

# Investmentaktiengesellschaft für langfristige Investoren TGV

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Dear Investors

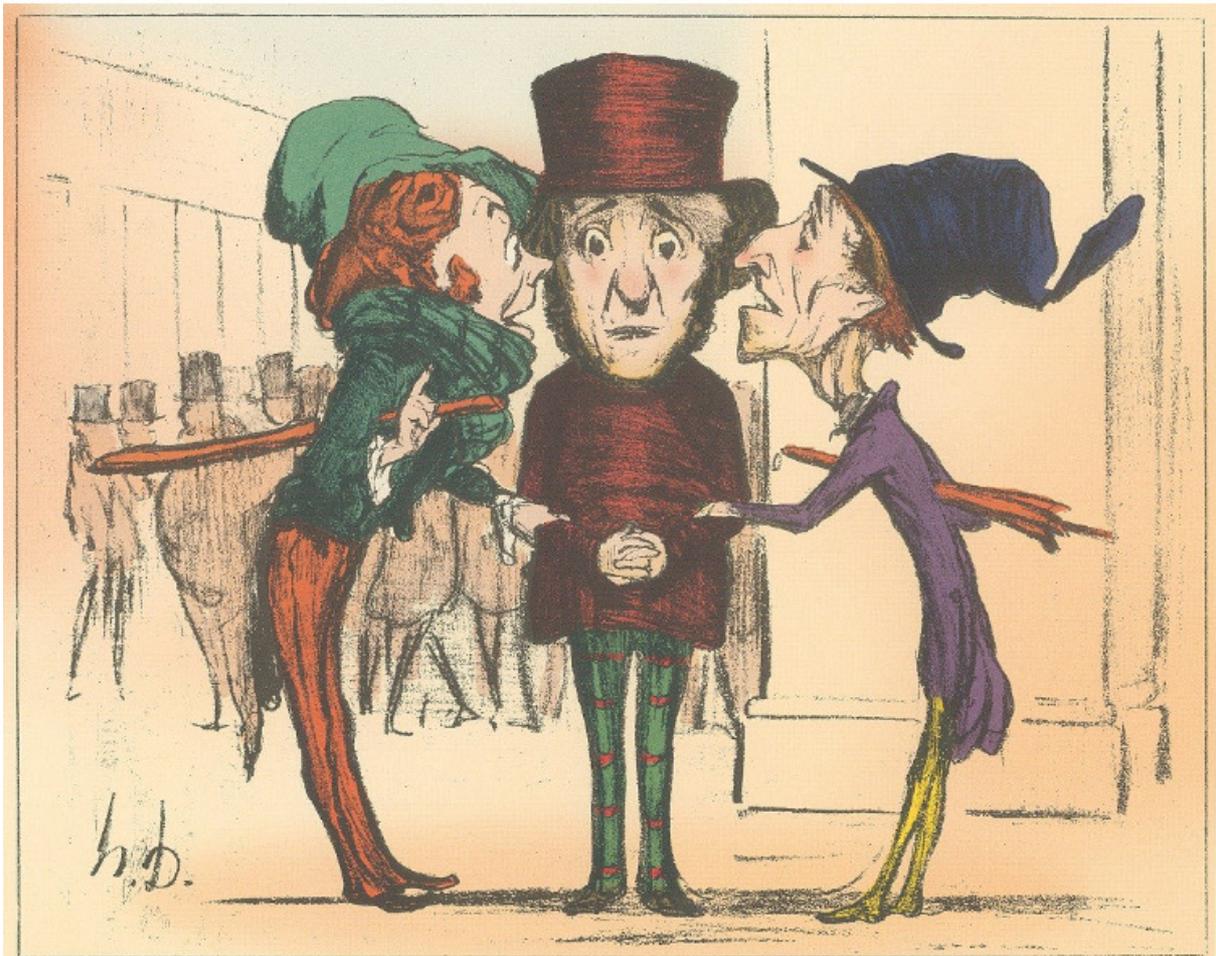
We are enclosing the shareholder letter for our Teilgesellschaftsvermögen “Falkenstein Fonds” for the first half of 2021 written by our sub-advisor Falkenstein Management GmbH.

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.)**  
**Eingetragen im Handelsregister Bonn HRB 16143**  
**Investmentvermögen mit veränderlichem Gesellschaftskapital**

# TGV Falkenstein Fund – H1 2021



*To buy or not to buy: That is the question*

*Reproduction of a drawing by Honoré Daumier from the Arnhold and S. Bleichroeder Holdings, Inc. Collection*

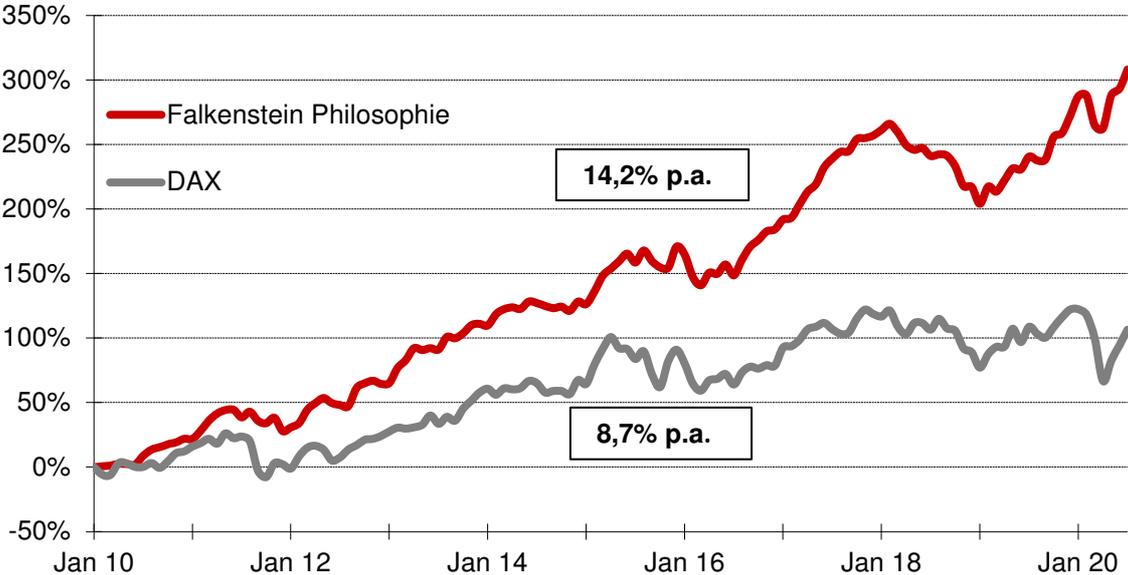
# LETTER TO THE INVESTORS OF THE TGV FALKENSTEIN FUND

Dear investors,

In the first half of 2021, the NAV of the TGV Falkenstein Fund (TGV Falkenstein) increased by 11.2%. Over the last five years – from July 1st, 2016, to June 30th, 2021 – we achieved an average return of 13.1% per year with the Falkenstein philosophy. We are currently above our long-term target return of 10.0% per year, but this is also due to the favourable beginning of the 5-year period in summer 2016. We will go into more detail on our investment strategy, considerations on the target return, and the history of the Falkenstein philosophy in the Investors notes at the end of this letter.

Since the beginning of 2010, the Falkenstein philosophy has achieved an annual return of 14.2% p.a. We are aware that the summarisation of historical returns that have been achieved with different vehicles must be scrutinised critically. Nevertheless, we believe that the following chart shows what long-term returns were achievable in the past with our mix of value and special situation investments. Given the negative interest rate environment, however, it seems questionable whether similar returns will also be possible in 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.

## Portfolio overview

As of June 30th, 2021, the assets of the TGV Falkenstein were 39.8 million euros. Net of liabilities of 0.9 million euros, the NAV amounts to 38.9 million euros. Around 34% of assets are invested in special situations and c. 66% in value investments, some of which, however, also have a certain special situation component.

### TGV Falkenstein Fonds

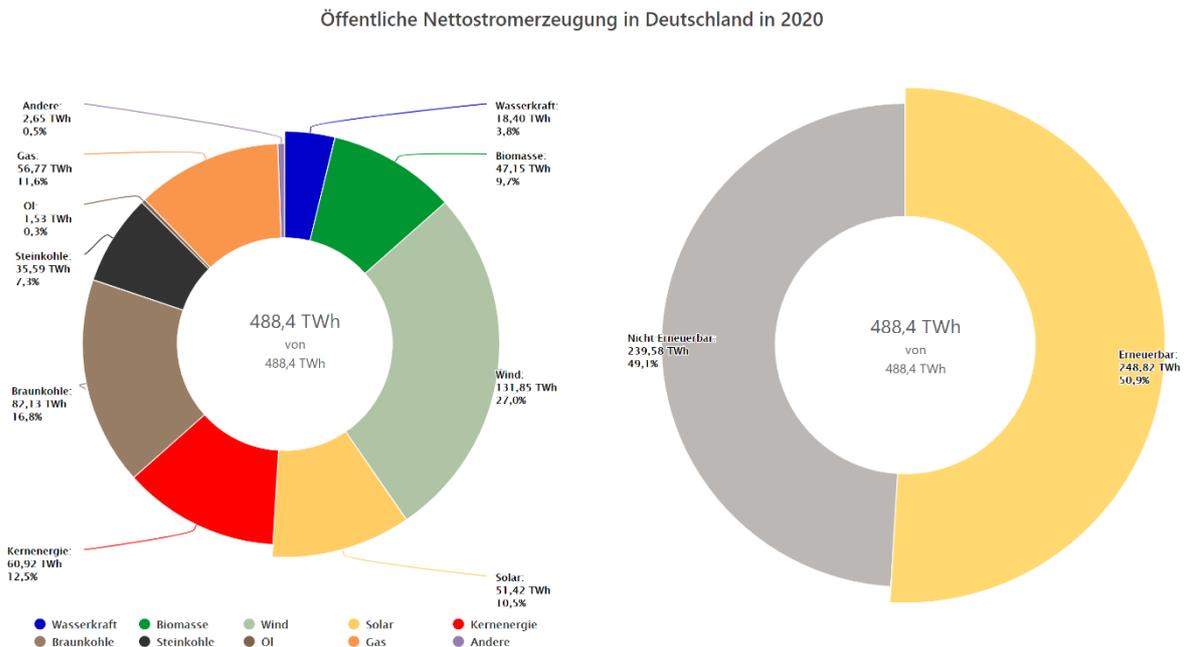
30. Juni 2021

Company	Price (EUR)	No. Of share	Value (EUR)	(%)
<b>Special Situations</b>			<b>13.372.207</b>	<b>33,6%</b>
Kabel Deutschland	108,00	25.000	2.700.000	6,8%
Osram	53,30	50.000	2.665.000	6,7%
Vita34	15,90	150.000	2.385.000	6,0%
Tele Columbus	3,35	551.418	1.844.493	4,6%
Rocket Internet	27,60	56.361	1.555.564	3,9%
AGOSI	139,00	8.850	1.230.150	3,1%
McKesson	24,80	40.000	992.000	2,5%
<b>Value Investments</b>			<b>26.462.979</b>	<b>66,4%</b>
Energiedienst	32,38	100.350	3.249.795	8,2%
Dräger ST	78,40	40.000	3.136.000	7,9%
Freenet	19,92	150.000	2.988.000	7,5%
Hawesko	59,60	50.000	2.980.000	7,5%
1&1 Drillisch	25,80	75.000	1.935.000	4,9%
RWE	30,56	60.000	1.833.600	4,6%
Uniper	31,06	50.000	1.553.000	3,9%
Swissquote	127,53	10.000	1.275.315	3,2%
Zooplus	273,20	4.000	1.092.800	2,7%
Cropenergies	10,82	100.000	1.082.000	2,7%
Energiekontor	54,70	19.000	1.039.300	2,6%
Wallstreet:online	24,90	40.000	996.000	2,5%
Encavis	15,94	60.000	956.400	2,4%
BKW	87,85	10.000	878.489	2,2%
Morphosys	65,42	10.000	654.200	1,6%
Pacifico	36,60	11.300	413.580	1,0%
Rhön	15,98	25.000	399.500	1,0%
<b>Barbestand</b>			<b>0</b>	<b>0,0%</b>
<b>Total Assts</b>			<b>39.835.186</b>	<b>100,0%</b>
<b>Cash &amp; Receivables / Liabilities</b>			<b>-908.201</b>	<b>-2,3%</b>
<b>NAV</b>			<b>38.926.985</b>	<b>97,7%</b>
<b>Shares outstanding</b>			<b>327.371</b>	
<b>NAV per share</b>			<b>118,91</b>	

## German electricity market

Around a quarter of the fund's assets are currently invested in electricity-producing companies. Therefore, in this section, we would like to take a closer look at the German electricity market.

Around 500 TWh of electricity were generated in Germany in 2020. Almost half of it came from renewable energies, which should be seen as a great success. However, the problem is that around 35% of the electricity produced in Germany in 2020 comes from technologies that will soon be shut down. Starting with the nuclear power plants in 2022, all lignite and coal power plants will be taken off the grid within the next fifteen years. This leaves only gas, biomass, and hydropower plants as reliable sources of electricity. In this context, reliability means that the power plants continuously produce electricity, even when the sun is not shining, and the wind is not blowing.



Quelle: [https://energy-charts.info/charts/energy\\_pie/chart.html?l=de&c=DE](https://energy-charts.info/charts/energy_pie/chart.html?l=de&c=DE)

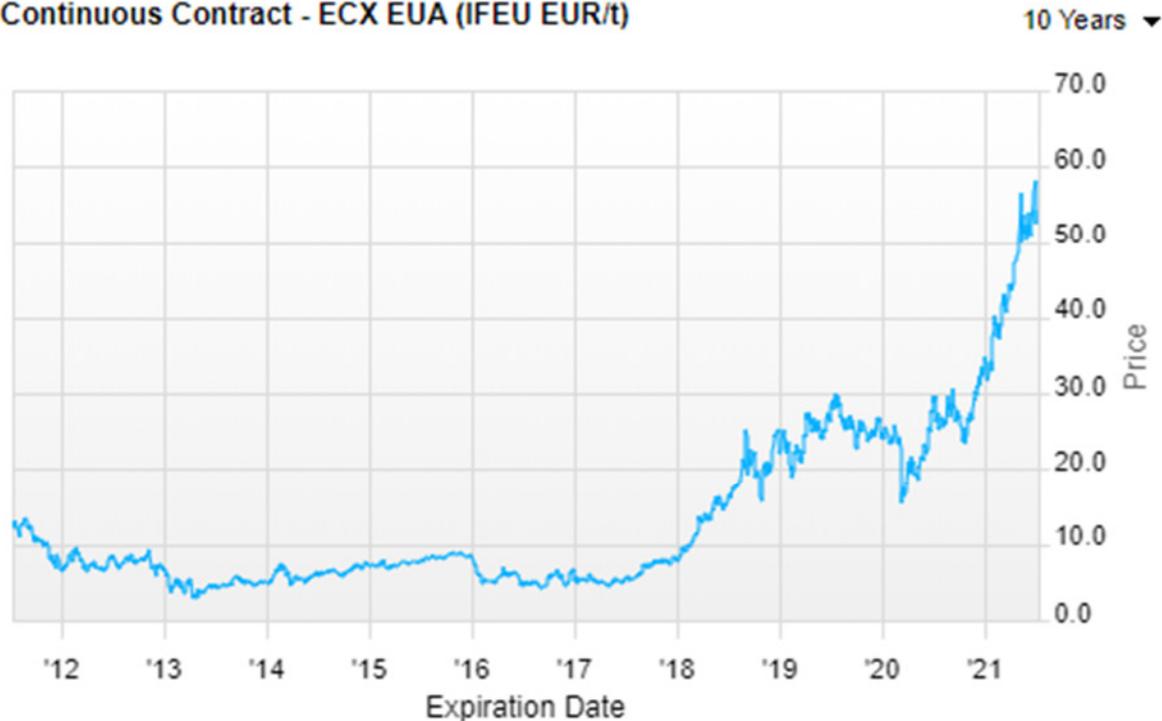
In addition, it must be assumed that the demand for electricity will rise in the coming years, e.g. from electric cars. Some studies predict an increase in demand from around 500 TWh in 2020 to 750 TWh in 2030. Even if 65% of this – corresponding with the German government's climate target – were covered by renewable energies, there would still be a gap of around 250 TWh. Domestically, this gap can only be filled by gas-fired power plants until storage technologies are sufficiently available. In 2020, however, the German gas-fired power plants only produced 57 TWh, which means that closing the 250 TWh gap appears ambitious, to say the least. Without additional power plants, it will likely not be possible to meet the demand. This will especially apply on windless and cloudy days when gas-fired power plants must cover almost 100% of the electricity demand. If this cannot be accomplished, the last option is to import nuclear power from France or lignite and coal power from Eastern Europe, which cannot be the aim of the German climate reform. Therefore, there should be the political will to make

the operation of gas-fired power plants more attractive, even if this topic is currently difficult for politicians to address. However, there is an instrument with which gas-fired power plants can be made "inconspicuously" more attractive, the so-called CO<sub>2</sub> certificates.

There is still often excess electricity capacity in Germany and Europe, so that not all power plants are always producing. While renewable energies and nuclear power plants are always on the grid, fossil fuels compete. Even though gas produces less than half of the CO<sub>2</sub> per MWh of electricity than power production with coal or lignite, it is significantly more expensive. Without CO<sub>2</sub> pricing through CO<sub>2</sub> certificates, the coal-fired power plants would be used before the gas-fired power plants. On the other hand, a higher CO<sub>2</sub> price means that gas-fired power plants become more profitable so that coal and lignite fired power plants are pushed out of the market.

The CO<sub>2</sub> price is, in turn, a mixture of regulation and free pricing. Simply put, politics determines the amount of CO<sub>2</sub> certificates issued per year and sets a fine that must be paid if a CO<sub>2</sub> emitter cannot present a certificate. This makes it very easy to specify a price range. However, the actual CO<sub>2</sub> price is then continuously determined on the EEX electricity exchange. After the supply of CO<sub>2</sub> certificates was too large for a long time, an adjustment of the system in 2018 led to a shortage of CO<sub>2</sub> certificates, because of which the CO<sub>2</sub> price rose from under EUR 10 per ton to now over EUR 50 per ton.

### CO<sub>2</sub> price



Source: Factset

In addition to the desired effect of replacing lignite and coal power plants with gas-fired power plants, there is also the side effect of a significant rise in the wholesale electricity price, caused by more expensive gas and the higher price for CO<sub>2</sub>. This electricity price effect is exacerbated by the above-mentioned reduction in the current supply surplus in the course of the shutdown of German nuclear, lignite- and coal-fired power plants.

### Wholesale electricity price



Source: Factset

An increase in electricity prices caused by the CO<sub>2</sub> price is particularly interesting for producers who do not have to buy CO<sub>2</sub> certificates because they do not emit any CO<sub>2</sub>. This applies to both nuclear and hydropower plants. For them, there is a significant margin expansion since their almost unchanged production costs meet significantly higher selling prices. Typically, however, the effect is only seen with a certain time lag, as most electricity producers sell the electricity for the next two or three years in advance. This brings us to the currently largest position of the TGV Falkenstein, Energiedienst Holding AG (Energiedienst).

### Energiedienst

Energiedienst is a Swiss company that generates its sales mainly in Germany, so the financial accounting is also carried out in EUR. With 54 hydropower plants on the Upper Rhine and in Valais, Energiedienst has a capacity of 654 MW and produces around 3,000 GWh of electricity per year, of which around 2,000 GWh are marketed freely. To simplify matters, one can argue that an electricity price that is 1 EUR/MWh higher leads to a 2 million EUR increase in EBIT at Energiedienst.

Energiedienst's predecessor companies, Kraftübertragungswerke Rheinfeldern AG and Kraftwerk Laufenburg AG, were founded in 1894 and 1898. The merger to create the Energiedienst group took place in 2002. In 2003, today's majority shareholder, German ENBW, began to build up positions. Today ENBW holds 67%, Geneva SIG 15%, and the free float is 18%. Due to this shareholder structure, a special situation is possible. However, our focus is on the positive market environment for hydropower described above and an interesting valuation of the company.

Energiedienst could increase annual earnings per share towards EUR 2.50 over the next three years. This is based on the already realised increase in the wholesale electricity price to over EUR 60 per MWh. However, due to forward sales in recent years, this will only be fully reflected in the profit and loss statement of Energiedienst by 2024. At the current share price level, this results in a price-earnings ratio (P/E) of 13 for Energiedienst in 2024, while the larger, Austrian competitor Verbund AG (Verbund) is more than twice as expensive with a P/E 2024 of 29. However, in our opinion, the following consideration is even more interesting than this valuation discount.

We believe that replacement costs of hydropower plants and electricity networks should be higher than historical costs. If you assume – as we do – that hydropower plants earn their cost of capital, the enterprise value of a hydropower plant operator should therefore also be higher than the historical costs. With Verbund, this is the case with a factor of 1.5. Therefore, the capital market pays a premium of around 50% on the historical costs of Verbund.

The situation is somewhat different at Energiedienst. The sum of the book value of property, plant, and equipment as of December 31st, 2020, and the accumulated depreciation results in historical costs of around EUR 2.5bn. The company value is around EUR 1.0bn; accordingly, the tangible assets of Energiedienst can be acquired at a discount of more than 50%. In other words, to buy one euro, less than 50 cents have to be paid at the stock market.

All in all, the Energiedienst investment combines a lot of what we like when it comes to investing: Not a spectacular business model, but solidity. A market environment without excessive competitive pressure and a positive price development. A solid balance sheet and a favourable valuation. And as the icing on the cake, a takeover by the majority shareholder cannot be ruled out.

Hamburg, July 2021

Dr Martin Possienke

Christoph Schäfers

## **Investors Notes**

**On the following pages, we briefly outline our investment philosophy, the set-up of the TGV Falkenstein Fund and consider a possible target return. Hopefully, there is nothing new here for investors who have been with us for a long time.**

### **Investment 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 developing congruent to the market or is already a special situation.

The time horizon of the value investments is long-term. In contrast, the time horizon of the special situations can be several years but is usually much shorter than 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, primarily due to a better understanding of the German capital market legislation.

### **Set up**

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 mutual 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.

All in all, the set-up has changed in a few ways compared to the time at Sparta. Above all, we act as a sub-advisor to the investment advisor (Fiducia Treuhand AG) of the TGV Falkenstein, and no longer as an independent board member. However, much has remained unchanged. The same team – consisting of Traute Kuhlmann, Martin Possienke, and Christoph Schäfers – is based in the same offices and is primarily pursuing the same investment approach that has been tried and tested over many years. We are still convinced that a mixture of value investments and special situations lead to above-average returns and that you can sleep easy with those investments.

## **Target return**

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.

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 the markets are even less efficient on the

special situation side, 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.

We like to compare our long-term average return with the overall development of German stocks (e.g. measured by the DAX or CDAX). However, it is important 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.

There will always be years in which the Falkenstein philosophy is inferior to direct investments in the DAX or another stock index. This is presumably especially true for years with dynamic upward movements, if only because the special situation portion of the portfolio is likely to lag behind the performance of the index in rising markets. In sideways movements or crisis years, however, our approach should do significantly better.

Since 2010, the Falkenstein philosophy has achieved an excess return of around 6% compared to the DAX. Unfortunately, however, we cannot assume that we will achieve an excess return of a comparable magnitude in the future, no matter how hard we try.

However, it is absolutely clear that an actively managed fund – like the TGV Falkenstein – must achieve a return after costs above the broad market indices over five or ten years. Otherwise, investors would do better with a simple and inexpensive investment in “the market” than with the TGV Falkenstein, which would not satisfy you nor us.