

Investmentaktiengesellschaft für langfristige Investoren TGV

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Rüngsdorfer Str. 2 e · 53173 Bonn · Germany

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Rüngsdorfer Straße 2e
53173 Bonn
Germany

Telefon: +49/228/368840
Telefax: +49/228/365875

E-Mail: info@langfrist.de

Dear Investors

We are enclosing the shareholder letter for our Teilgesellschaftsvermögen “Intrinsic” for the first half of 2020 written by our sub-advisor CL 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

Sub-fund Intrinsic

Half-year report 2020 of the subadvisor CL Capital GmbH

Dear co-investors,

The performance of the TGV Intrinsic in the first six months of 2020 was +3.3%, bringing the NAV to 112.79€ as of June 30, 2020. The DAX generated a return of -7.1% during the first six months of 2020. Since the launch of the TGV Intrinsic on March 29, 2019, the fund has achieved a performance of +12.8%. The DAX grew by +6.8% over the same period.

The half-year report 2020 of the TGV Intrinsic explains (1) after the overview of the portfolio structure and the performance, why I (2) have intensively delved into payment service providers and digital wallets¹ over the past months. The starting point of my research on this topic was my visit to a bar in Kenya, where I was not able to pay my tab cash or by card. Based on this experience, I present (3) the new investment of the TGV into FEMSA, a Mexican family-run business. In my view FEMSA has a good chance to evolve from a brewery to a technology company and is well-positioned to build the leading digital wallet of Mexico.

Portfolio structure and performance overview as of June 30, 2020

Portfolio

NAV per share	112.79€
Number of investments	11
Weighting largest investment	15.2%
Weighting five largest investments	57.6%
Weighting cash	5.5%

Alphabetical listing of the five largest investments of the TGV Intrinsic

Alphabet

MercadoLibre

Microsoft

TomTom

Wabtec

¹ With a digital wallet (also called an e-wallet), users can pay for a variety of services and goods or send each other money once the digital wallet has been topped up with money. Well-known digital wallets today include Apple Pay or PayPal.

Performance overview

Period	TGV Intrinsic (1)	Dax (2)	Delta ² (1)-(2)
2019 (9 months)	9.2%	15.0%	-5.8%
2020 (6 months)	3.3%	-7.1%	10.4%
Since inception	12.8%	6.8%	6.0%
p.a. since inception	10.0%	5.4%	4.7%

MercadoLibre represents the only change in the largest portfolio items. Due to the very positive share price development in recent months, the company is now one of the five largest investments. The majority of companies in the TGV Intrinsic portfolio have weathered the challenges posed by the outbreak of COVID-19 well and strengthened their own market position through targeted investments. A good example is the Microsoft communication platform Teams, which allows companies to provide more efficient internal and external communication. Microsoft has increased the frequency of introducing new product features since the outbreak of COVID-19. This should help to keep the numerous newly acquired users active on the platform even after the pandemic. In March, Teams had 32 million daily active users – this figure more than doubled to 75 million users in two months. I see the statement of Microsoft CEO Satya Nadella on the pandemic as representative of several portfolio companies in the TGV Intrinsic: *“We have seen two years’ worth of digital transformation in two months”*. In addition to software companies, COVID-19 has also given digital payment service providers a boost. I analysed companies from this industry in the past because they influence several TGV investments and because many exciting companies are active in this industry.

Payment service providers and my attempt to pay for a beer in Nairobi

My overarching search criteria for investment are always: Intrinsically motivated entrepreneurs who build a business model in structurally growing markets that will have a stronger market position in ten years than today. These search criteria are often met by digital payment service providers:

² Rounding differences are possible

- (1) A high number of intrinsically motivated entrepreneurs because digital payments give access to financial services to previously excluded parts of the population.
- (2) A structurally growing market due to rising consumer spending and the switch from cash to digital payment.
- (3) Companies with a stronger competitive position in the long term by building network effects.

Surprisingly, there is little or no alternative to using the products of a few digital payment service providers in everyday life. Last autumn, I wanted to invite two befriended investors to a beer in Nairobi. But to my surprise, I found that neither cash nor credit cards were accepted in the bar. The only way to pay was a digital wallet called M-Pesa. I had similar experiences in Uganda and Rwanda. For restaurants, taxi rides, and even for buying an Apple charging cable from a dealer, only M-Pesa was accepted as a method of payment. M-Pesa is part of the Kenyan company Safaricom, which I visited in Nairobi³. M-Pesa was originally founded to allow people in large cities to send money to their family members in the country via mobile phone. Since it was founded in 2007, M-Pesa has grown to over 37 million active users, and more than 11 billion transactions are carried out each year.

Not only in Africa but worldwide, digital payment service providers operate in a structural growth market. Two factors are crucial for this growth: rising consumer spending and the shift from cash to digital payment methods. Consumer spending has been growing globally for many years by 3-4% per year, and it is realistic to assume that this trend will continue in the coming years. Digital payments are growing by an additional 4% per year faster than global consumer spending as people worldwide use more digital payment methods for their purchases each year. COVID-19 has further reinforced this trend. Digital payments are used almost exclusively for the rapidly growing share of purchases via the Internet. Furthermore, many small retailers such as bakeries, hairdressers, or tailors now accept card payments to ensure contactless payment. Digital payments have, therefore become even more important due to COVID-19.⁴

Development of network effects in digital wallets

For digital payment service providers, there are very good opportunities to build sustainable competitive advantages. One of the strongest competitive advantages I can see in companies, in general, are network effects. They often create mutually reinforcing effects: -> increasing customer benefits -> thereby increasing customer numbers -> which in turn leads to increasing customer benefits. In many cases, digital wallets show exactly this effect. First, a bilateral network

³ Unfortunately, the ownership structure of Safaricom is not ideal, which is why the company is currently not considered as a purchase recommendation.

⁴ For example, a study by Mastercard dating from April 2020, found that contactless payment in supermarkets and pharmacies worldwide is growing twice as fast as non-contactless transactions. Of 17,000 consumers surveyed in 19 countries, 74% stated that they are willing to continue using contactless payment methods even after COVID-19.

of (1) merchants who accept the wallet as a means of payment and (2) customers who are willing to pay with the wallet must be established. The more retailers become part of the network, the higher the value for users of the wallet. At the same time, the growing number of users is interesting for retailers, as customers explicitly search for retailers where they can use their digital wallet.

When I met one of the founders of MercadoLibre two years ago, I asked him what the decisive factor for the success of MercadoLibre in the next ten years would be. He didn't hesitate for a second: "Building a bilateral network for our digital wallet." At the end of 2019, MercadoLibre began to charge a fee of 0.6% on payments with the wallet MercadoPago from vendors in Argentina. That sounds like a small fee. But if you consider that in 2019, with a growth of over 200%, a transaction volume of \$ 3.3 billion was already processed, the sales potential becomes clear. Another company in Latin America that I believe has a good chance of building a successful digital wallet is the Mexican family company FEMSA. I have recommended investing in FEMSA in the past months.

FEMSA – A Mexican brewery on its way to becoming a tech company

In 1890 the Cuauhtémoc brewery, which is the origin of today's FEMSA, was founded in Monterrey. The company currently operates four business divisions:

- a. FEMSA Comercio: The division essentially operates three retail concepts: convenience shops (under the OXXO brand), pharmacies (Cruz Verde and YZA), and petrol stations (OXXO Gas).
- b. Shares in Heineken: The brewery was sold to Heineken in 2010. In return, FEMSA received shares in Heineken and still holds 15% of the shares in the Dutch brewery group.
- c. Shares in Coca-Cola FEMSA: Since the 1980s, the family behind FEMSA has been building the largest bottler of all Coca-Cola brands worldwide by volume⁵ and holds a stake of 47% in the listed company Coca-Cola FEMSA
- d. FEMSA Strategic: includes other companies, notably one of the largest logistics companies in Latin America called Logistica.

I will focus on FEMSA Comercio in the remainder of this letter, as the division will be the most important driver for the value of the company as a whole in the coming years. The fact that they can continue to grow in Mexico and Latin America for many years, have similar core competencies in the retail and purchasing sectors, and achieve positive economies of scale with increasing size, is what compounds the three retail concepts from FEMSA Comercio.

⁵ In 2019, Coca-Cola FEMSA produced and sold 11.1% of the worldwide Coca-Cola production volume.

The first OXXO shop was opened in Monterrey, where FEMSA's headquarters are located, in 1978. A typical OXXO shop is 100m², carries about 3,200 products for daily needs⁶ and achieves an annual after-tax return of over 30% on the capital invested. FEMSA currently operates almost 19,500 OXXO shops in Mexico and around 300 other OXXOs in Colombia, Chile, and Peru. An average of three new OXXO shops are opened every day. During my company visit to Monterrey earlier this year, the management of FEMSA estimated the market potential in Mexico alone to be 30,000 OXXO shops. But the speed of openings in Colombia, Chile, and Peru has also increased significantly over the past two years. In new geographies, FEMSA adapts the basic business model very closely to local habits. Only when the numbers show that the concept is well received by customers, further stores will be opened at high speed. At the end of 2019, after a ten-year search, FEMSA found the right partner for entering the Brazilian market with Raizen.⁷ In cooperation with Raizen, OXXO will now be adapted to Brazilian consumer habits. In the future, the Brazilian market could grow to a size similar to the Mexican market.

FEMSA also operates Chile's largest pharmacy chain, Cruz Verde, and YZA, which is now the third-largest pharmacy chain in Mexico. The market in Mexico is still very fragmented, and FEMSA plays a very active role in consolidating it by opening its own pharmacies but also by buying in competitors. The operation of petrol stations started four years ago. This became possible after the petrol station market in Mexico was liberalised. Since then petrol stations have been allowed to operate independently of the state operator PEMEX, which is experiencing financial difficulties. Of the total of 12,500 petrol station in Mexico, PEMEX still operates around 10,000. FEMSA now operates around 550 under the OXXO Gas brand. FEMSA has great growth potential because many Mexicans trust the OXXO brand more than the market leader PEMEX – especially since PEMEX is rumoured to pump less gasoline than subsequently billed. FEMSA thus has good chances of expanding its market share in the coming years.

FEMSA Comercio has been digitising its shops more and more for several years. Today, customers can already pay for over 5,000 different digital services in an OXXO shop. Customers top up their mobile phones with credit, pay electricity bills, or bills for goods ordered online, and can choose in which OXXO they would like to collect their Amazon package. Customers can also send each other money and have the money disbursed in an OXXO shop. Another important step on the path to digitisation was the loyalty program, which will bring the three retail concepts closer together. Customers can obtain a wide range of everyday products in the shops operated by FEMSA. Through personalised offers, FEMSA can further increase customer loyalty and use the resulting higher sales to convert them into better purchasing conditions. FEMSA has been gaining experience with digital payments since 2012. At that time, OXXO introduced the Saldazo debit card

⁶ Mostly food and beverages, some also carry other items such as cosmetics or non-prescription drugs.

⁷ Raizen operates Shell petrol stations in Brazil and has around 6,000 operated shops with proven expertise in the convenience sector.

and has issued over 14 million cards to date.⁸ Many Mexicans either have little trust in banks or see a bank as an upper-class institution. Combined with the high level of trust in the OXXO brand, this has made the Saldazo debit card Mexico's largest card program.

Digital wallet as a consequent continuation of the digitisation strategy

The digitisation of the shops has laid the foundation for introducing the digital wallet this year. The most important factor for a successful digital wallet, as described above, is the establishment of a bilateral network of (1) retailers and (2) customers. The biggest challenge usually is to get one side excited about the platform, even though the other side is not yet active on the platform. However, FEMSA does not have this problem. Over 13 million customers make their purchases in OXXO shops every day. The success of the Saldazo debit card has shown how well a new product can be launched through the OXXO shops. That is why FEMSA has a good chance of quickly convincing a significant number of customers to use the digital wallet. This is also because FEMSA has great advantages on the dealer and service side. OXXO customers are already used to buying a variety of digital services in the shops, which now only have to be integrated into the digital wallet. Beyond that, the enormous customer base is so attractive for every new dealer or service provider that entry into the payment network represents great added value for them.

Mexico today has a society in which people still make significant payments in cash. According to the World Bank, in 2018, more than half of the Mexican population over the age of 15 had no bank account. This is another advantage for FEMSA and explains why no digital wallet has been able to establish itself as the clear market leader yet: To operate a digital wallet, an interface is required, through which cash can be transferred to the digital platform. With OXXOs, pharmacies, and petrol stations, FEMSA has over 21,000 contact points through which customers can deposit their cash into a digital wallet. In comparison, all banks in Mexico only have a combined branch network of close to 13,000 branches. Due to the low penetration of bank accounts in Mexico, FEMSA's infrastructure represents a significant competitive advantage.

The opportunities that arise from a successful digital wallet are obvious: With the help of an app, people can handle a variety of services and retailers get into contact with numerous potential consumers. FEMSA can then monetise this platform. The other services that can be offered via such a platform are also potentially valuable: For example, a digital wallet can use the transaction history to assess the creditworthiness of its users. Thanks to the digital wallets from MercadoLibre in South America or M-Pesa in East Africa, people that were previously excluded from such financial services can now have access to loans without having a bank account.

⁸ Of the 14 million Saldazo debit cards issued, 60% are actively used, whereas the average of active to issued cards in Mexico is generally only 40%.

I see the greatest risk for the creation of a digital wallet in the change that FEMSA has to go through in its corporate culture. A newly opened OXXO shop generates profits after just a few months. With a digital wallet, it is more important in the first few years to bring as many customers as possible onto the platform and to make many services available. Profits are often only generated a few years after the platform was launched. This must lead to a reconsideration of the expectations of the management and means a change in the structure of the budget meetings and planning sessions. On the way to becoming a technology company, the type of employees that FEMSA has to hire also changes. Software engineers have to be managed differently and may be more productive in a different business environment than current employees. Nevertheless, I am optimistic that FEMSA will successfully go through this change for several reasons.

Change simply is in the company's DNA. When it was founded in 1890, FEMSA was initially a beer brewery, then built the world's largest Coca-Cola bottler, and then developed into a major retail company. In doing so, FEMSA has managed an impressive balancing act on several occasions: the far-sighted capital allocation has enabled the existing business divisions to be further developed – in some cases also with partners – so that FEMSA has been able to participate in the increase in value. At the same time, management always looked into investing in future business models. Extensions or innovations of the business model mostly took place close to the core of the existing business, and this also happens in the case of the digital wallet. The wallet is a consequent further development of the digitalisation of retail concepts that started several years ago.

The far-sighted capital allocation is made possible by the five founding families, which still hold around 39% of the shares. The chairman of the board of directors, Jose Antonio Fernandez, belongs to one of the families and has been running the company since 2001, having worked in several operational positions before, and in particular being responsible for setting up OXXO⁹. A long-term perspective also brings two other people into the management. Cascade, the family office of Bill Gates, is the second-largest shareholder of FEMSA with around 8%, and Michael Larson, the Cascade CIO, has been on the board since 2011. Robert Denham from the American law firm Munger, Tolles & Olson (founded in 1962 by Charles Munger and others) has also been a member of the FEMSA Board of Directors since 2001. Larson and Denham are closely involved in every capital allocation decision. The close network with Warren Buffett and Charlie Munger is also very helpful for these decisions.

Much like FEMSA needs long-term owners to implement its strategy, TGV Intrinsic relies on investors who support the long-term strategy. There were no outflows or nervous calls during the current COVID-19 pandemic, for which I am very grateful. I look forward to the coming years of our partnership. As an investor in the TGV Intrinsic, you should already have received the

⁹ A highly recommended video about Jose Antonio Fernandez can be found on YouTube: „Approach to Leadership Evolves: Jose Antonio Fernandez, FEMSA“

invitation for this year's digital investors' meeting on September 5. I look forward to your questions and to welcoming you in person again next year.

I wish you all a healthy and successful second half of 2020.

Clemens Lotz

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