Memorandum

To : Forum Staff

From : BW

Date : July 14th, 2016

Subject : FES Chief Investment Officer Report on Q II 2016 Results**_V_1.0**

The report of the CIO has been put together for **stakeholders interested in what we do**, mainly

a) our **internal professional** team as a basis for a structured internal discussion

b) the **many companies** which share their time with us answering our questions to give them a better understanding what type of investors they are dealing with

c) the close to 1.000 p.a. **applicants to FORUM** to help them understand what work and life at FORUM are like.

This Interim Report covers the **period from April 1st, 2016 to June 30th, 2016**.

1. Results in Q II 2016

1.1 Results and Benchmarking: Market Price Perspective

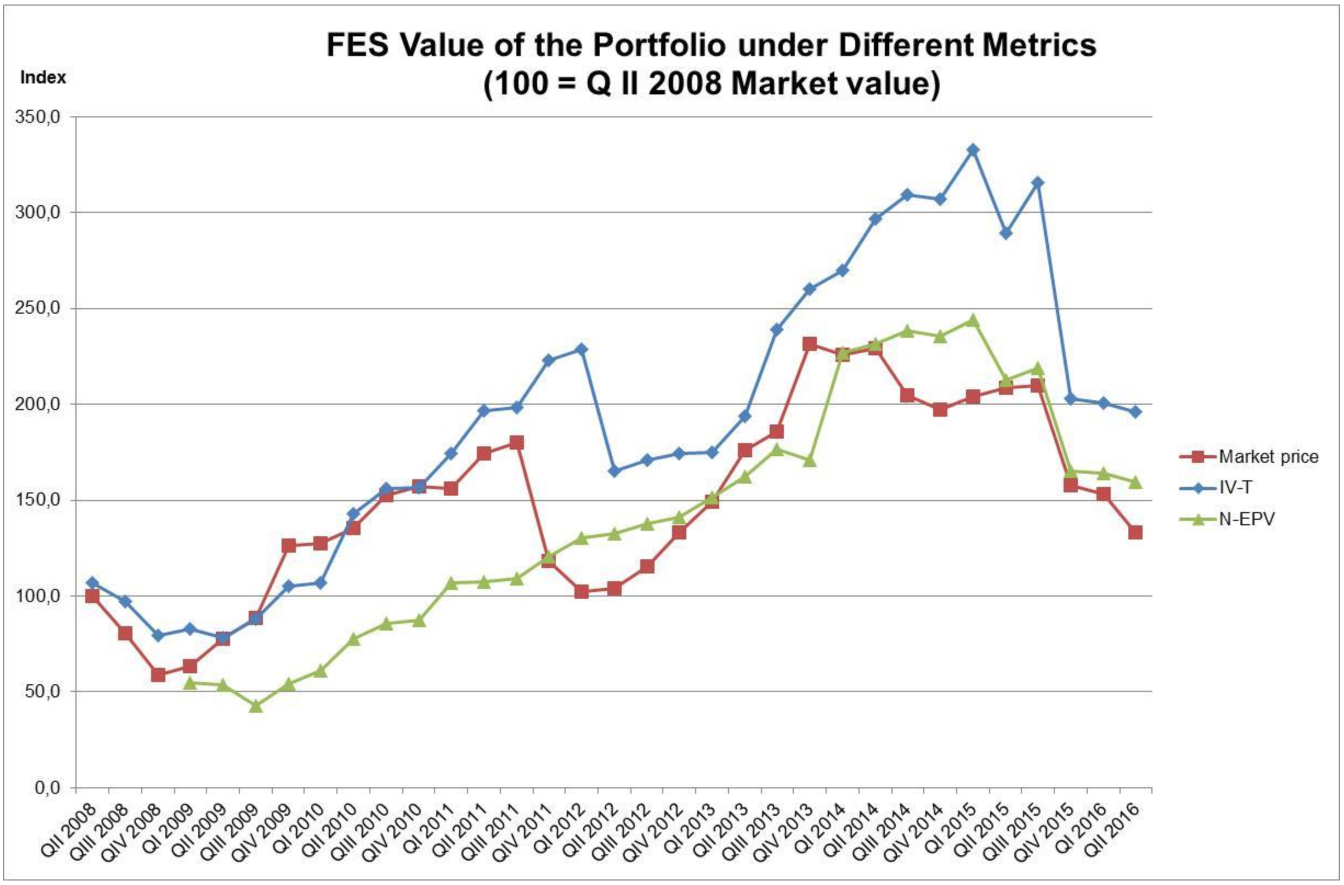
In Q II 2016 the **Market Value of FES decreased by 13,2%**

The key benchmark for our performance at market price is the STOXX Europe Small 200 Performance Index ("SES 200"). During Q II 2016 it increased by 4,3%. **Thus we underperformed this benchmark by 17,5 percentage points in the quarter.**

YTD, FES NAV is down by 17,5% - vs. our benchmark which is down by 2,9%. Thus YTD underperformance is 14,6%.

1.2 The Intrinsic Value Perspective

Please look at the **Chart 1** below showing how the key metrics of Intrinsic Value have developed over time:



a) **The line in green shows the value of the portfolio at Net Earnings Power Value ("N-EPV"). N-EPV captures the Earnings Power Value of the existing business in a steady-state situation** – i.e. does not attribute any value to growth.

   In the quarter **N-EPV decreased by 2,6%.**

b) The line in blue shows the value of the portfolio at IV-T – i.e. including the value of growth.

   In the quarter **IV-T decreased by 2,3%.**

Ca. 1,0% of the loss is linked to Currency Exchange Rate, mainly GBP which lost ca. 7% after the Brexit announcement.

1.3 Margin of Safety

To interpret **Margin of Safety** of the fund look at **Chart 1** above again. Now you should focus on **how the red line – depicting NAV – is moving relative to N-EPV and IV-T.**

1.3.1 NAV vs. N-EPV

This ratio tells you what percentage of the NAV is covered by the Net Earnings Power Value of the businesses we own - excluding growth.

At the end of Q II 2016 NAV at market prices was ca. **16% below N-EPV**. This is low compare to the history of FES.

1.3.2 NAV vs. IV-T

The upside from NAV to IV-T is ca. 55% at the end of Q II 2016. This ratio tells you what Margin of Safety we have **from the full value of the companies we own** - including the value of the growth we expect them to generate.

When interpreting this number please remember that we calculate IV-T by **discounting the expected value** of the business in five years at a rate of 8 - 12% p.a. Thus **if the market price of a share reaches IV-T you can expect an IRR of 8 -12% p.a. holding it for the next 5 years.**

1.3.3 Summary of Margin of Safety

With NAV

a) ca. 16% below N-EPV

b) ca. 35% below IV-T

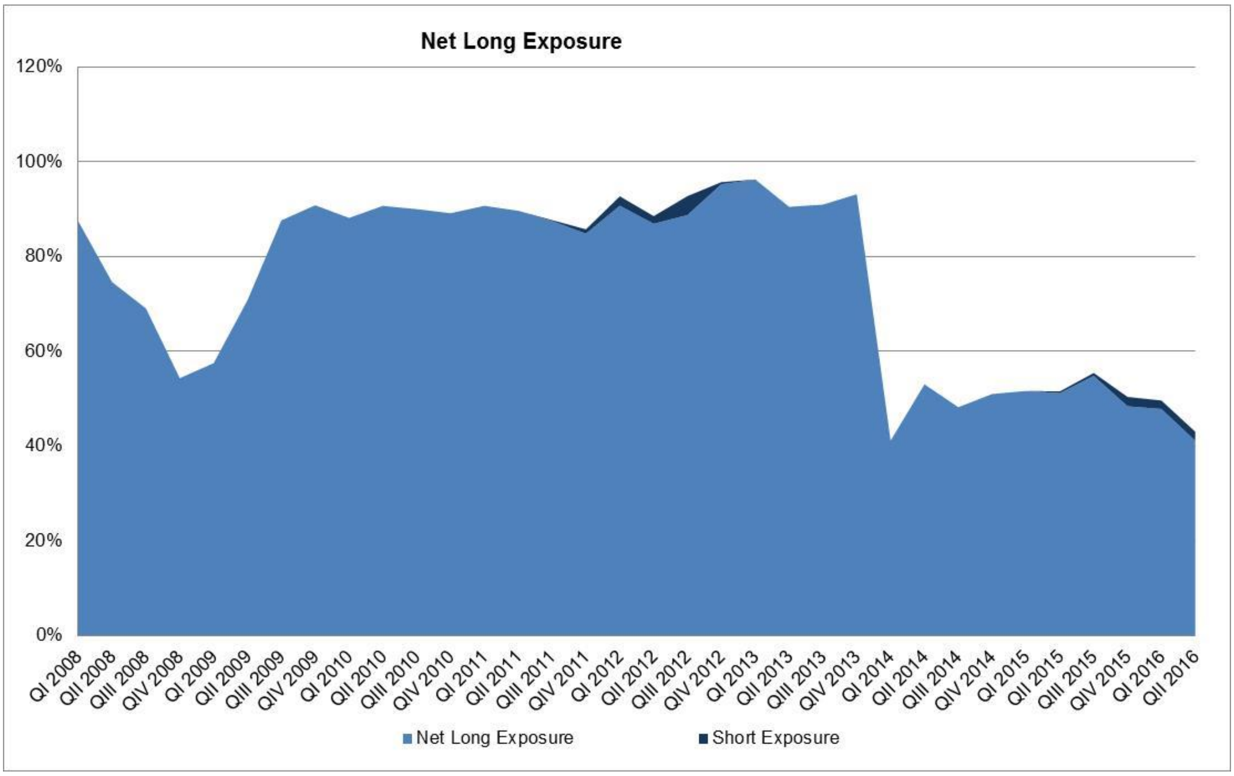
the Margin of Safety of the portfolio **is below the historical average observed at FES**.

This is the result of our strategic holding, whose share price dropped by ca. 43% since the beginning of 2016.

Which leads us right into the discussion of what we own.

2. Portfolio Positioning - Long/Short

Please see **Chart 2** below for an overview of the portfolio positioning.



At the end of the reporting period our exposure was as follows:

a) Invested part long 43%

b) Exposure short 2%

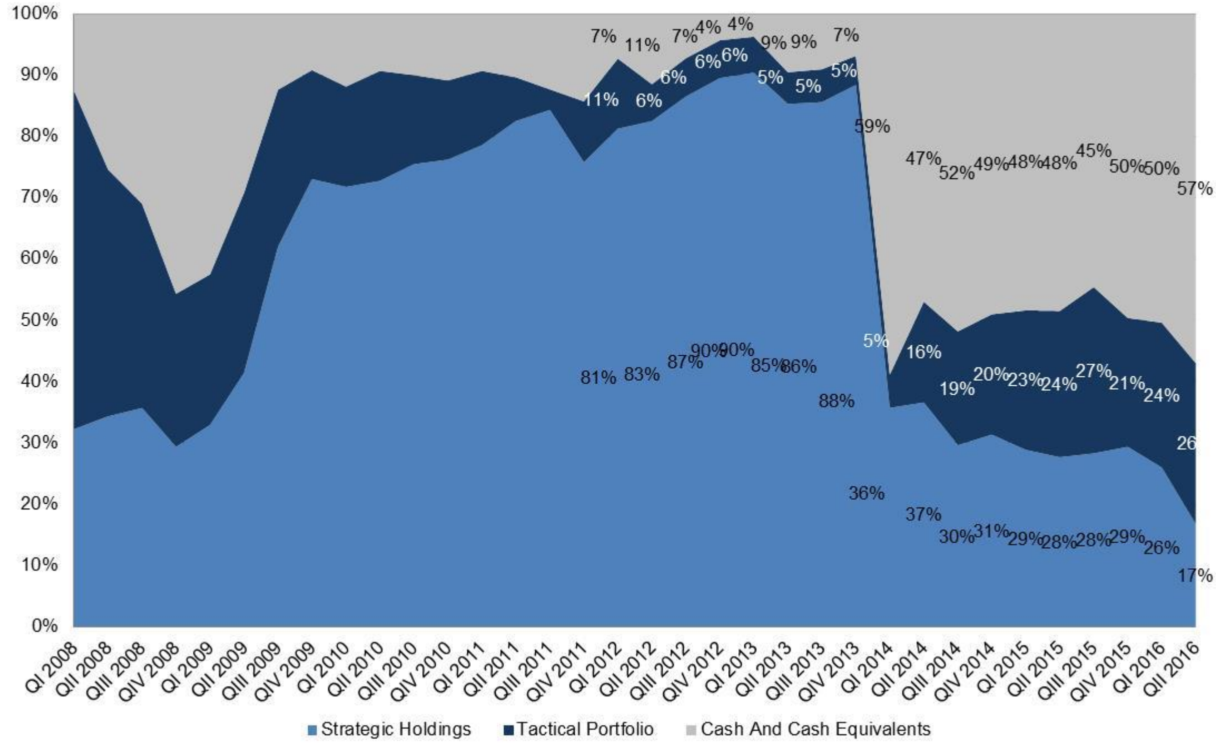
c) Exposure net long 41%

The remaining part is Cash & Cash Equivalents.

3. Asset/Mix

3.1 Development of Asset Mix

Please see **Chart 3** below for an overview of the portfolio positioning:



As you can see, the decline in QII 2016 and globally since beginning 2016 is linked to our Strategic Holding.

3.2 Strategic Holdings

3.2.1 Immunodiagnostic Systems Holdings ("IDS")

We have commented about the **main recent changes at IDS** in our FY 2015 Report.

There has been no significant change in the meantime.

3.2.2 New Candidates

We did not add any new investment in our strategic portfolio in Q II 2016.

3.3 Tactical Portfolio

3.3.1 Development of Tactical Portfolio

We think about our portfolio primarily in **the following five types of businesses, resp. investment situations:**

a) **Franchise Businesses**: businesses with high customer stickiness, strong competitive advantage, in fate of their own destiny

b) **Hybrid Businesses**: businesses combining aspects of Franchise Businesses and Execution Businesses (see below)

c) **Execution Businesses**: businesses which need ongoing strong operating management – otherwise they degenerate quickly as they have little structural competitive advantages.

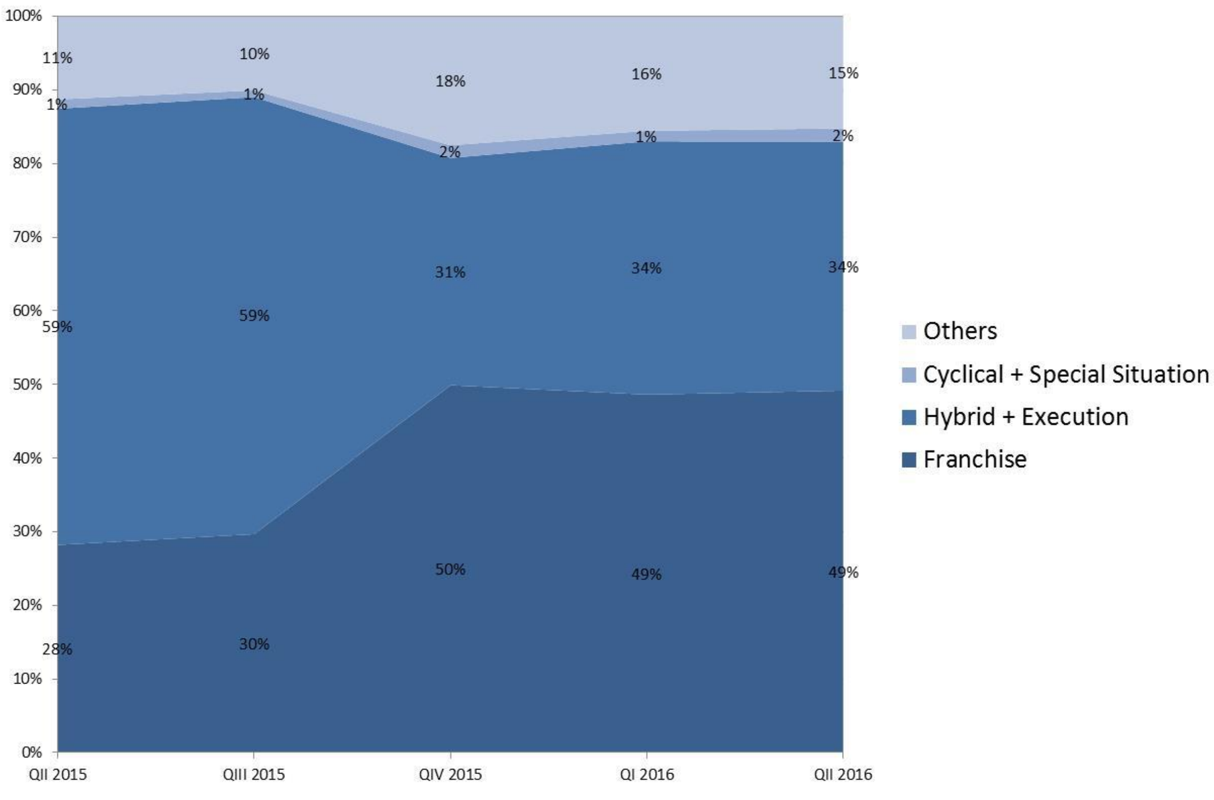
d) **Cyclical Businesses**: businesses whose earnings are primarily driven by the commodity cycle. They can have high customer stickiness and competitive advantage, but these characteristics will only play out over the full cycle.

e) **Special Situations and all other**: this category is mostly comprised of positions involving merger arbitrage, corporate restructurings or stock exchange arbitrage.

A second dimension of the **quality of businesses are their compounding economics** – i.e. the ability to re-invest free cash flow resp. equity into profitable growth at an ROIC above what an investor would be able to get from investing in a stand-alone business.

According to our Investment Philosophy **we try to allocate the majority of our tactical portfolio to Franchise Businesses – preferably those with strong compounding economics.** We will also invest in the other categories, but **only when the risk-adjusted return expectation is absolutely outstanding.**

The Chart 4 below gives an overview over the **types of investments** we own.



As you can see the Portfolio structure has not changed in QII 2016.

Below we will discuss the main developments in each category.

3.3.2 Franchise Businesses (49% of Tactical Portfolio)

This category consists of three positions: an FMCG company, a media company and an operator of wind mills.

You know that the largest position is **Wessanen,** the largest European producer of organic food brands. In the quarter we met the CEO again and learned that he is dedicated to use the cash flow from the business to make bolt-on acquisitions. As in all FMCG companies integration synergies are quite high - think of the sales force - thus the IRR on projects appears attractive.

The share of our Franchise Businesses stayed unchanged in the quarter at ca. 49% of AUM.

3.4 Hybrid and Execution Businesses (34% of Tactical Portfolio)

We have 7 companies in this category.

In QII 2016 our holding **Kuoni got taken-over**. It had one of the best CEOs in our portfolio, thus we regret that PE will see the returns from his achievement - but they paid us a nice premium upfront.

At the same time, we kept building up our position in a specialty finance company.

3.5 Cyclicals and Special Situations (2% of Tactical Portfolio)

In the quarter we added an investment which we would classify as a special situation: a company with very poor governance in a very attractive field of business. An activist investor we know has targeted them and sees a good chance to increase the earnings power and the valuation. Our own analysis also shows an **attractive upsid**e, thus we joined the group of investors - this time leaving the lead to another investor.

The other holding is a company exposed to soft commodity prices.

3.6 Other (15% of Tactical Portfolio)

This category consists of a Genuss-Schein of Commerzbank. The current yield to maturity in 2020 is 4,75% p.a.

According to Basle II it does not qualify as tier 2 equity; the percent counted as equity will decrease by 1/10 each year – making it increasingly unattractive to the bank. **Thus we expect an offer for early redemption.**

4. Development of the Short Book

4.1 Portfolio Structure and Evolution

At the end of the quarter we had **4 short positions** with a total exposure at market prices of 1,9% of AUM.

4.2 Results

During Q II 2016 the value of our short portfolio at market prices decreased by 3,9%.

As our benchmark index increased over the same period by 4,3% **this is a significant outperformance**. As we “fish in the same pond” for shorts as for long we consider this benchmark appropriate.

5. Risk Report

5.1 Overview

We would like to refer you to the discussion of the major risks facing the fund in the 2015 CIO report. **Since then there have been no significant changes.**

5.2 Brexit

On the day after 52% of British voters voted for Brexit, the short-term reaction of financial market was quite negative:

- **a)** from Thursday June 23rd - the day before the results became official - and Tuesday, June 28th, 2016 the FTSE 250, i.e. the UK midcap index capturing the 250 shares below the FTSE 100, dropped by ca. 14%.
- **b)** The drop was very different by sector and company. E.g. housebuilders and real estate dropped by ca. 30%, retailers by 20 - 25% while producing companies did not see much decline.
- **c)** The GBP devalued by ca. 7% against the €.

We did not trade during those 3 days:

- a) We had updated our limits for entering new positions or adding our positions, **but with the exception of one they were not reached**. The one position was a Spanish Execution Business and we felt we should wait for the outcome of the Spanish elections which took place on the Sunday thereafter.
- **b)** We did not feel tempted to enter the shares and sectors which had dropped significantly, those are not **sectors we prefer.**

We **had not hedged** our portfolio against a share price drop, either:

a) We do not hedge currencies as a policy

b) We felt that the odds were strongly in favor of "remain" and insurance against an exit event would cover an event with **low probability** and **limited risk to our portfolio.**

We do feel, though, that Brexit has increased the mid- and long-term risks to the global economy from political decisions. We see the risks from elections in the USA and Italy as more severe now than before Brexit - so often one fails to imagine the turmoil from sudden distortions in people´s expectations. **Thus as mentioned above we will reduce our net long exposure going forward.**

6. Outlook

6.1 Macro Outlook

We refer to our **Macro Dashboard for Q II 2016**. Since our last Macro Dashboard:

a) **profit levels in the USA** have recovered slightly, getting back to the band they had been moving in for several quarters. The drop in corporate profitability has not continued.

   Data for Europe do show ongoing weakness in profitability, though. This is where we invest and thus we have to be aware of the risk to the market.

b) **valuations have stayed at a high level**. Yet all metrics continue to be below what we define as "bubble territory", i.e. two standard deviations about the historical range.

Thus we expect equity markets to be volatile going forward.

7. The Firm

At the end of Q II 2016 our investment team consists **of**

a) 4 associates with at least 2 years of seniority at FORUM or equivalent outsides

b) 1 analyst

c) BW as portfolio manager.

Kind regards

Burkhard Wittek

Glossary

Execution Business: a business which needs the right management decisions every day to perform well. Conversely, it has little customer stickiness and low competitive advantage.

Franchise Business: a business with high customer stickiness and a strong competitive advantage. Companies in this group would be strong brands in FMCG, software companies with critical applications and a revenue model based on recurring revenues or companies with network economics

Hybrid Business: a business which has characteristics both of Franchise and Execution Business

Net Asset Value ("NAV"): the value of the fund at market prices.

Net Earnings Power Value ("N-EPV"): it captures the Earnings Power Value of the existing business in a steady-state situation, i.e. based on expected sustainable earnings over a cycle, without structural or management improvements and without growth. Thus it has a fairly high reliability, **it measures "what is there".**

Total Intrinsic Value ("IV-T"): it captures the total value of the business which is the sum of its N-EPV, structural improvements of the business and the value of expected growth. As such it contains several critical assumptions about the future and is less reliable than N-EPV.

IV-T discounts the future expected value – thus if the market price of a share reaches IV-T you can expect an IRR of 8 -12% p.a. – this is the range of discount rates we use.