). It is important, however, that we do not use these indices as a short term “benchmark”. We do not calculate tracking errors and certainly do not try to optimise or even minimise it by adjusting portfolio weights close to the benchmark. We also consciously neglect other key figures of modern portfolio theory such as volatility, beta factors, and the like.

When we look at broad stock indices, we always take a long-term view. For us, it is more important how the underlying securities develop across market cycles than their performance in a single year. There will always be years in which the Falkenstein philosophy is inferior to a direct investment in the DAX or another stock index. This is probably particularly true for years with dynamic upward movements, if only because the special situation portion of the portfolio is likely to lag behind in rising markets. In sideways movements or years of crisis, however, our approach should do better.

In the past, with the Falkenstein philosophy, an excess return of more than 7% p.a. compared to the DAX was achieved. The limitation already mentioned for the total return also applies to this excess return. It will likely not be attainable on this scale in the future, no matter how hard we try.

However, it is perfectly clear that for an actively managed fund such as the TGV Falkenstein, the return after costs must be above the broad market indices over a period of five or ten years. Otherwise, investors would do better with an investment in “the market” than with the TGV Falkenstein, which would neither satisfy them nor us.

Portfolio overview

As of June 30, 2020, TGV Falkenstein had a fund volume of almost EUR 31m. After the launch on December 30, 2019, the fund was almost fully invested at approximately 90% in mid-February 2020, so that it, unfortunately, suffered in the “corona bear market”. The TGV Falkenstein reached its low of EUR 85 on March 15, 2020. The issuer’s termination of Series D of the Dräger participation certificates on March 24, 2020, moved the fund price in the right direction again. The TGV Falkenstein ended the first quarter of 2020 with a share price of EUR 94. In the course of the second quarter, the general recovery of the stock markets and the encouraging development of some special situations helped to move the fund price into positive territory. As of June 30, 2020, it reached EUR 105, which means that it has increased by a little more than 5% since the beginning of the year or since inception.

TGV Falkenstein Fund

30. Juni 2020

Company	Price (EUR)	No. of shares	Value (EUR)	Share (%)
Cash & Receivables / Liabilities			2.055.946	6,7%
Special Situations			13.362.697	43,5%
Dräger GS D	508,00	10.000	5.080.000	16,5%
McKesson	26,10	75.000	1.957.500	6,4%
Springer	63,00	30.000	1.890.000	6,2%
Comdirect	13,60	100.000	1.360.000	4,4%
Dräger GS A	583,10	2.000	1.166.200	3,8%
Dräger GS K	581,10	1.500	871.650	2,8%
Stada	93,50	6.239	583.347	1,9%
Rhön	18,16	25.000	454.000	1,5%
Value Investments			15.276.236	49,8%
Dräger ST	59,20	40.000	2.368.000	7,7%
TLG	17,43	100.000	1.743.000	5,7%
1&1 Drillisch	23,13	75.000	1.734.750	5,7%
Swissquote	76,02	20.000	1.520.319	5,0%
RWE	31,11	40.000	1.244.400	4,1%
Morphosys	112,45	10.000	1.124.500	3,7%
Rocket Internet	19,09	50.000	954.500	3,1%
United Internet	37,71	25.000	942.750	3,1%
Dt. Telekom	14,95	60.000	896.700	2,9%
Dt. Börse	161,05	5.000	805.250	2,6%
Uniper	28,70	25.000	717.500	2,3%
Energiedienst	28,28	25.000	707.071	2,3%
Tele Columbus	3,09	123.319	380.439	1,2%
STO	101,00	1.357	137.057	0,4%
NAV			30.694.879	100,0%
Shares outstanding			291.245	
NAV per share			105,39	

As of June 30, 2020, the assets of the TGV Falkenstein were allocated as follows: 7% liquid funds, 43% special situations and 50% value investments. As already mentioned, the target allocation for value investments is between 30% and 70%. During the first half of 2020, value investments tended to be in the lower region of this corridor. At this point, we would like to point out once again that the assessment of which position is a value investment, and which is more of a special situation is not an exact science. Rather, the classification follows to the best of the fund advisor's knowledge and belief. The transitions are often fluid, or the investment is a "potential special situation" that we very much favour and actively look for.

On the special situation side of the portfolio, things were very lively in the first half of 2020. From our point of view, the highlight was the termination of all three series of Dräger participation certificates by the company. The associated redemption price was more than 100% above the prices of the participation certificates before the announcement. The squeeze-out at comdirect was decided by the shareholders' meeting and will probably be completed within the second half of 2020. The squeeze-out announcement at Axel Springer after its delisting is also worth mentioning, in particular from a performance perspective. A squeeze-out was also announced at Stada and, just like Axel Springer, we are eagerly waiting for the price to be fixed while writing this letter. Asklepios prevailed against B. Braun in the takeover battle at Rhön Klinikum and, after the extended acceptance period has expired, holds 92.6% of the voting rights.

Even outside the TGV Falkenstein, the market was on fire. Of particular note is the extrajudicial settlement regarding the adjustment of the squeeze-out price paid to the minority shareholders of AXA-Gruppe AG. This case dates back to 2007 and led to a supplementary payment of 14m in favour of Sparta. An example that clearly shows how much patience you have to have in special situations, but also how profitable they can be.

And then there was Audi. First the squeeze-out announcement in February 2020 and then the price determination in June, which cumulatively led to more than doubling of the Audi share price. How we as TGV Falkenstein consultants managed to miss this will probably remain our inexplicable secret forever. Or to put it in the words of the President of the BaFin: "It's a shame that something like this happened". He said these apt words, however, in the context of the behaviour of his agency related to the supervision of Wirecard, another high- or lowlight of the first half of 2020, which also did not affect TGV Falkenstein.

Even when looking at the value portion of the fund, it becomes apparent that several assets can be classified as potential special situations. 1 & 1 Drillisch, TLG, and Uniper shall be mentioned as examples. As described at the beginning, this is typical of the Falkenstein philosophy. Securities in potential special situations typically generate the highest performance contributions when the potential special situation becomes a real one. Before they were called in March, we also classified the Dräger participation certificates as a potential special situation in the value segment of the TGV Falkenstein.

With regard to the corona situation, you have almost certainly noticed that we try to avoid an assessment or a prognosis. However, it is also apparent that as of June 30, 2020, around 80% of the capital invested by TGV Falkenstein was invested in companies that are either in a special situation or that can be assigned to the healthcare, telecommunications, or utilities

sector. Since these sectors are areas of everyday economic life that are unlikely to become superfluous even in the context of a longer-term crisis, this particular portfolio set-up may best describe our assessment of the corona situation and its potential impact on economic life.

Words of gratitude

We would like to thank the persons responsible at *Langfrist*. We have known each other for many years, whether as members of the supervisory board of Sparta, as like-minded investors, or as friends, and we particularly appreciate the trusting collaboration in which the spoken word is always treated like a written contract. We would like to thank all members of the *Langfrist* team for the good advice and patience we were met with when we developed the documentation during the start-up phase of the business.

And of course, our special thanks go to the old and new friends of the Falkenstein philosophy for the trust they have placed in us. We are aware of the responsibility that comes with your trust, and we will fulfil this duty with utmost commitment. That's a promise.

Hamburg, July 2020

Dr Martin Possienke

Christoph Schäfers