

Investmentaktiengesellschaft für langfristige Investoren TGV

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Dear Investors

We are enclosing the shareholder letter for our Teilgesellschaftsvermögen “Partners Fund” for the first half of 2019 written by our sub-advisor MSA Capital GmbH.

Yours sincerely

Investmentaktiengesellschaft für langfristige Investoren TGV

Vorstand: Jens Große-Allermann, Waldemar Lokotsch
Aufsichtsrat: Dr. Maximilian Zimmerer (Vors.), Wolfgang Fritz Driese (stv. Vors.), Alexander Pichler (stv. Vors.)
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Investmentvermögen mit veränderlichem Gesellschaftskapital

Bonn, July 2019

Dear investors,

The share price of the Sub-Fund (TGV) Partners Fund was € 151.63 as of June 28, 2019. The change in value for the first half of 2019 including all costs was + 6.80 %.¹ The DAX achieved a performance of + 17.42 % over the same period.

Year	TGV Partners Fund (1)	DAX (2)	Difference Δ (1-2)
2015 (9 months)	+ 1,48 %	- 10,22 %	+ 11,70 %
2016	+ 16,27 %	+ 6,87 %	+ 9,40 %
2017	+ 20,24 %	+ 12,51 %	+ 7,73 %
2018	+ 0,76 %	- 18,26 %	+ 19,02 %
2019	+ 6,80 %	+ 17,42 %	- 10,62 %

Per annum	+ 10,48 %	+ 0,84 %	+ 9,64 %
Absolut	+ 52,68 %	+ 3,61 %	+ 45,99 %

Following the sharp price decreases across the board at the end of last year, everybody was popping bottles again in the first half of 2019. Today, most indices are largely where they started their roller coaster ride in the autumn of 2018. The TGV Partners Fund profit was not nearly as massive but is in positive territory at + 6.80% over the first half of the year.

The focus on just a few companies, which was extremely helpful for 2018, led to a substantial underperformance compared with the broad indexes in the first half of 2019.

Part of the relatively weak price performance so far this year can be explained by the current – and not always undisputed – news about the companies in the TGV Partners Fund: for example, **Tucows** had a relatively weak first quarter in its mobile business. **Alphabet** and other “Internet giants” increasingly attract the attention of various competition authorities. **Amaysim** made a major right issue and significant restructurings in the first half of the year, and **Majestic Wine** announced its intention to divest its retail business.

None of this news came unexpected or was necessarily negative for the long-term investor. One of the peculiarities of Mr. Market is that sometimes, extremely negative news has positive aspects for the *long-term* investor.

However, it also happens that news that is very positively received has a negative core. More on this later ...

¹ Performance calculated according to “BVI-method”. The difference in percentages and changes in NAV are due to yearly disbursements from the fund related to taxes.

Regular readers know that I do not attach much importance to investing in short-term periods of less than five years. In my opinion, it depends exclusively on how the TGV Partners Fund develops over a longer period of time. After a little over four years, we are still at the beginning of our journey.

The companies in the TGV Partners Fund

Of the fourteen companies the TGV was invested in on June 28, 2019, as usual, I am listing the ten largest positions in alphabetical order:

- Admiral Group
- Amaysim
- Gruppo MutuiOnline
- Majestic Wine
- Rolls-Royce
- Alphabet (Google)
- Computer Modelling Group
- Interactive Brokers
- NOW
- Tucows

These ten companies represent around 85% of the fund's assets. The largest company the TGV is invested in, currently has a market capitalisation of approximately € 650 billion, the smallest of around € 15 million.

The central investment principles of the TGV Partners Fund have not changed and will not change in the future. When recommending potential investments, I remain committed to the following criteria:

1. Does the company have a reasonable business model?
2. Does the company have a lasting competitive advantage?
3. Does the management act rationally, with integrity, and does it consider the shareholders to be partners?
4. Can we purchase the company's stocks at a reasonable price?

Changes in the top 10

The portfolio is essentially unchanged. Only the shares of **National-Oilwell Varco**, a company in the oil service industry, were sold and the funds invested in the shares of the **Computer Modeling Group** (CMG), a Canadian software company, which is also active in the oil service industry.

Change: National Oilwell Varco in Computer Modeling Group

National-Oilwell Varco is one of the companies that has been in the portfolio since the launch of the TGV Partners Fund in the spring of 2015. In the 2015 annual and semi-annual reports, I explained how the so called "decline curve" leads to the constant drying up of oil and gas wells. For this reason, continued investment in new and existing oil wells and reservoirs is required. Since 2015, global oil demand had increased from around 93-94 million barrels a day (BPD) to around 99 million BPD in 2018. The supply increased from about 92 million BPD in 2015 to approximately 95 BPD in 2018. While the demand for oil is very stable, the structure of supply has indeed changed since 2015.

One key reason why the production volume increased despite a crisis of historic proportions triggered by the oil price collapse in 2014 is the so-called "shale oil". As a result of the production technology of horizontal drilling, which has undergone considerable development in recent years, the US supply has been expanded rapidly and vigorously. In contrast to conventional oil wells, which are, for example,

located under the ocean floor, shale oil requires low initial investment costs and extraction can start relatively quickly. Shale oil has helped the US become the largest oil producer in the world within ten years. Today the US produces about 12 million BPD, of which almost seven million BPD are produced from shale oil.

The downside, however, is that a shale oil well produces about 50 % less within 12 months and typically 70-80 % less after four years compared to the first day of production. Large conventional wells, on the other hand, have a comparatively low decline curve of 3-5% per year. At the same time, the operating costs of shale oil production fluctuate sharply. Energy, labour, and materials have a far greater impact on the profitability of a barrel of shale oil than on conventional sources.

This comparatively much higher reduction of shale oil output carries risks for a stable supply. If investments in conventional and relatively slow-moving oil wells are permanently omitted, their share of total production falls. The dependency on fast-producing but also quick to run dry shale oil would become more significant over time.

For this reason, despite all, it makes sense in the long term, to tap different types of sources. However, investment in conventional oil and gas fields worldwide has been sluggish for years, and the level of investment is well below 2014 levels. This cumulative deficit is reflected in a historically low number of newly discovered wells and recoverable deposits.

This reluctance to invest also impacted the companies in the TGV Partners Fund. All in all, investing in companies in this field has been anything but successful in the last four years. Although no capital has been lost over the years, the TGV Partners Fund would be far better off today had it never invested in this sector.

However, this is no reason to throw in the towel on the sector. I still believe that the companies in this industry have a bright future in the TGV Partners Fund. In the long term, more investments are needed to develop conventional oil and gas fields as well as shale deposits. This is why I recommended **Computer Modeling Group (CMG)**, a company in this very field.

CMG is a small software company based in Calgary (Canada) that develops so-called reservoir simulation software for producers in the oil and gas industry. Emerging from a university project, today, with around two hundred employees, it is a clear and focused market leader in its niche. The largest competitor in the market is the US Behemoth Schlumberger, for which, however, the own product in this area represents only a tiny part of its entire product range with a correspondingly low focus.

Reservoir simulations help plan and control how an oil well can be efficiently accessed and exploited. Because the sub-surface and properties of a given reservoir are never the same, today, sophisticated software is used to reconcile different production and extraction methods with the properties of a reservoir. This includes, for example, the analysis of data on the composition and flow rate of the oil and gas, the permeability of the rock, or the productivity depending on the choice of production method. As a result, in the subsequent production, much more oil and gas can be extracted than without a previous simulation. At the same time, the ever-improving computing capacity allows more and more variables to be captured and ever-better simulations and thus also production results to be achieved.

If the exploitation of a reservoir is planned with a certain software, its use is guaranteed for the coming years. CMG has a stellar reputation with its customers and has excelled in the last twenty years. Thus, the turnover was increased tenfold during this time, while the company was always highly profitable. The result is a gilded balance sheet

Unfortunately, I regularly found the valuation of the company's shares to be expensive. When I visited CMG for the first time in 2014 in Calgary, the stock traded at around 15 CAD for more than 40 times its reported profit. I was enthusiastic about the business and the people involved, however, not the price. An excellent company for a high price.

Due to the ongoing crisis in the oil and gas industry in general and the sector situation in Canada in particular, in recent years, the shares of CMG have been under constant pressure. A combination of weaker sales growth due to the crisis and increased investments in proprietary software caused the share price to fall from around 15 CAD in May 2014 to around 6 CAD in May 2019. Now I think it is an excellent company for a good price.

Against this backdrop, I recommended selling the shares of National-Oilwell Varco and investing the funds in the shares of Computer Modeling Group (CMG). Since I did not want to increase the overall risk with regard to the oil and gas industry, I had to balance the pros and cons of the sale of NOW or National-Oilwell Varco. I hope that later I will be able to say that the better was the enemy of the good in this case.

The marshmallow test – „Doing the right thing.”

Most of you have undoubtedly heard of the *marshmallow test* before. In the 1960s, carried out by the American psychologist Walter Mischel, four-year-old children were given a choice to consume a marshmallow immediately or to receive two marshmallows after the supervisor's return at a later time. The research and results of the test were perpetuated in textbooks as “delayed gratification”.

The capital market is full of marshmallows ... and CEOs and shareholders who want them.

I regularly try to identify companies where the management is free, rational, and disciplined enough to wait for the second marshmallow. Since I have this picture in my head, there have been several situations in recent months where I had to smile to myself. It was a matter of postponing a reward from one day to the next, the very heart of the marshmallow test.

These decisions, similar to waiting during the marshmallow test, occur in many shape and forms. They manifest, for example, in extensive investments that do not generate any noteworthy revenue in the short term, let alone profits. But they can also be more subtle: in the form of not executed pricing power, which benefit the customer today and thus stimulate growth, or in the form of eschewed undertakings that involve too high a risk for the company (which others carry out due to their short-term profitability).

Now the situation on the capital market is complicated by the fact that decision-makers in companies do not sit in a locked room by themselves. External observers or investors with short-term agendas put enormous pressure on the management, whispering into their ears that it is alright, even their duty, to take the one marshmallow immediately. Furthermore, it is usually uncertain whether there

are going to be two, three, or no marshmallows as a reward. “A bird in the hand is worth more than two in the bush,” sing the sirens.

However, many of the companies the TGV Partners Fund invests in show that corporate executives pass the “Mr. Market Marshmallow Test”. Some have built a culture favouring two marshmallows tomorrow over one marshmallow today. A few even go so far as to consciously create room for the capacity to suffer and to hone the organisation in on many marshmallows in the future. The fact that these companies – despite the noise from the outside – still “do the right thing”, bears testimony to a great strength that can hardly be expressed in numbers.

To return to the intro: in the past half year, two companies in the portfolio apparently reported particularly bad news, which at second glance turn out to be quite positive.

Amaysim has, as described in the last annual report, had a terrible 2018. The initiated review of the strategy by the CEO Peter O’Connell has led to numerous restructuring measures, essentially a radical concentration on the company’s own roots and the central values of Amaysim (“amazingly simple”). At the same time, the company decided to undertake a major rights issue to make those painful but necessary adjustments, and to be able to operate in the market for the coming years from a position of financial strength.

This focus on one’s own values also applies to the energy business acquired a few years ago. Obviously, the value proposition in relation to the performance for the customers was worse than that of their own mobile business. In the future, Amaysim wants to build on the old strength with a new, simple amaysim energy product. I will follow this development closely. And even if this process takes longer and is very painful in the short term, it is factually correct and important.

Majestic Wine² announced a possibly even more radical change in the spring of this year. The Company has decided to reverse the 2015 marriage between Majestic Wine’s retail business and the Naked Wines Internet business. The retail shops are to be sold, and the growth of the Internet business of Naked Wines to be significantly accelerated in the future. At the same time, the group is to be renamed “Naked Wines” in order to take the new circumstances into account.

Although this step is sure to be painful in the short term and causes many extraordinary expenses, I think it is entirely correct. Focusing on one thing, in this case, Naked Wines’ fast-growing business, is the right thing.

Incidentally, this does not mean that Majestic Wines’ speciality stores are bad business – not at all. But sometimes one plus one does not equal two. And in that case, you have to respect CEO Rowan Gormley and his team for recognising this fact and correcting it quickly, albeit painfully. A vivid example of the marshmallow test.

Now, I have highlighted two examples of apparently negative news that were not entirely negative for the long-term owner. Therefore, you might ask for an instance in which it is the other way around, and news that is apparently positive may have a negative impact.

² A detailed description of the business model of Majestic Wine is included in the 2018 annual report.

As an example, I would like to highlight **Google**, the subsidiary of Alphabet. Many investor colleagues are thrilled that for some time now, Google has been increasingly trying to milk so far little-monetarised services such as YouTube or Google Maps more and more. Per se, this is not bad news. However, much attention must be paid so they do not exaggerate and drive users to competitors because the customer benefit was lost sight of.

As they say: „easy does it“. In the case of Google, in the past few months, several signals have surfaced at the same time, that in some areas the organisation tends to enjoy a quick marshmallow today rather than waiting for two marshmallows tomorrow.

The most memorable example for me is “AdWords”, the core business of Google Search. In the past, Google AdWords had been highlighted with a clearly visible orange background and green text. Today, they are only separated from the unpaid, organic results by a green font. Since March 2019, Google is also experimenting with replacing the noticeable green font with a standard black font.

The result is more clicks and therefore, more sales because it is harder for the users to distinguish advertising from organic search results. Circumstances that clearly do not benefit the user. Other examples include the insertion of two advertisements for certain spots on YouTube or the recent price increases on Google Maps for website operators, G-Suite, and the changes in the auction mechanism to a first-price sealed-bid auction model.

All these aspects together make me feel a little irritated, questioning whether Google may have tightened the screw a little too much. A final answer or even a solution does not exist at this point. Nevertheless, we have to ask these kinds of questions regularly and for every company in the portfolio.

Obviously, I still came to a positive conclusion when it comes to the opportunities and risks for the TGV Partners Fund. The advantages and strengths of Alphabet far outweigh the irritation. All in all, Alphabet and its subsidiary Google are fantastic companies, and I use many of their products every day.

As long-term investors, it is impossible to expect exclusively good news from the companies we are invested in. As in life, for companies, there are sometimes sunny and sometimes rainy days. Sometimes a product does not pan out as expected; sometimes, our own strategy needs to be adjusted. Markets and consumers are changing. A quarterly “only uphill” in every market phase does not exist.

I believe the companies within the TGV Partners Fund can each demonstrate a robust mix of structural growth opportunities, outstanding market positions, and excellent management teams. Of course, individual companies will also experience bad quarters or years. All in all, I am convinced that the day after tomorrow, there will be more marshmallows in the basket than there are today.

With this in mind, I wish you a wonderful summer and thank you for your confidence.

Warm regards from midsummery Bonn,

Mathias Saggau