Investmentaktiengesellschaft für langfristige Investoren TGV

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Dear Investors

We are enclosing the shareholder letter for our Teilgesellschaftsvermögen "Intrinsic" for the year 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.)
Eingetragen im Handelsregister Bonn HRB 16143
Investmentvermögen mit veränderlichem Gesellschaftskapital

Sub-fund Intrinsic
Annual report 2020 of the sub-adviser CL Capital GmbH

Dear fellow investors,

The performance of the TGV Intrinsic in 2020 after all fees was +25.2%. The NAV as of December 30, 2020, was EUR 136.70. The DAX achieved a return of +3.6% for 2020. Since the TGV Intrinsic was launched on March 29, 2019, the fund has achieved an annual performance after costs of +19.5%. In the same period, the DAX gained +10.4% per year. The annual return becomes relevant after five years at the earliest.

In the 2020 annual report of the TGV Intrinsic, I will first address the portfolio structure and performance overview. Using the example of the Cuban Missile Crisis in 1962, I will explain to what extent good luck or bad luck can have a say in the outcome of an event. To survive unfortunate events, resilience of the companies of the TGV Intrinsic plays an important role. Long-term thinking and building your organisation based on it are important cornerstones for resilience – this applies to the investments of the TGV Intrinsic as well as to myself.

Portfolio structure and performance overview as of December 30, 2020

Portfolio structure

NAV	136,70EUR
Number of investments	14
Weighting biggest investment	12,4%
Weighting five largest investments	55,0%
Weighting cash	4,2%

Alphabetical listing of the five largest single positions within the TGV Intrinsic

Fomento Económico Mexicano (FEMSA)
MercadoLibre
Microsoft
TomTom
Wabtec

Performance overview

Period	TGV Intrinsic (1)	DAX[1] (2)	Delta[2] (1)-(2)
2019 (9 months)	9,2%	15,0%	-5,8%
2020	25,2%	3,6%	21,7%
Since inception	36,7%	19,0%	17,7%
p.a. since inception	19,5%	10,4%	9,0%

For the first time, the Mexican holding company FEMSA is one of the five largest portfolio positions of the TGV Intrinsic. Due to the falling share price in summer, the return I expected on the investment and the attractiveness compared to other portfolio companies increased, so I recommended further share purchases. The overall good annual performance of the TGV Intrinsic in 2020 is mainly due to an event over which I had/have no influence – the COVID-19 pandemic. Due to the pandemic, the habits of many people have changed and have resulted in a sustained higher intrinsic value in several of the investments of the TGV Intrinsic. These companies are already generating cash flows today, that without COVID-19 would only have been possible in a few years. I attach little importance to my contribution to fund performance in such a year – at no time have I made investment recommendations with theses based solely on the effects of the COVID-19 pandemic.

Investment recommendations for the TGV Intrinsic should lead to a good, annualised return over a long time. Whether individual years show a very good fund performance or a very poor fund performance is not important to me, and both are likely to occur. An example of this is the Microsoft share, which has risen 26% p.a. between the IPO on March 13, 1986, and January 29, 2021. The path there was by no means linear. Within a single calendar year, the share price fell temporarily by more than 60% (in 2000), twice by more than 50% (in 1987 and 2008) and nine times by more than 25% (1988-1990, 1993, 2001, 2002, 2009, 2010, 2020). The price for a good long-term return is the acceptance of significant short-term price fluctuations. Therefore, when assessing fund performance, short periods should not be taken as an indication of the quality of investment recommendations (neither positive nor negative) – as in 2020, they are simply subject to too many external influences beyond control.

[1] A global stock index, such as the MSCI World would be a more suitable benchmark index, but for cost reasons I chose the DAX.
[2] Rounding differences are possible.

In short periods of time, what we call good luck, or bad luck can significantly affect the outcome of an event. A historically remarkable example is the Cuban Missile Crisis of October 1962. At that time, the world was on the verge of the outbreak of a third world war, and it was only thanks to several lucky coincidences that this crisis ended without escalation. This episode in world politics also shows how many decisions in life in general – and when it comes to investment recommendations in particular – have to be made based on incomplete information.

The Cuban Missile Crisis in October 1962

On Tuesday morning, October 16, 1962, the United States are certain that Russian missiles have been stationed in Cuba and are aiming at American targets. The US are on the verge of a military strike, which would probably lead to World War III. Robert F. Kennedy is US Attorney General and one of the closest advisers to his brother, US President John F. Kennedy. In his book "Thirteen Days", Robert F. Kennedy describes in detail the processes, discussions, and decisions in the White House over the following days. While reading this book, I was particularly impressed by John F. Kennedy's thoughtful and careful decision-making process. He analyses incentive structures within his organisation with a high degree of accuracy, creates options for himself to retrospectively adapt decision paths that had been taken, and makes decisions contrary to consensus opinion. Beyond that, he shows great empathy towards the Russians and continuously tries to put himself in Russian President Khrushchev's shoes to find peaceful alternative solutions.

In the days after October 16, 1962, the situation is worsening. The exchange between Khrushchev and John F. Kennedy becomes more emotional. Work on the missile bases in Cuba is progressing, an American plane is shot down over Cuba, and Russian submarines armed with torpedoes are only a few miles away from the OAS naval blockade off the coast of Cuba, referred to as "quarantine". On October 27, 1962, the Americans use "practice water bombs" to force the Russian submarines to surface. The three Russian commanding officers aboard the submarines, in turn, have explicit permission to fire if they unanimously decide to attack. However, they have lost radio contact with Moscow and for days they don't know whether a war has already broken out on the surface. After heated discussions and only because of the veto of political officer Vasily Arkhipov against an attack, the Russian submarines finally surface peacefully. A Russian attack would probably have led to a counterattack by the Americans in Cuba and thus to World War III. In the hours that follow, Khrushchev and Kennedy reach an agreement to dismantle the missile bases in Cuba. In return, the US withdraw their missiles stationed in Turkey.

With his skilful approach, John F. Kennedy plays an important role in preventing the outbreak of World War III. However, the Cuban Missile Crisis in 1962 also shows that despite careful decision-making, a catastrophe was only prevented with a lot of luck. It serves as a good example for long-term investors that companies should have a high level of resilience to survive unfortunate circumstances and crises. Such resilience is primarily achieved through one factor: long-term thinking. Long-term thinking significantly influences an organisation's structure and sets the right incentives to increase resilience in crises by acting with foresight. John F. Kennedy also pursued his long-term goal of prosperity for the USA with a high level of awareness of incentive structures in his organisation.

How long-term thinking builds business resilience

> *"The time to repair a roof is when the sun is shining"* – John F. Kennedy

John F. Kennedy was well aware of the power of incentive structures. He withdrew from discussions several times during the Cuban Missile Crisis to ensure that his advisors could discuss freely – without having to mind Kennedy's opinion. He viewed his military advisers' recommendations with great scepticism, as unsurprisingly, they recommended a military strike. A quote from the book "Thirteen Days" illustrates his awareness of the incentives of his military advisors:

> "*The first advice I'm going to give my successor is to watch the generals and to avoid feeling that because they were military men their opinions on military matters were worth a damn. […] These brass hats have one great advantage in their favor, if we […] do what they want us to do, none of us will be alive to tell them that they were wrong."*

During the entire Cuban Missile Crisis, John F. Kennedy showed sensitivity for the incentive structures of individuals and factored them into his decisions. Always with the knowledge that his long-term goal of prosperity for the USA may not have been completely congruent with the goals of individual advisors.

I am convinced that people get their greatest possible drive from intrinsic motivation and the investments within the TGV Intrinsic are managed by intrinsically highly motivated people. Their inner drive leads them to build organisations that generate sustainable added value for different stakeholders.[3] This, in turn, results in a long-term orientation of the companies with positive consequences for the corporate culture, investment activity, and capital structure. I often find this long-term orientation in companies run by founders or families. FEMSA is a good example of how a family business sticks to strategic initiatives even through crises.

[3] Typically, a successful business model should consider the following stakeholders (in alphabetical order): customers, employees, lenders, owners, regulators, society, suppliers.

Long-term orientation of family businesses

> *"We are not thinking or worried about the next quarter numbers – never. If you ask me how they are going to be: I don't know and I don't care. Because we see the long-term potential of the company. We are always making decisions that will influence the numbers in the future, not in the very next quarter. If you have to save some maintenance to make the numbers of the quarter look nice, you are killing the company and the message that you are sending to all the ranks of the company is very, very bad."* – José Antonio Fernández Carbajal

Family entrepreneurs know that they and their companies have to survive crises again and again and that the profit from one individual year does not play a role in the long-term value creation of the company. This attitude corresponds exactly with my investment recommendations for the TGV Intrinsic. José Antonio Fernández Carbajal, a member of one of the FEMSA founding families, took over the operational management of the company in 1995 and is still Chairman of the FEMSA Board of Directors to this day. As the quote, and above all his actions from the past, show, corporate decisions at FEMSA are geared towards the company's long-term success. The COVID-19 pandemic was a good chance to review this assessment. Although FEMSA suffered more operationally from the COVID-19 pandemic than other TGV Intrinsic investments, my expectations were exceeded. Many other companies would have cut back on important investments to optimise profits in the short term. FEMSA, on the other hand, continued all important initiatives and even increased its investments in some cases.

In the core business of convenience shops, FEMSA has been gradually adjusting employee remuneration for several years. This change leads to higher costs in the short term, but in the long term to less employee turnover, which, in turn, will have a positive effect on sales per OXXO shop. The OXXO expansion to Brazil was also continued as planned. The structure there initially leads to costs that are not offset by sales and thus burdens profit. The first OXXO shop was opened in Brazil at the end of 2020, and more will follow in 2021. I reported in detail on the digital wallet initiative in the 2020 half-year report. These investments were also continued, and I expect the app soon to be launched. FEMSA is a prime example of a company whose long-term orientation has not been affected by a crisis. To continue strategic initiatives in a crisis and remain capable of acting, in addition to a long-term orientation, appropriate cash reserves are required.

How long-term thinking affects a company's capital structure

> *"A banker is a fellow who lends you his umbrella when the sun is shining, but wants it back the minute it begins to rain"* – Mark Twain

Debt financing is, in theory, a convenient way to finance a company. However, outside capital has a major disadvantage: dividends to owners can be suspended, interest payments to outside creditors usually not. Several negative developments are often intertwined in a crisis: a sharp drop in sales while costs remain stable or drop slower, resulting in growing losses and dwindling liquidity reserves. Such a capital structure, shaped by outside capital, takes away the freedom to continue investment projects in a crisis, as FEMSA was able to do. Furthermore, banks look particularly carefully at loans granted in this situation and try to reduce loans to endangered companies. Within a short time, it is possible that a company can no longer service its bank debts and so a decades-long entrepreneurial success story could come to an abrupt end. For a manager who thinks short-term, the increased risk may still be attractive, because with a higher debt ratio, all other things being equal, the return on equity increases. He might not have to experience the weakened resilience of the company himself if, before the next crisis occurs, he has already been hired by a new company.

The TGV Intrinsic is invested in companies with little or no net debt and whose return on capital employed still exceeds their cost of capital considerably. Microsoft, for example, has always had significant net cash reserves since it went public, and still achieved an after-tax return of 48% on the incremental employed capital last year. Bill Gates justified the company's overcapitalisation with the fact that crises would always have to be overcome:

> *"I was always worried because people who worked for me were older than me and had kids, and I always thought: What if we don't get paid? Will I be able to meet the payroll?"* – Bill Gates

Therefore, the cash reserves should, at all times, cover all fixed costs for a year. This maxim still applies today. In the fiscal year 2020, Microsoft had sales of USD 143 billion. It incurred non-variable and semi-variable costs of USD 74 billion. Microsoft's balance sheet includes cash reserves of USD 137 billion and bank debt of USD 63 billion, making a net cash reserve of around USD 74 billion. Even today, Microsoft is in the comfortable position to cover all of its non-variable and semi-variable costs for a year, even if it doesn't generate any sales. Microsoft thus has an enormous resilience to emerge from future crises unscathed and hopefully even strengthened.

Bottom line

The investments of the TGV Intrinsic are managed by entrepreneurs who act with high intrinsic motivation and a long-term vision. They are aware of the regular occurrence of crises and strive for a high resilience of the company. Resilience of this kind is also important because the potential scope of a crisis often only becomes clear afterwards. This also applies to the Cuba crisis of 1962 described above: It was only many years later, at a conference held in Havana in 2002, on the occasion of the 40^{th} anniversary of the Cuban Missile Crisis, that it became clear that the Russian submarines off the coast of Cuba in October 1962 had more than just regular torpedoes on board. In fact, they also had a nuclear explosive device on board, which the officers were explicitly permitted to deploy. This fact was unknown to anyone outside the Russian military until 2002, and the world had been much closer to the abyss in 1962 than assumed. Perhaps it was precisely because of his ignorance of the real threat that John F. Kennedy made the decisions that led to a better outcome for humanity.

I believe that this realisation teaches above all humility: about how difficult it is to assess the potential extent of a crisis and how often decisions have to be made based on incomplete information. That is precisely why entrepreneurs must allow room for error in their decisions, just like I do with my investment recommendations. Long-term thinking and building an organisation based on this are the cornerstones for the investments of the TGV Intrinsic as well as for myself.

You are cordially invited to this year's investors' meeting on May 22, 2021, in Bonn-Bad Godesberg. Depending on the pandemic situation, a decision will be made at relatively short notice whether the meeting will be virtual as in 2020 or in person. I would be delighted to have a personal exchange with you. Until then, I wish you a good start in 2021 and stay healthy!

Sincerely,

Clemens Lotz

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