Memorandum

To : Staff and Friends of FORUM Family Office

From : BW

Date : November 3rd, 2016

Subject : FES CIO Report on Q III 2016**_V_2.1**

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 July 1st, 2016 to September 30th, 2016**.

1. Results in Q III 2016

1.1 Results and Benchmarking: Market Price Perspective

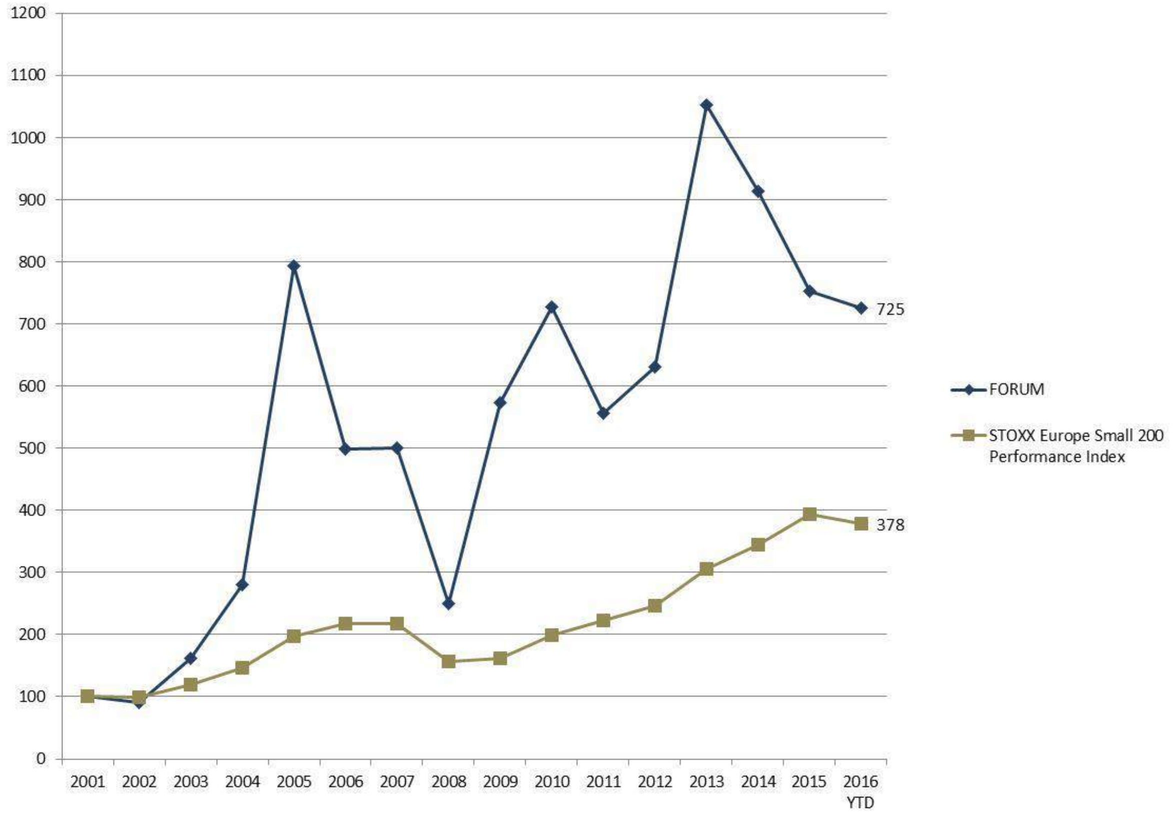
In Q III 2016 the **Market Value of the FES portfolio increased by 9,1%.**

The key benchmark for our performance at market price is the STOXX Europe Small 200 Performance Index ("SES 200"). During Q III 2016 it decreased by 1,1%. **Thus we outperformed this benchmark by 10,3 percentage points in the quarter.**

YTD the FES Net Asset Value ("NAV") is down by 6,3% - vs. our benchmark which is down by 3,9%. Thus YTD our underperformance is 2,4%. As you will see below the biggest negative contributor continues to be our strategic stake in IDS.

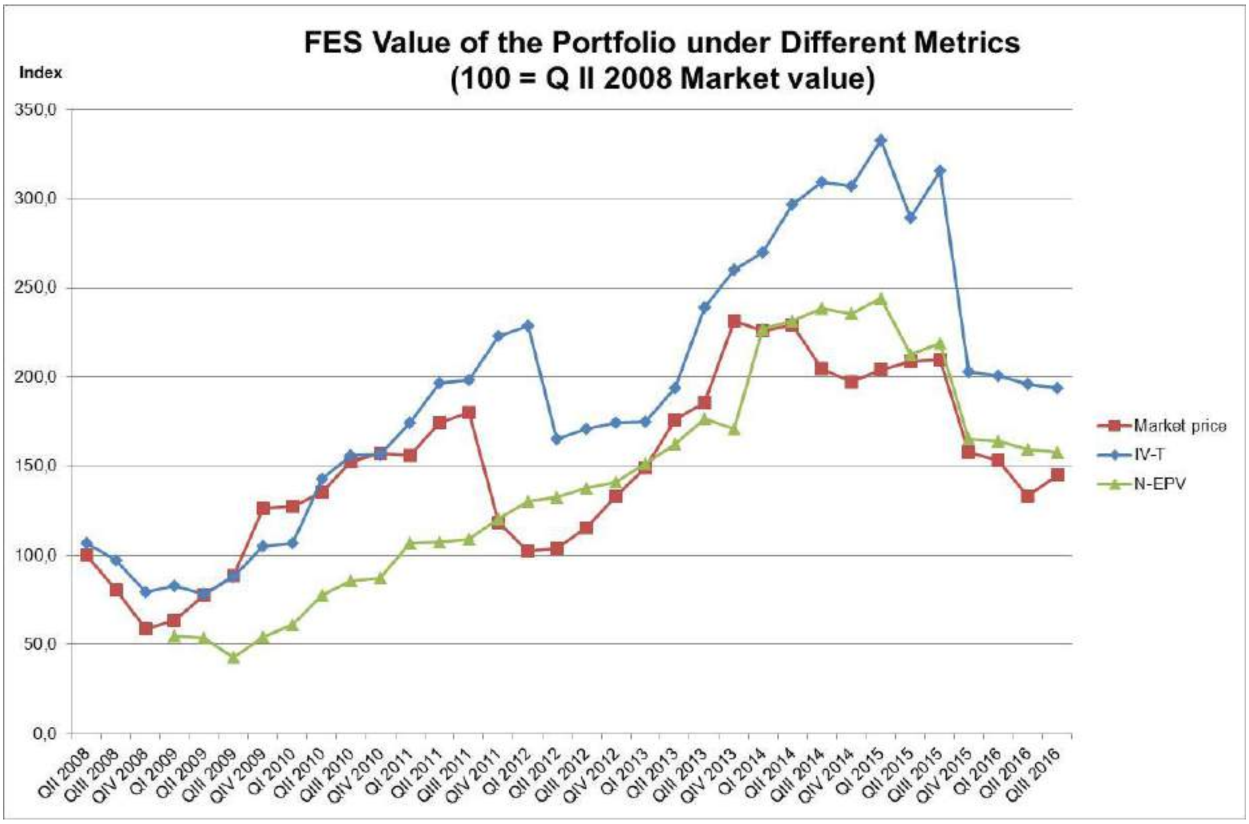
The table below shows the out-/underperformance of Forum Family Office by period and cumulative:

Performance	FORUM Family Office	STOXX Europe Small 200 Performance Index	Over/(Under) Performance vs. Index
IRR 2002 - YTD	**14,4%**	**9,4%**	**4,5%**
Cumulative since Inception	**625,4%**	**277,8%**	**92,0%**
Cumulative Gain Last 10 years	**145,5%**	**173,4%**	**-10,2%**
Gain YTD	**-3,6%**	**-3,9%**	**0,3%**



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 1,3%.** This is mainly due to the devaluation of the GBP against the €.

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 0,9%.** This is also mainly due to the devaluation of the GBP against the €.

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 III 2016 NAV at market prices was ca. **7% below N-EPV**. This is **low compared to the history of FES**. It implies that **the market values our holdings below the value of the cash generating capacity - excluding any growth.**

1.3.2 NAV vs. IV-T

The discount of NAV from IV-T is ca. 29% at the end of Q III 2016 (June 30th: 33). 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.**

The discount of ca. 29% is significantly above the historical averages observed at FORUM Family Office. It indicates that the market is not valuing the growth potential we see in the companies we own at all.

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 in five years you can expect an IRR of 15 - 20% p.a. Or we have to adjust our IV-T estimates as they were too optimistic.**

1.3.3 Summary of Margin of Safety

With NAV

a) ca. 7% below N-EPV

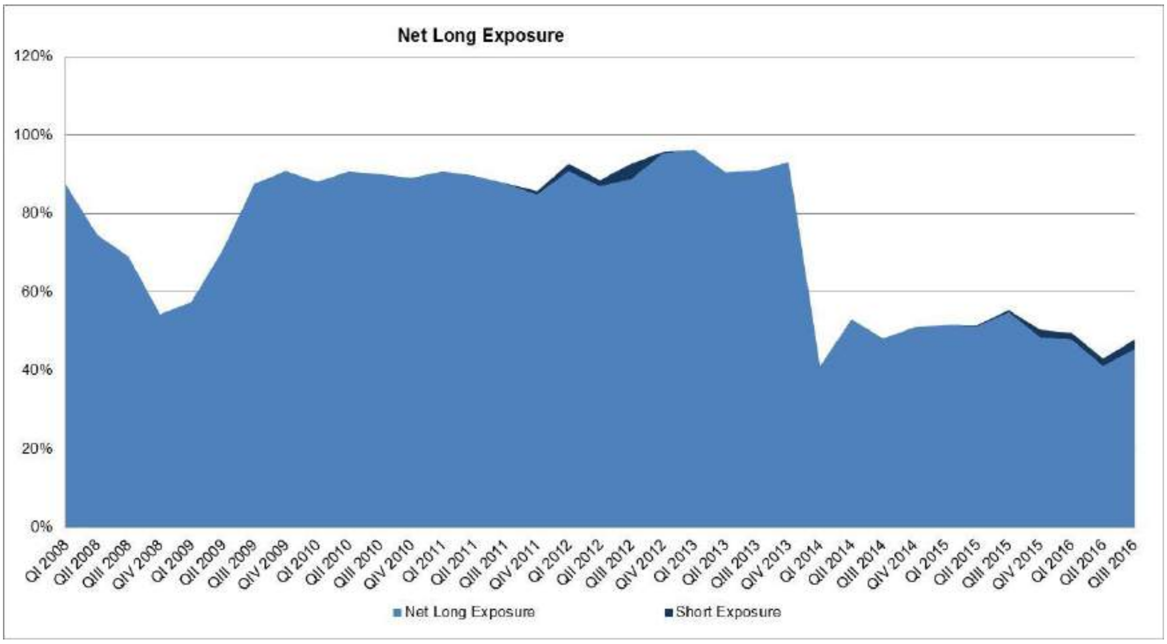
b) ca. 29% below IV-T

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

This 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 47,9%

b) Exposure short 2,5%

c) Exposure net long 45,3%

The remaining part is Cash & Cash Equivalents.

With only 45% net long exposure we have two issues:

a) from a **long-term perspective** we forfeit the underlying compounding of good companies which we are able to pick.

b) From a **short-term perspective** we are positioned for a massive correction in the market. As you know from our Macro Dashboard we see some risks, but not so much geared to the negative.

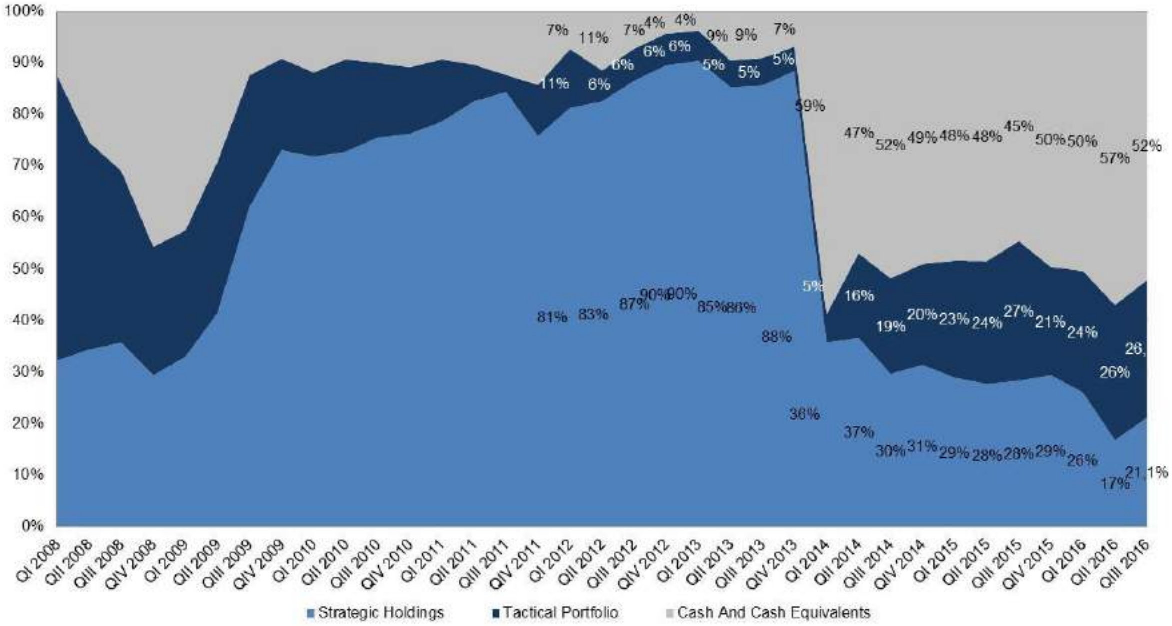
Thus I feel that we are not positioned in line with our assessment of risk/reward balance of economies and markets.

In our last CIO report we said that we would try to increase our net long exposure to **a ratio of 55 - 60% for the end of Q III 2016.** We have not been able to achieve this due to the high valuations and the return requirements we have. Thus we will try to reach this goal by the end of the year.

3. Asset-Mix

3.1 Development of Asset Mix

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



Strategic holdings are investments in which we have a significant share of votes and tend to be on the Board.

The **tactical portfolio** is comprised of all other investments. These tend to be small and liquid stakes in a variety of companies.

In Q III 2016 the value of the tactical portfolio continued to exceed the value of the strategic holdings again - unfortunately due to the decrease in the share price of our strategic holding IDS YTD.

3.2 Strategic Holdings

Since the sales of Pulsion Medical Systems SE in 2014 we only have one strategic holding, **Immunodiagnostic Systems Holdings ("IDS").**

As the author of this paper is a Board member of this holding this is a very sensitive issue to talk about publicly. In general our position is

a) the underlying business model of offering systems for lab testing requiring proprietary assays is highly attractive - it is razor-/razor blade in nature and such businesses tend to be able to earn EBIT margins > 20%. This was confirmed by our previous strategic holding Pulsion and by IDS´peer Diasorin.

b) Previous management has left the current team with a Herculean task to be cleaned up. They are tackling one issue after the other, but in many areas we have to start with re-constructing solid foundations.

c) The business will see its low point in FY 2017 and resume growth from there onwards.

I am confident that we will ultimately be able to exit this investment with a reasonable return. I recently checked the evolution of our other major strategic holding - Pulsion Medical Systems SE - since we got in: in the 5th year after our investment we had an unrealized loss. In the end this investment generated an IRR of 20% p.a. over a decade. Thus we think this is a case for patience - knowing what we own at the core.

In both cases there were massive restructurings to be done - and we had underestimated what a sub-par management team can do even to a good business.

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

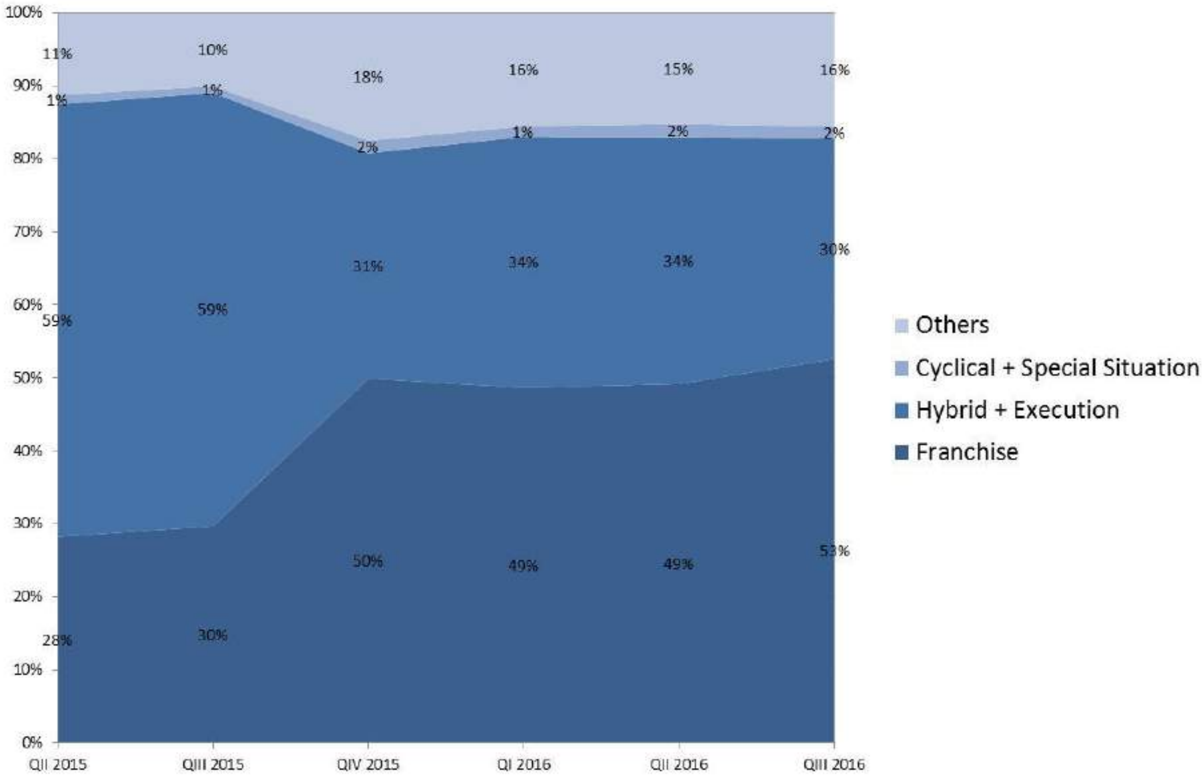
b) **Execution Businesses**: businesses which need ongoing strong operating management – otherwise they degenerate quickly as they have little structural competitive advantages. **Hybrid Businesses** combine aspects of Franchise Businesses and Execution Businesses. Both of these businesses are largely "in control of their own destiny".

c) **Cyclical Businesses**: businesses whose earnings are primarily driven by the commodity cycle - thus they are not in control of their own destiny. They can have high customer stickiness and competitive advantage, but these characteristics will only play out over the full cycle.

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

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 shows you how the mix along these types of investments has evolved over time:



As you can see the Portfolio structure has stayed largely unchanged in QIII 2016.

Below we will discuss the main developments in each category.

3.3.2 Franchise Businesses (53% 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. The underlying growth potential of the organic sector was apparently also seen by:

a) Danone which paid an **EV/EBITDA 2016 of ca. 20x to take over WhiteWave** in July 2016

b) Unilever, which acquired privately-held **Seventh Generation** in September 2016, a company producing eco-friendly and bio-based cleaning products, for a price of **3,5x EV/Sales** according to the Wall Street Journal.

This drove Wessanen share price up during the quarter from € 9,45 at the end of Q II to € 11,32 at the end of Q III 2016. We also believe Wessanen may be an attractive acquisition target on the mid-term for one of the big FMCG companies.

The share of our Franchise Businesses increased in the quarter at ca. 53% of AUM.

3.4 Hybrid and Execution Businesses (30% of Tactical Portfolio)

We own 6 companies in this category.

These are the businesses of **medium and lower quality**. They have in common that they are largely in control of their own destiny – unlike the commodity/cyclicals businesses in the next category.

The industries in this group range from machine components to specialty finance.

In the quarter the share of these holding decreased slightly to 30% from 34% at the end of Q II 2016.

3.5 Cyclicals and Special Situations (18% of Tactical Portfolio)

Beginning with this quarter we have included the "other" category into this group. There has been no change to this category in QIII 2016.

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 2,5% of AUM.

4.2 Results

During Q III 2016 the value of our short portfolio at market prices decreased by 9,8%. This contributed to a gain of 0,1% for overall results.

As our benchmark index decreased over the same period by 1,1% **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 Euro/European Integration

I pointed out in my previous reports that I expected the ECB and the BoE to increase the level of support for financial markets by lowering interest rates and/or increasing volumes of bond purchases. The effects are two-fold:

a) **short-term** this might give another boost to bond and equity markets

b) **medium-term** the unwanted secondary effect would be even less pressure on Southern European countries to implement structural reforms even more. This increases the medium-term risk for another outbreak of a €-crisis similar to what we saw in 2012.

The Central Banks have indeed increased their support for financial markets by stepping up bond purchases. We have now seen several instances of the ECB buying portions of new bond issues by corporates, i.e. making a primary market. And the short-term effect is chipping in - prices for equities are staying at historically high levels of valuation.

We are concerned about the secondary effect of further degradation of the structural politics in Southern Europe. We are very worried about what we see done by left-wing governments in Greece, Italy and Portugal - and to a lesser part France. We think this will backfire and lead to an open crisis in the foreseeable future.

6. Outlook

6.1 Macro Outlook

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

a) **Profit levels in the USA** have stayed flat or recovered slightly.

   Data for Europe do show ongoing weakness in profitability. 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 III 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) 1 intern who is helping us to explore investment opportunities in LastAm.

d) 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. It is calculated based on after-tax cash flow to enterprise value (i.e. before interest rate) after eliminating expenses/cash out for growth. We also base it on a level of earnings considered mid-cycle earnings, i.e. we adjust actual earnings we we consider them peak or trough earnings.

We then capitalize this cash flow metric – we refer to it as "**Owner Earnings**" or "OE" – with a cap factor based on business quality and market capitalization. E.g. for a large-cap franchise business we capitalize Owner Earnings with a factor of 12x.

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.