

Investmentaktiengesellschaft für langfristige Investoren TGV

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Dear investors

Attached, you will find the annual report for the year 2021 provided by our sub-advisor JMX Capital GmbH for the sub-fund „Truffle“.

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

Annual Report 2021 of the Sub-Advisor

Dear investors,

The performance of +65.4% in the past financial year is eye-catching and requires commentary. The performance chart in the next paragraph shows that the return distribution of TGV Truffle has always been erratic. This makes sense since the portfolio has been dominated by a few stocks since the TGV was launched. Such a concentrated portfolio will always fluctuate. In some years, these fluctuations level out – for example, in 2019: some stocks rose sharply while others fell. Aggregated, it amounted to +1.9% performance for the year 2019. In 2021, there was an accumulation of positive events and an absence of setbacks – so the overall result was correspondingly strong. Positive things have happened not only in the price development of the companies the fund is invested in over the past year but also in the operative business. Some of the preparatory work required for these developments took years, but success crystallised cumulatively in 2021. Loosely based on Vladimir Ilych Lenin¹:

„There are decades where nothing happens; and there are weeks where decades happen.“

Measuring and Weighing

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

Portfolio Facts	
NAV as of 30/12/2021 in EUR	253.47
Total number of investments	13
Weighting largest investment	29.8%
Weighting Top-5 investments	74.5%
Weighting cash / fixed deposit	-0.3% ²

Alphabetical Listing of Top-5 Investments:
Aareal Bank
Associated British Foods
MEDIQON Group
Talgo
Tucows

¹ It is, in fact, debatable whether Lenin ever said these words. He most certainly cannot have hoped that his words would end up on page one of an investor letter!

² Negative amount results from netting cash and cost accruals.

Period	TGV Truffle ³	Berkshire ⁴	(Difference) ⁵	6% p.a. Benchmark	(Difference) ⁵
2015 ⁶	-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%
2020	+27.4%	-5.9%	+33.3%	+6.0%	+21.3%
2021	+65.4%	+39.6%	+25.9%	+6.0%	+59.4%
Since inception ⁷	+153.7%	+96.6%	+56.9%	+48.3%	+105.4%

Since the launch of the TGV Truffle, the annual performance has been 14.8% after all costs and taxes at TGV level. As stated in the 2020 semi-annual report, with an assumed long-term inflation rate of 2% p.a., a return on shares of 8.5% p.a. seems plausible to me and is therefore also included in my valuation models. The additional return realised since 2015 results, on the one hand, from better-than-expected corporate development in the last 24 months in various portfolio companies. In addition, there were several anticipatory effects in the valuation in 2021. Future, probably more gradual increases in value were realised in one go – quasi “in advance”. This anticipatory effect was most evident in the case of two takeover bids made for TGV Truffle portfolio companies over the past six months.

Portfolio changes

The most significant change in the portfolio was the sale of the Zooplus position after the company was taken over by Private Equity investors. I introduced this share in the last letter to investors with the following words:

„Based on a conservative estimate of a long-term margin level (I am assuming EBITDA margins around 6%), the share is not valued expensively. Thus growth in the share price in line with long-term sales growth appears plausible. I am pleased that the TGV Truffle is now a shareholder in Zooplus. I have been following the company since it went public and have watched a ten-fold price increase since 2008 from the sidelines. The TGV Truffle will now finally be part of this development!“

³ Performance after all costs.

⁴ in EUR

⁵ Differences due to rounding.

⁶ 03/31/2015 to 12/31/2015

⁷ Since 03/31/2015

Although it has not been possible to achieve another tenfold increase in value since the beginning of the investment, the TGV was only invested in Zooplus for a few months. I often look at takeover offers with mixed emotions. As the prices paid usually still represent attractive entry conditions for the buyer. In the case of Zooplus, the situation is somewhat different: the first offer from the financial investors was already 40% above the stock market price at the time and thus well above the previous all-time high. After a subsequent bidding war, the price offered continued to rise. The final offer price for the takeover of Zooplus was EUR 490 per share, more than twice as high as the purchase price of TGV Truffle just a few weeks earlier. I still consider the expectations I expressed in the semi-annual report regarding Zooplus' growth and possible margin profile to be realistic. For the financial investors to earn any money at all, however, the future of Zooplus must also be quite rosy. Since the Zooplus position was highly weighted and the price rose sharply within a short period, the performance contribution for TGV Truffle from Zooplus is correspondingly high.

The TGV Truffle then invested the proceeds from the sale of Zooplus in shares in Aareal Bank AG – which, curiously enough, was also the target of a takeover bid just a few weeks after the TGV invested. I have been following Aareal Bank for many years, and I believe the bank's business model is solid. The core business is issuing first-class commercial financing and refinancing via so-called Pfandbriefe (covered mortgage bonds). Pfandbriefe are heavily regulated and highly conservatively structured interest-bearing securities secured by mortgages. In the past few decades, this business has run without any dramatic loan defaults, even during the financial crisis of 2008. I consider Aareal's risk culture to be conservative. However, due to the drop in interest rates, there has been a very strong reduction in profitability in this area of the lending business in recent years. Of course, this has put pressure on the price development of the share, and when TGV Truffle invested, the bank was valued at approximately half the value of the equity on the balance sheet. If an adequate return on equity can be expected in the medium term (which I find very likely), this is favourable. So much so that a valuation at least at the value of the equity seems plausible. However, the key element of the investment is a long-standing subsidiary of the bank – Aareon. It is the leading software company in the European real estate industry. The SAP system of this industry, so to speak. Aareal has built this jewel over decades and kept it as a 100% subsidiary. In recent years, the value of Aareon for the group valuation of Aareal Bank has become ever clearer. In 2020, the financial investor Advent became a minority shareholder in Aareon. At that time, it became clear to me that Aareon's ugly duckling existence within Aareal Bank would now come to an end, and I intensified my research. The result was that a simple addition of the two parts – i.e. the bank's equity valuation and Aareon's valuation in the same way as similar software companies – could result in a fair value of more than EUR 50 per share. The TGV Truffle acquired the shares below EUR 25 on the market in the summer.

Unfortunately, I was not the only investor who has come to this conclusion. At the beginning of October, a takeover bid at EUR 29 per Aareal Bank share was announced by a consortium led by two financial investors. One of the financial investors is Advent – Aareon’s minority shareholder. The other is Centerbridge, who have historically made a name for themselves as experts evaluating complex loan books. Advent is therefore willing to significantly increase its bet in Aareal/Aareon, after having been invested for a year and having had complete insight into the business since then. Centerbridge, on the other hand, took a detailed look at the loan book of Aareal Bank and still seems to want to invest around EUR 800 million for the takeover. In short, both financial investors not only seem to share my assessment of the valuation of Aareal Bank Group, but they were even able to make this assessment with much deeper due diligence access and better information than available to me as an outside shareholder. Unlike in the case of Zooplus, I see the purchase price for Aareal as too cheap. For this reason, I will not recommend selling Aareal Bank shares at EUR 29 but aim for TGV Truffle to remain invested in Aareal Bank in the long term – possibly also in the form of a minority shareholder of the financial investors. Whether and how this is possible will be seen in the coming weeks, and I will report about this in the 2022 semi-annual report. Unlike many funds, TGV Truffle can hold shares on the OTC market of the German Stock Exchange, where Aareal Bank will presumably be listed in the medium term.

A major new position in the TGV is the Spanish company Talgo. Talgo is a train manufacturer founded in the 1940s. The design of Talgo trains is special and not suitable for all routes. But where it can be used, Talgo trains can often offer the most powerful and cheapest technical solution. From 2023, for example, Talgo will deliver the new ECx trains for Deutsche Bahn AG, which will replace the current ICs.

The Spaniard’s revenue mainly comes from maintenance contracts with the train operators, some of which last for decades. A fee is payable for each kilometre driven. Talgo maintains the trains for this fee – a very similar model to the one I have described in the past for aircraft turbines in the case of the former TGV investment Rolls-Royce. This type of compensation is very stable in itself. Similar to aircraft engines, there was only a standstill of trains in 2020 due to the Corona crisis, although maintenance sales have completely recovered to date.

Two main trends should drive the medium-term development of Talgo: Firstly, it is almost certain that hundreds of billions in investments will flow into the European rail sector in the coming years. On the other hand, the supply is quite consolidated, and the large investments are likely to end up with a small number of market participants – Talgo is one of them. Secondly, it is not just the rail operator side that is being liberalised, but also that subcontracting orders are far less likely to be awarded locally only. Deutsche Bahn used to work with Siemens frequently – today, there are several rail providers in Germany, and they obtain their technology from all over Europe. Talgo (as a fairly small supplier with inexpensive products) should succeed in gaining relative market share here. With very little debt, Talgo

is currently trading at a price-earnings ratio of around 10 times the expected profits for 2023 at the end of 2021. This is far too cheap given the growth profile and earnings quality described.

Expectations

There are fat years, and there are lean years. From the point of view of TGV Truffle performance, the years 2020 & 2021 were really fruitful. As explained in detail, this is, at least in part, due to special effects. I would be even more cautious in my statements had the performance of the last few months been driven solely by an expansion in valuations. But this is not the case. Rather, the portfolio is quite “fresh” – some stocks have been bought only recently (e.g. Aareal and Talgo), and, in my view, the undervaluations have yet to be balanced up. In the case of the longer-standing investments (e.g. Alimentation Couche-Tard, MEDIQON, Tucows, or System1), the shares are trading at multi-year highs, but the operative business development of the past few months has been correspondingly positive.

In this respect, I am still quite optimistic with regard to the current portfolio and look forward to being able to advise TGV Truffle for many years to come. However, we were certain of one thing: if we can look back on the performance from 2022 to 2032 in 10 years, it will certainly not be a straight but a rather bumpy ride. However, I don't want to predict those bumps, I rather want to use them.

Book recommendation

The fact that financial investors are courting listed companies and trying to take them over is by no means new. In the 1980s, takeover fever was rampant in the United States.

I recently managed to read a classic from that era: John Taylor's “Storming the Magic Kingdom” is a gripping account of how Walt Disney became the sport of Wall Street interests. Then as now, it is often clear: in the end, people make the decisions, and these people are not necessarily always rational. And even if all the key players act rationally, the interests of different shareholders can create confusing conflict situations for a company. What should happen if one shareholder is not *allowed* to sell, but another *has* to sell? This shows how companies can gain security and clarity (or be “bought away” less easily by financial investors) when stable and long-term anchor shareholders are on board.

Outlook

I would like to thank you for the continued trust over the past year and look forward to your questions at the next investor meeting on May 21, 2022. Whether it will be virtual or a face-to-face meeting will only be decided in a few weeks - let's hope for the best! In any case, I wish you a good start in 2022 and, above all, good health!

Best regards from Hamburg,

Jan-Hendrik Mohr