Memorandum

To : Staff and Friends of FORUM Family Office

From : BW

Date : February 15th, 2017

Subject : FES CIO Report on Q IV 2016**_V_final**

This report of the CIO has been put together for **stakeholders interested in what FORUM Family Office ("FFO") does in the area of publicly-quoted companies**, mainly

a) our **internal professional** team as feedback how well we worked as a team – long-term investment performance is our ultimate scorecard

b) the **companies and their Executives** 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 they should expect when joining FORUM.

At times we will refer to our activities in the publicly-quoted space as **FORUM European Smallcaps ("FES").**

This Annual Report covers the **year 2016.**

For a deeper understanding of what we do and how we think we would like you to look at the three Appendices at the end of this Letter:

a) Appendix 1: Methodology for calculating our results in publicly-quoted equities

b) Appendix 2: Summary of our Investment Philosophy

c) Appendix 3: Glossary

A. Overview – FORUM vs. Financial Markets

1. FES Results 2016

1.1 Results at Market Values

In 2016 the value of the FES portfolio at market prices decreased by 0,7%. In terms of index levels this is the result of a decrease from 753 at the end of 2015 to 747 at the end of 2016 (100 = January 1st, 2002).

In 2016 our benchmark index STOXX Europe Small 200 (dividends re-invested) increased by 0,5%. Thus we have delivered **a relative underperformance of -1,2%.**

We estimate the negative **currency impact to be ca. - 3,7% on the portfolio**, mainly linked to the GBP depreciation following the Brexit.

As you may recall from the Interims a poor H1 2016 was followed by a second half with strong gains. Thus I am confident that we have re-gained our traction during 2016 and **that 2017 will turn out to be a good year for us, getting back to the performance levels we have shown since inceptions of our operations on January 1st, 2002.**

1.2 Results at Intrinsic Value

Please see the graph in **Appendix 1** for an overview of the portfolio

a) at market prices

b) at N-EPV

c) at IV-T

over time.

As mentioned above, in 2016 the value of our portfolio at market prices went down by 0,7%. In the same period the Intrinsic Value also had moderate declines:

a) Net Earnings Power Value ("N-EPV") went down by 4,6%

b) **Total Intrinsic Value ("IV-T") decreased by 1,4%**.

Our goal is to **increase Intrinsic Value of our portfolio by ca. 15% p.a. in the long-run**. In 2016 due to the still important cash position in our portfolio and the ongoing restructuring at our main holding, the compounding remained below our long-term target.

1.3 Margin of Safety

A key building block of Value Investing is the **Margin of Safety**. We measure it in two ways:

a) by the discount of the portfolio at market prices from the value of the portfolio at **N-EPV - i.e. the Intrinsic Value of the companies capitalizing just today´s (normalized) cash flows - giving no credit to growth.**

b) by the discount of the portfolio at market prices from the value of the portfolio at **IV-T - i.e. its Intrinsic Value including the value of growth.**

1.3.1 Margin of Safety Based on N-EPV

At the end of 2016 we continue to have no Margin of Safety based on this metric - market values are slightly below N-EPV:

Portfolio at Market Prices:	€ 150,90
Portfolio at N-EPV:	€ 157,70.

The main reason for this situation is our portfolio mix: the core are Franchise Businesses with outstanding management and good runway for growth. We calculate N-EPV by **capitalizing steady-state, after tax (!) cash flows of these businesses with a capitalization factor of 12,0x (implying an after-tax cash flow yield of 8,3%).**

In an interest rate environment where 10-year government yields in Northern Europe are below 1%, equity markets price these businesses with an after-tax cash flow yield of 3 - 5% - leading to share prices significantly above our N-EPV.

Thus the fact that our mix of businesses is priced above N-EPV should not be worrying per se. But it signals that the value of the portfolio **is exposed to a significant increase in interest rates: such a development would lead equity markets to price these businesses lower.**

1.3.2 Margin of Safety Based on IV-T

We look at this Margin of Safety at two levels:

a) for the **invested part of the portfolio**. At the end of 2016 the value of the stocks we owned at market prices was 41% below the value of the stocks we owned at IV-T - this is the Margin of Safety.

b) When taking the **overall portfolio including cash** at the end of 2016 IV-T, the discount to IV-T drops to 28%. This implies an upside potential of 39%.

At first glance this looks like a moderate upside potential. To interpret it correctly you have to understand the way we calculate IV-T:

a) We project the company´s revenues, earnings and steady-state cash flows out by 5 years.

b) We calculate the Enterprise Value and resulting share price at the end of year five **using a "normalized" multiple reflecting long-term averages.**

c) We then **discount back the estimated share price in 5 years to 2015**. The discount rate reflects our expected return from the type of business, for a mid-cap Franchise Business like Wessanen we use a discount rate of 8,3%.

Thus IV-T is **the present value** of what we expect to happen in the next 5 years. The non-discounted projected share price in year 5 is significantly higher than IV-T - **thus if we hold on to such a position we would generate a return at the discount rate.**

Thus going forward you should expect the current portfolio to deliver a return of 8 – 10% from share price appreciation plus the dividend yield of 2 -3% plus hopefully a share price appreciation of IV-T. In reality we will manage the portfolio to add returns from new investments made with a higher upside and selling positions once prices have reached or exceeded IV-T. This portfolio management will hopefully close the gap to the 15 - 20% return we target.

In the Letter to Clients 2015 we explained the mechanics of this model using Wessanen as an example - the principle is still valid.

1.4 Conclusions

Performance-wise 2016 was a transition year. We see some positive momentum toward the end of the year. In terms of Intrinsic Values the Margin of Safety based on N-EPV is slightly negative, but given the strong share of quality businesses in the portfolio that is no reason to worry. The upside in the portfolio including cash is 39%, boding well for the outlook for 2017.

2. Financial Markets in 2016

2.1 Stock Market Indices

Below please find the performance of the main equity market indices**:**

	2014	**2015**	**2016**
a) MSCI World	+4,9%	-0,9%	+6,0%
b) S&P 500	+13,0%	+0,7%	+8,5%
c) Stoxx 600	+7,2%	+9,6%	-1,7%
d) **STOXX 200 European Small**	**+4,9%**	**+15,7%**	**+0,5%**

As you can see both the MSCI World and the S&P 500 made solid gains of 6,0% and 8,5%. Conversely, stock markets in Europe were more subdued **with the representative Stoxx 600 recording a loss of 1,7%. The main reasons for these developments were:**

a) **Southern Europe**: the DAX, the large-cap equity index for Germany recorded a gain of 7,0%. Conversely, most southern European markets recorded losses, with the capital market pricing in increasing risk for a new "flaring-up" of the Euro crisis as in 2012.

b) **The European banking system** has still not been restructured after the financial crisis 2008/09. As a result the banking sub-sector is down Year-on-Year, in spite of a year-end rally as a response to a steeper yield curve.

We benchmark ourselves against the Stoxx 200 European Small including dividends, it is a performance index comprised of the 200 lowest market cap constituents of the STOXX 600. As in 2015 the small-cap sub-index outperformed the Stoxx 600.

Please look at **Appendix 3,** showing the evolution of our benchmark in 2016. The main highlights were:

a) From January to mid-February 2016 the index dropped by ca. 10%, largely driven by fear of the Chinese economy getting into difficulties. Thus there were **buying opportunities in cyclicals and companies with China exposure.** These stocks recovered quickly.

b) The index then recovered again with the second drawdown in 2016 coming from Brexit at the end of June 2016. This event **created another set of buying opportunities** in some stocks outside of Britain with exposure to the global economy and certain sectors within the UK economy, e.g. housing and retail.

c) In mid-November / December 2016 the market **rallied strongly with above 5% gain**.

2.2 Level of Valuation

For our assessment of equity market valuations we look at several metrics for long-term valuation, **most prominently Shiller´s CAPE**, i.e. the Price/Earnings ratio based on average Earnings per Share in the last 10 years. For Europe we are actually using the MSCI Europe CAPE. Here is the development:

	Hist. Average	**Dec. 31st, 2015**	**Dec. 31st, 2016**
Europe	**17,8x**	**15,4x**	**16,0x**
USA	16,6x	24,2x	27,7x

Thus **European valuations** are largely in line with their historical averages. There is a big spread between valuations for Northern Europe and the South.

Conversely, **CAPE in the USA** is ca. 60% above its historical averages. For that you get a healthier economy with no issues around its currency. Yet historical data suggests that statistically there is an 80% probability that returns in the next 7 years will be below 2% p.a.

Thus we believe that with a 5 -7-year time horizon there is a higher probability of Europe generating traditional equity returns of 6 - 7% p. than the USA. Yet any correction in the USA would have a short-term effect on valuations in Europe as well.

Our philosophy on this has been to **slightly increase our level of cash** above our normalized level to be able to take advantage of such a possible correction.

B. Portfolio Perspective

1. Asset Mix

1.1 Evolution of Asset Mix

Please see **Appendix 4** for an overview of the composition of our long book. As you can see the portfolio mix by asset class is still largely unchanged from the structure it had after the disposal of our strategic holding in Pulsion Medical Systems SE in Q I 2014:

	Q IV 2014	**Q IV 2015**	**Q IV 2016**
a) Strategic Holdings	31%	29%	22%
b) Tactical Portfolio	20%	21%	34%
c) Cash and Cash Equivalents	49%	50%	44%
- *Thereof from short positions*	*0%*	*2%*	*3%*
d) Total	**100%**	**100%**	**100%**

In H2 2016 we started to increase our long exposure again. At present market conditions we are targeting a net long exposure of 60 – 70%.

1.2 Returns by Asset Class

Below please find an overview over returns by asset category:

	Share of AUM EOY 2015	**Return 2016**
a) Strategic Holdings	29%	- 24,2%
b) Tactical Portfolio	21%	30,1%

c)	**Sub-Total Invested**	**50%**	**-1,4%**
d)	Cash and Cash Equivalents	50%	0%
e)	**Total**	**100%.**	**- 0,7%**

As you can see, while our strategic holding IDS generated yet another negative return, in this case -24,2% (including a strong negative currency effect), **our Tactical Portfolio performed very strongly with a 30% return.**

2. Composition of Tactical Portfolio

In managing our tactical portfolio we use a set of classifications based on the characteristics of the businesses and situations we are invested in. These are

a) **Franchise Businesses**: high customer stickiness, strong competitive advantage. This has historically been at the core of our investments with a portfolio weight of 40 – 60%.

b) **Hybrid and Execution Businesses**: lower quality businesses

c) **Special Situations**: businesses where value can be crystallized or created by active involvement. This may be done by us or by befriended investors.

d) **Cyclicals**: these are businesses exposed to some underlying cyclicality, e.g. companies selling into the mining or oil exploration sector.

Appendix 5 shows the evolution of the invested part of our portfolio along this dimension.

The key task for 2017 will be to invest a significant portion of the cash (44% of AuM) into Franchise Businesses – without compromising on our internal Hurdle Rate!!

3. Regional Portfolio Mix

The major event in 2016 is the **first-time allocation of 3% of AUM to Mexico, specifically two companies.**

We have been covering Latin America for 5 years by now meeting CEOs and evaluating the evolution of a small watchlist of companies which we consider potential investment candidates. One of the learnings in these years was that the valuation of the currency is at least as important as the valuation of the specific stocks.

Thus when the Mexican peso devalued by ca. 15% after the election of Donald Trump for US president and the Mexican stock market also dropped for fear of a recession we felt this was a situation with high uncertainty, but limited risk if the investment was made in a stable asset. **It brings the cumulative devaluation of the Peso against the US-dollar since Jan. 1st, 2015 to ca. 42%.**

We will explain one of these investments below in more detail to - hopefully - give you comfort on these moves. **The managers of both companies have strong ties to Europe.**

When defining **regional exposure based on the country of operations** there are two changes:

a) the **Mexican economic exposure drops to ca. 2%** as one of the two holdings only does ca. 40% of its business in Mexico, the remainder in other countries of Latin America and the USA.

b) we also have a **ca. 10% economic exposure to Indonesia** as by now 100% of the operating assets of M.P. Evans are located in this country.

We are well aware that our edge in assessing companies, markets and management is in Europe and would expect this exposure to be lower soon.

4. Portfolio Mix by Market Capitalization

Refer to **Appendix 6** for an overview of the portfolio segmentation by Market Capitalization.

The "below € 300m market cap" segment is mainly made of our Strategic Holding (22%).

For the tactical portfolio, we now have the bulk of our investments **in the mid-cap category defined as market capitalizations between € 300m and € 3bn**. I would predict that we will retain our focus on this category for some years to come, it still offers a good chance for building up an informational and framework edge as it is covered by local brokers, but **less by the leading Anglo-Saxon brokers or funds.**

C. Discussion of Individual Investments

Our wish is NOT to discuss individual investments. There are several reasons for this:

a) We often need several weeks for first FFOVF and subsequently FORUM Family Office to build up a new position. Similarly, we have been trading in and out of some names having done our Due Diligence. We think in either case **we have developed intellectual property which we would like to preserve as long as possible.**

b) Commenting on an investment decision **creates a psychological Endowment bias** - after I have explained the logic of our investment I may be more reluctant to sell shortly afterwards as that may be interpreted as admitting a mistake.

On the other hand many readers are asking us for more details to get a better understanding of what we do.

As a compromise we will comment below on a few holdings, particularly those which are either good examples of what we do or positions we have exited and see little chance to re-enter in the short term.

1. Strategic Holdings

1.1 Immunodiagnostic Systems Holdings („IDS“)

This investment has been a lengthy and problematic case. The situation culminated at the end of 2014/beginning of 2015 when we exchanged the complete Board (with 1 exception) and I became Interim CEO for a short period.

Since April 1st, 2015 Patricio Lacalle has taken over as CEO, he is a proven hand who was instrumental in converting Pulsion into a wonderful investment case from 2010 – 2014. It took him a bit longer in the case of IDS as previous management had left a company with significant deficiencies. **But the Interims as of September 30th, 2016 show that the turnaround is taking shape.**

In 2016 the share price of IDS dropped by 11,8%. Based on LTM published results valuation is still very low, < 6x Adjusted LTM EBITDA. Thus if the hoped-for turnaround materializes there is significant potential for further increases in the share price.

1.2 New Investments/Candidates

In 2016 we looked at several new candidates – but did not make any new investments. The lesson from both Pulsion and IDS is that situations which require a deep-rooted change in the Board and management take longer than one anticipates at the outset – and this is reducing IRR.

Thus we are focusing now on easier tasks. As Buffett put it: “**I don’t look to jump over 7-foot bars: I look around for 1-foot bars that I can step over**”. We like to think about situations with active ownership involvement along the dimensions of

a) Sumo (requiring a lot of force and lengthy)

b) vs. Judo (using simple mechanisms to get to a fast end).

Pulsion and IDS were clearly Sumo-type wrestling contests, we are now hoping for more “judo” situations.

2. Franchise Businesses

2.1 Overview

At the end of **2016 this category is comprised of 5 investments:**

a) 2 FMCG companies (“Markenartikler”)

b) 2 wind farm operators

c) a specialty media business.

In total these businesses **make up ca. 66% of the Tactical Portfolio**.

During the year we exited a software business as we saw some warning signals.

Conversely, we started to build up the position in the **second FMCG business** which is headquartered in Mexico.

2.2 Wessanen

As most of you know by now our largest holding is **Wessanen, an FMCG business in organic food run by an outstanding manager.** We described this business in detail in the Report of the CIO 2015.

In 2016 Wessanen delivered on all targets we had for the business:

a) organic revenue growth of ca. 7% (YTD as of Q3 2016)

b) 4 bolt-on acquisitions

c) revenue growth by 8,8% (YTD as of Q3 2016), EBIT growth by 22% (YTD as of Q3 2016).

Whilst the company delivered these results an increasing number of analysts initiated coverage of the company. As to be expected for a company with such a strong news flow all were positive. **As a result the share price increased by 42% in 2016.**

Based on consensus at the current share price of € 13,50, **EV/EBITDA is**

a) 20,8x based on 2016e

b) 16,7x based on consensus earnings 2017 (our estimates are similar).

These multiples are at the high end even of takeovers with integration synergies priced in. At those valuations Margin of Safety becomes very small or non-existent.

2.3 New Investment in Mexico

In 2016 we started building a position in a Mexican company which - like Wessanen - is also active in the sector of FMCG. There are several companies in Europe and the USA in the same sector, and it appears that the rules of consumer marketing and management of the distribution are very similar.

In addition to having been global Head of Consumer Goods at BCG for many years **I worked for many years for the best-in-class European peer to the Mexican company. Thus I feel quite confident about understanding this business.**

The company ran into some issues while being managed by the founder. Management has now been transferred to a CEO - who managed part of the business before and left an impressive track record - and a CFO hired from the outside.

This allowed us first to get in at a valuation which is significantly below the levels reached in previous years. Secondly, we had a good reading on the CEO as he had managed a division of the group for 8 years leaving a transparent track record in the segment reporting.

The situation reminds us a bit of two analogies:

a) **Wessanen** - there the CEO also was promoted from inside from the largest region accounting for > 50% of group revenues.

b) **Gruma.** This is the market leader in tortillas in Mexico and underwent an apparently similar transition from founder to traditional management ca. 5 years ago

Thus when calibrating this investment in our Circle of Competence **we would rate it A1 for being a sector and an investment situation which we understand as good as it gets at FORUM**. Thus we think we can accept the country risk – partially protected by the previous depreciation of the currency.

3. Hybrid and Execution Businesses

3.1 Overview

The second category of our portfolio are **Hybrid and Execution Businesses** – i.e. businesses with lower stability, but which can generate significant value as well if executed by good management.

At the end of 2016 we had **6 investments** in this category:

a) Berkshire Hathaway

b) A software company which has been de-listed

c) A holding company with several activities in construction and infrastructure

d) A manufacturer of machinery with a high share of aftersales

e) A company in the area of car rental/car leasing

f) A hotel company.

As of December 31st, 2016 these investments account for ca. accounted **22% of the invested part of the Tactical Portfolio**.

In the course of the year we divested 2 positions which were either too small to make an impact or where we felt that the risk/reward ratio had become unattractive. Furthermore one position was taken over.

4. Special Situations

In this category we own the same 2 positions as a year ago:

a) A hybrid capital issued by a bank – with a high probability of being redeemed early.

b) A German company with strong Governance issues – and a befriended activist trying to solve these issues.

In 2016 there were **no catalysts for the underlying value to crystallize**, thus the contribution of this asset class to overall returns was modest. In order to get to a satisfactory IRR we will have to review these positions in the course of 2017 – if there is no likely catalyst we may exit these positions – in particular if we have alternative investment opportunities in other asset classes, e.g. Franchise Businesses.

5. Cyclicals

In the cyclicals category we own MP Evans, we discussed this position at length in the 2015 Report of the CIO. **We entered this position as a "Special Situation"** – seeing value in several non-consolidated assets owned by the company which thus did not show up in the P&L and could not be detected by analysts screening on P&L-based valuations. The investment thesis was that these assets would be divested, crystallizing the value of the underlying core asset – which were palm oil plantations in Indonesia.

In 2016 our investment thesis played out, crystallizing the value of the core operations. In addition the company received a takeover offer which was rejected by shareholders as too low.

All of these developments have generated a 63% increase in the share price. This made MP Evans our best-performing investment in 2016.

After the investment thesis as a special situation ran its course we are left with a "naked" investment in a producer of an agricultural commodity with the assets located in Indonesia. **This does not fit our Investment Philosophy, thus this position was exited in early 2017.**

6. Cash and Cash Equivalents

As of December 31st, 2016 our **gross cash quota – i.e. including the cash generated from shorting - stood at 47%** (Dec. 31st, 2015: 52%) of AUM.

Of this 3% (Dec. 31st, 2015: 2%) have been generated from entering short positions. **Thus net cash – defined as cash net of Shorts - is 44% (Dec. 31st, 2015: 50%) of AUM.**

We would like to invest a part of this cash to generate the potential for return. We have a good pipeline and in 2017 have already been able to deploy a part of this cash into attractive investments.

D. Short Book

As of December 31st, 2016 we had **4 open short positions from a diverse range of industries.** We believe that these companies will underperform the stock market in the next 6 - 12 months.

The short portfolio is **composed entirely of stochastic bets** – each of these companies has its investment case, but we prefer to allocate not more than 2% to each as there are residual event risks. We have not had and do not have a conviction bet with active position sizing.

We prefer not to discuss these positions as they are **particularly sensitive.**

At the end of the year the total **short exposure amounted to 2,6% of AUM**. The performance of the short portfolio was positive, but the value creation to the total fund remains insignificant**.**

E. Portfolio Perspective - Performance Attribution

Below is an attempt to disaggregate the composition of the performance along several dimensions to allow you to assess sensitivities in particular.

1. Performance Invested Part vs. Overall

As discussed before, the **invested part of our portfolio generated a performance of -1,4%** in 2016. The overall performance of **FES (cash included) was - 0,7%.**

2. Position Sizing

The result of the portfolio was affected by our strategic investment in IDS which accounted for ca. 60% of the invested part portfolio at the end of 2015.

Within the Tactical Portfolio, the largest position Wessanen dominates, followed by a long tail-end of positions smaller than 3% of AUM.

A key task for the portfolio manager in 2017 will be to **correct this unbalanced structure.**

3. Dependence on IDS

The largest position of FES is IDS with a weight of ca 22% as of December 31st, 2016. As outlined above this investment was down 11,8% at market value in 2016, plus another 12,4% linked to the currency, dragging down overall performance.

We are confident to see a recovery in IDS in 2017, both operationally and on the share price. In the game of strategic investments we have to make concentrated bets to achieve the influence we seek, thus these large positions will contribute to lumpy performance. **This is volatility, not risk, and we do not get deterred from it.**

F. Post-Mortem 2016

FORUM has a history of doing post-mortems in order to have a structured process for learning. We had a great time reviewing all decisions taken in 2016, pinning down what went wrong and identifying ways to get better. The process started with a lengthy written documentation and then a discussion with the whole team.

Below is a summary of the conclusions we drew for our Investment Philosophy and Investment Process.

1. Errors of Commission and Errors of Omission

1.1 Errors of Commission

With the exception of IDS and a small tactical position **all positions we owned at the beginning of 2016 or acquired during the year were up**, thus there is **no apparent error of commission.**

1.2 Errors of Omission

After reviewing the biggest gainers in each country in a 3 and 5-year time perspective we felt that **we missed too many which we could have seen and invested in**. As a result we have made several changes to our investment process, in particular the screening phase.

Every team member feels disappointed about the misses in his territory or sector, **thus I am confident that we have "buy-in" into these changes.**

2. Evolution of our Investment Philosophy

2.1 Blend between Core Holdings and Supporters

There were **no significant conclusions for our Investment Philosophy**. The discussion re-emphasized the point that at the core of our portfolio we will tend to have an allocation of 40 - 60% to Franchise Businesses, i.e. businesses with the highest business quality.

Yet in order to deliver outstanding returns we need the other asset classes. For the right decision-making it is key to understand the investment situation clearly as the assessment of the situation and often also valuation will differ between by type. E.g. in a special situation with an activist investor Sum-of-the-Parts valuation ("SOTP") will become relevant while in a cyclical investment we have to focus on Reversion to the Mean ("RTM").

2.2 Portfolio Management: Larger Positions, less Tail-End

At the end of 2016 we have 8 positions with allocations of less than 3% of AUM. These positions will not be able to make a difference to the overall performance. Yet in many cases we do not feel that we want to increase them at this point in time - implying a lack of conviction. Back-testing clearly reveals that in the past these positions have generated below average returns to the invested part of the portfolio.

We defined a more rigid way of determining position sizing. One of the changes is that we will not enter a position unless we are willing to allocate a certain percentage to it – **this threshold is higher now than it was before.** This should prevent that we have a "tail end" of holdings which do not make a difference. If we do not reach this level within a certain time window we will divest the position.

3. Evolution for our Investment Process

In the Report by the CIO for 2015 we discussed that we had increased the level of Due Diligence required for any new investment by introducing a process step **termed BDD which requires a small team, not just the analyst who had the idea or covered the region**. We feel that this was a very positive change **and we have more conviction in the investments which underwent a BDD.**

We have identified several ways to **improve the BDD process**, in particular regular review of timelines, a level 2 alert if the situation is very critical and a better balance between "more analysis" and decision-making.

With these changes we hope **to get better in particular with respect to**

a) taking advantage of share price dips, e.g. the China fear dip in January 2016 or the opportunities which arose from Brexit.

b) finish BDD projects **in a shorter time frame**.

We have also decided that we will invest **more time in joint reviews of our screening process.** The screening process itself will be more standardized, making sure every analyst covers all aspects of screening and not just his personal preferences. This will require **investment into software mirroring our screening approach.**

Finally, as always **CEO access remains key**. The review reminded everybody that we have to make sure to get access to CEOs as early as possible - a meeting with IR or even the CFO can lead to a wrong impression about the company in question. Generally we have no issues meeting CEOs as we are building a reputation as professional long-term investors in the community and refuse to pay any gatekeepers to get us this access.

4. Implications for HR

We have to **urgently fill the position of our analyst covering Germany.** Any strategic investment we will make will most likely also be from Germany, thus this would address this gap as well.

Secondly, we are now also offering **positions to professionals with sector-specific work experience who would help us to increase our understanding of sectors which we like to "fish in", e.g. healthcare.**

G. Risk Exposure of Fund

Please remember that we define risk as "Permanent loss of Earnings Power Value". At the end of 2016 we feel that based on this definition the risks below are the most relevant ones for us.

1. Company-specific Risks

1.1 Political and Currency Risk Mexico

With a Mexico exposure of ca. 2,6% based on headquarter location and ca. 1,5% based on revenue mix we are exposed to the general political/institutional risk in that country as well as currency risk. As the main holding is an FMCG company addressing the mid- and lower price points in its category we feel an impact of a recession would be moderate.

Following Greece for two decades by now has also taught us that in the long-run good management is a very strong hedge against country risks – and we are sure both Mexican companies have outstanding managers.

2. General Risks

2.1 EU and Euro

I should point out that **we have an unresolved currency risk in Europe**. And it is not getting better, but worse, as the ECB has lowered interest rates so much that there is no political pressure to tackle the issue of an uncontrolled rise of government debt - which is a key driver for the tension on the currency.

It could well re-surface in 2017, e.g. in connection with the general elections in the Netherlands, France and Germany.

2.2 Donald Trump as President

This is a risk nearly impossible to quantify – and it may even be positive for the US economy. Yet what I see and hear about him does not fit into many patterns of my personal experience. My instinct tells me that there is clearly a risk that some conflict may escalate to a very high level - and this can permanently impair wealth.

H. Team

FORUM would not be without the team it has. At the end of 2016 we have

a) four talented and motivated professionals doing the research

b) two support staff covering our back office as well as recruiting. They review ca. 1.000 applications p.a.!

In the course of 2016 one investment professional left us after 3 years. For 2017 we will try to **re-build our team of professionals to 5**.

Learning continues to be a central part of our culture and all staff have several ways to learn – from post-mortems, ca. 20 investment book reviews and the sectors they cover. **This should pay out over time for them and for FES.**

I. Outlook

2016 was a transition year with the value of our portfolio stagnating. 2017 should be better as we have found some new investment ideas and due to the improving operations in our strategic holding.

There is still a lot of work to do:

a) The **cash position at the end of the year is still too high**. We need to find good ideas, both for the tactical and strategic portfolio.

b) Our short portfolio is non-significant at ca. 3% AUM. We must ramp-it up.

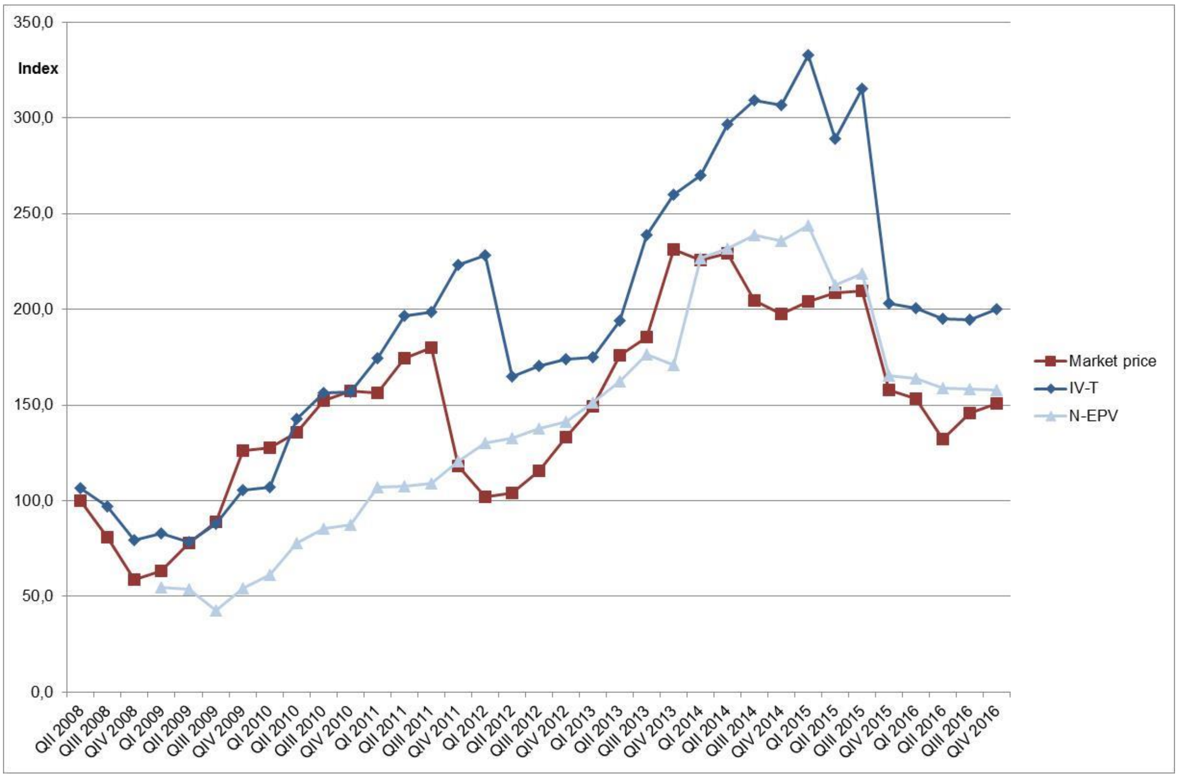
By historical standards we continue to have a lower Margin of Safety than in many periods. This induces the risk of multiple contraction if the whole market goes into multiple contraction.

Yet macro analysis of the corporate sector and its valuations shows that **Europe has a level of profits close to historical levels and valuations even below history**. **Thus we feel this is the right place to be in 2017!**

....
Burkhard Wittek

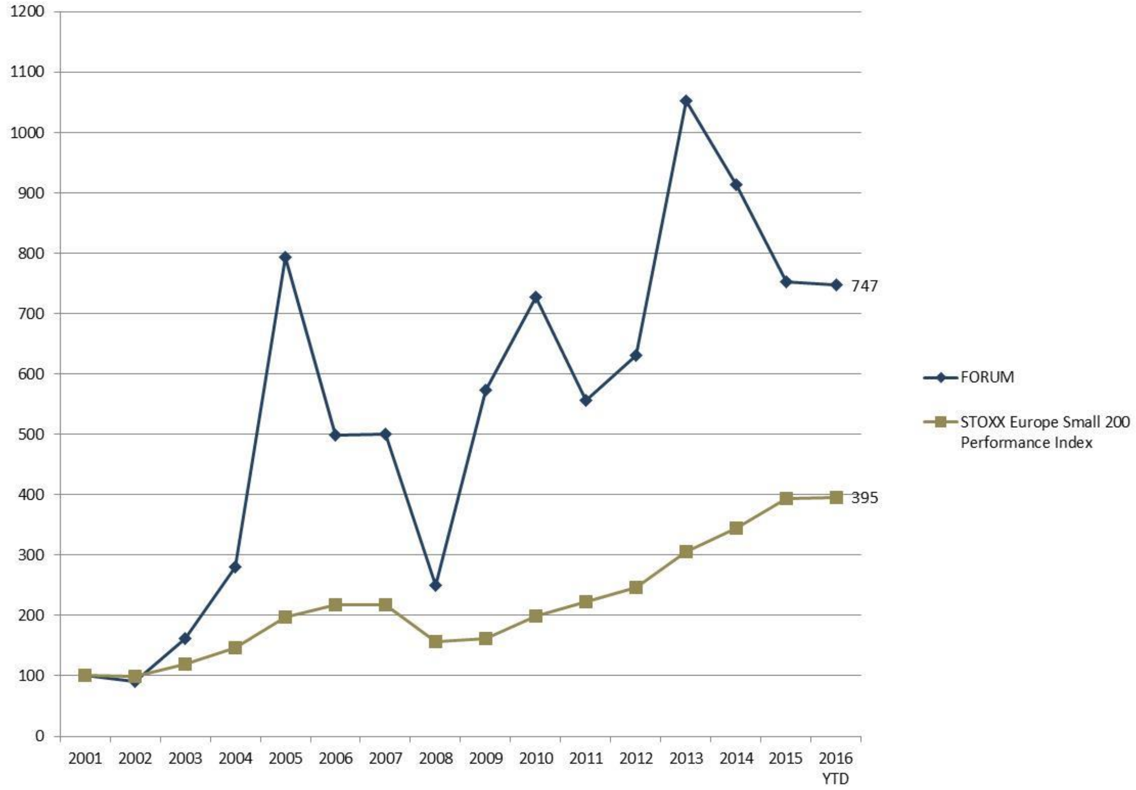
Appendices

Appendix 1: Portfolio at Market Prices and Intrinsic Values in € per Share



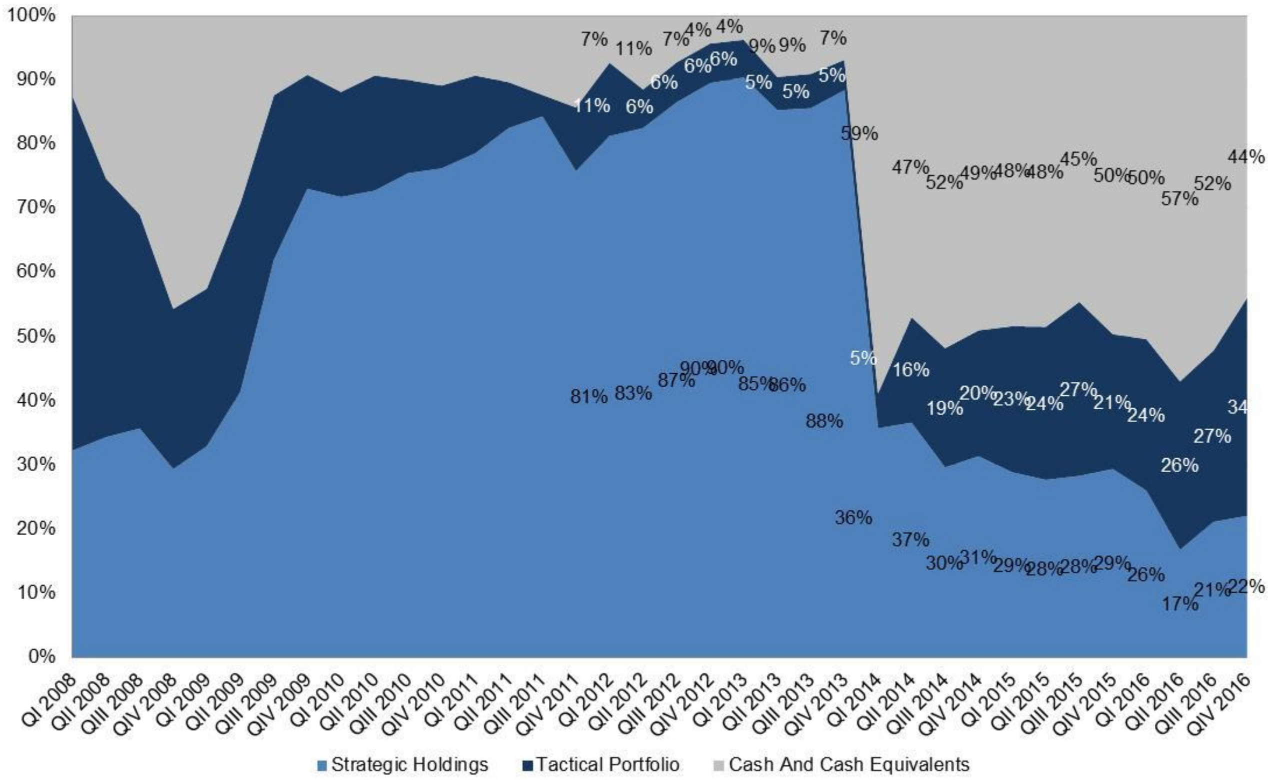
Appendix 2: Benchmarking of Results (June 14th, 2013 = 100)

Performance (2002), p.a.	FORUM Family Office	STOXX Europe Small 200	Over/(Under) Performance vs.
	Percent	Percent	Percent
2002	-9,0%	-0,3%	-8,7%
2003	77,0%	19,6%	48,0%
2004	74,0%	22,9%	41,6%
2005	183,0%	34,4%	110,6%
2006	-37,0%	10,6%	-43,0%
2007	1,0%	0,0%	1,0%
2008	-50,0%	-28,3%	-30,2%
2009	129,0%	4,0%	120,2%
2010	27,0%	22,8%	3,4%
2011	-23,5%	11,5%	-31,4%
2012	13,2%	10,9%	2,1%
2013	66,9%	24,3%	34,3%
2014	-13,2%	12,4%	-22,8%
2015	-17,5%	14,2%	-27,8%
2016	-0,7%	0,5%	-1,2%

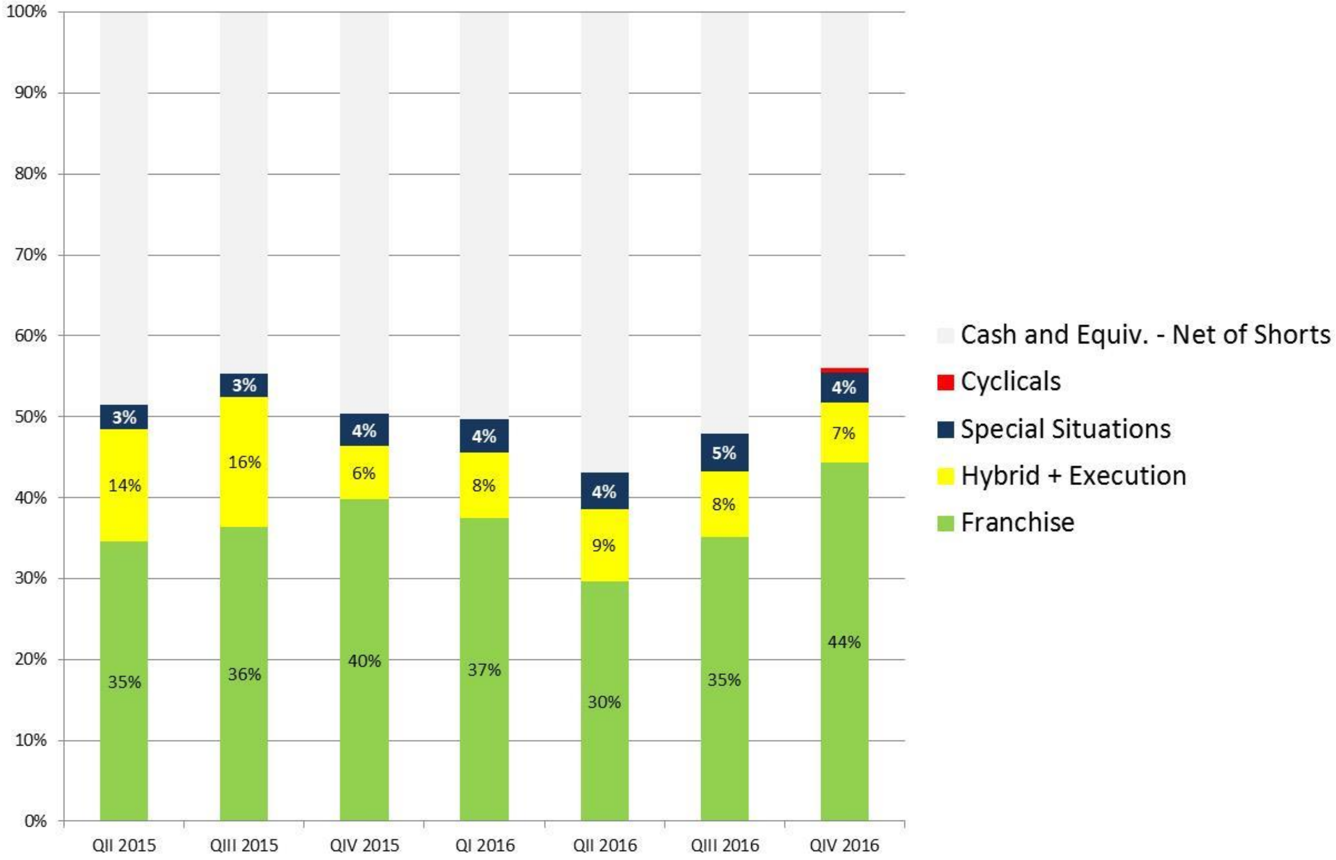


Appendix 3: Stoxx 200 European Small NR Annual Performance

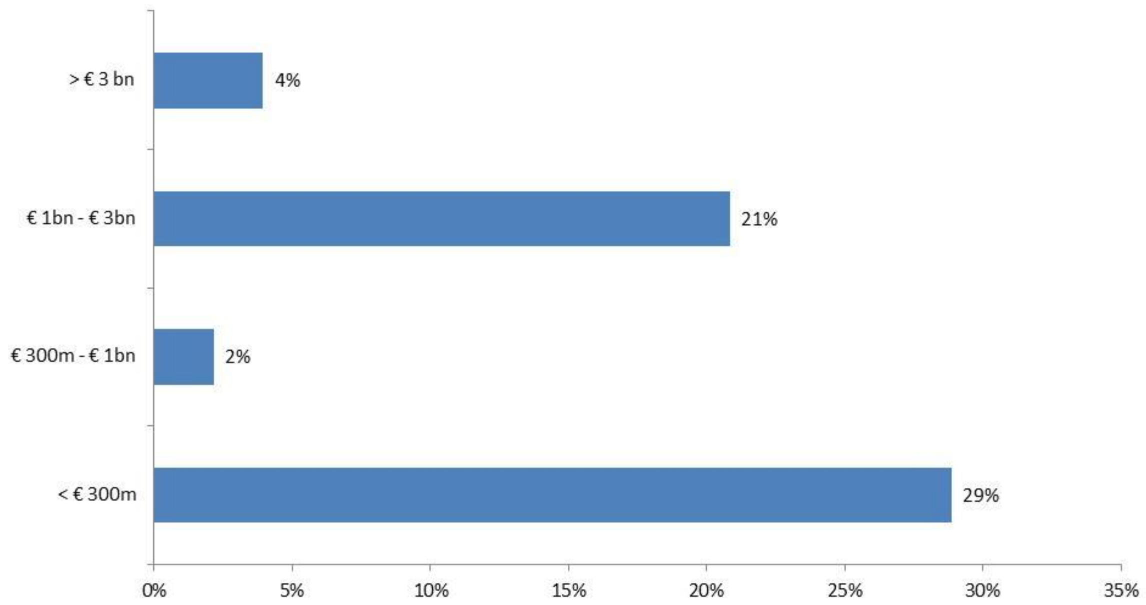
Appendix 4: Portfolio Mix



Appendix 5: History Portfolio Allocation by Business Quality



Appendix 6: Portfolio Allocation by Market Cap



Appendix 1: Methodology for Calculating FES Results

1. Segregation FES and FPE

FORUM Family Office ("FFO") has an Investment Philosophy to **only invest in companies.** We have no real estate, no hedge funds and own no shares in forests etc. We do this in **several sub-classes of assets:**

a) Publicly-Quoted: controlling Stakes/Strategic Positions with Board Involvement

b) Publicly-Quoted: tactical positions which are liquid

c) Private Equity.

To hedge our exposure to the cyclicality equity markets we also **have a book of short positions in publicly-quoted companies.**

To calculate the results of the publicly-quoted part of our portfolio – i.e. long and short positions – we use the following methodology:

a) We value our PE holding at Investment Cost, i.e. their value is constant over time

b) The change in market value between 2 periods is calculated as the difference between the full value of our wealth

c) The gain /loss in percentage is calculated as the ratio between the change in Market Value, divided by the Value of our portfolio excluding the PE portfolio at the beginning of the period.

Below is an example of the calculation (fictitious numbers):

	Year N	**Addition to PE** (at cost)	**Year N+1**
Cash	10	-10	0
Listed Portfolio	80		90
PE Portfolio	10	+10	20
Total Wealth	**100**		**110**

Performance of the Listed Portfolio + Cash:

$$\frac{Total\ Wealth\ (N+1) - Total\ Wealth\ (N)}{List\ Portfolio\ (N) + Cash(N)} = \frac{110-100}{80+10} = \frac{10}{90} = +11{,}1\%$$

Appendix 2: Summary of FFOVF Investment Philosophy

1. Long Book

Our Investment Philosophy has **the principles of Value Investing as interpreted by Warren** Buffett at its core: we invest with a Margin of Safety in businesses which we understand well.

We think about our ability to understand a business well - i.e. **our Circle of Competence** - as follows:

a) We have an "**outer Circle of Competence**" which defines the limits of what we do. Regionally this is Western Europe. In terms of type of businesses we have to be able to understand their products, business models and the "systems" of customers and competitors they are operating in. **We do not invest outside of this outer Circle of Competence.**

b) There is also an **"Inner Circle of Competence**" - companies which we understand particularly well. These are companies which have a more or less simple product or service offering, we have been following their industries for many years or even decades and we can assess the CEOs. **This is our "sweet spot",** here our confidence in any valuation and risk assessment is the highest. This sweet spot should constitute the majority of what we do.

c) We will be willing to pay more for companies in the sweet spot than for companies within the outer Circle of Competence, but outside this sweet spot.

In terms of company size **we focus on small- and mid-cap companies** – which we define as companies with market capitalizations in the € 300m to € 2bn range.

When we make an investment decisions we start by looking at "**What we Get**": to us the most important aspects are:

a) **Business Quality:** the category we like most are **Franchise Businesses** with a strong customer franchise and a strong competitive advantage. Second in rank come **Hybrid Businesses**. And the businesses requiring the biggest management attention and having the lowest visibility are **Execution Businesses.**

We try to have a significant part of our assets in Franchise Businesses. At the same time this is not a dogma: there are periods where these businesses are grossly overvalued by the market, allowing no attractive returns - just peace of mind. E.g. the so-called "**Nifty-Fifty**" favored in the 1960 had a great run until 1972, then the bubble burst. In the subsequent 7-year period this group of highest-quality stocks underperformed the S&P 500 by 30%.

We do not go for "peace of mind" - but for risk-adjusted returns. At this point in time it is increasingly difficult to find such businesses at valuations allowing our target returns. In this interest rate environment such businesses are priced like "bond-substitutes".

b) **Management and Governance:** in any business the CEO, the rest of the management team and the Non-Executives on the Board can make a huge difference to what shareholders will earn over time. A business with 15% ROE **will double the equity base it has built up in its lifetime in the next 5 years**: how this money is spent/re-invested can create of destroy a lot of value.

c) **Internal Compounding,** i.e. the ability **to grow profitably**: in the long-run a business which has the option to grow at high rates while requiring little capital will generate enormous value from compounding - and current valuations do often not reflect the difference in sustainable growth rates between businesses.

   Therefore we look for **visible growth with a long runway**. With real GDP growth in Europe at 1 -2% at best this is not an easy task. Companies able to pick up bolt-on acquisitions at value-creating multiples and the ability to do Post-Merger integration have created such a system, **sometimes referred to as roll-ups**. We have several of them in our portfolio.

Based on the results of "what we get" we will then decide "**what we pay**". The principles are:

a) At the core of our valuation is the **Net Earnings Power Value ("N-EPV")**. We define N-EPV as the capitalized value of the cash flows the business can achieve on a sustainable basis assuming no growth. This value anchors us on paying only for "what is there today".

b) Even for the best businesses - Franchise Businesses, high management quality and visible profitable growth - we will not pay substantially above N-EPV. This is our definition of the **Margin of Safety.**

c) In any case we **require an expected return of 20% p.a.**

We define **risk as the permanent loss of capital.** If the risk of permanent loss of capital is more than insignificant we will not invest - even if the upside appears promising.

Conversely**, share price volatility is not important to us** - we consider these fluctuations mostly statistical noise. Instead we review the underlying earnings power of the businesses regularly: is it unchanged or has it been impaired?

We are looking for investors who share this definition of risk - they will have a long-term perspective on investing like we do.

2. Short Book

Our **short investments** serve three purposes:

a) Autonomous opportunities from overvaluations with a catalyst

b) Hedging of company-specific risks in long positions

c) Hedging of the overall portfolio against market overvaluation.

Within the short investments we have

a) conviction bets

b) stochastic bets.

As in shorting the long-term trend is against us and there are non-calculable event risks, e.g. a takeover - we have so far only had one conviction bet - **otherwise we do stochastic bets, spreading event-risk over many positions which will work out "on average".**

Historically our short book has been 5 - 10% of AUM. We would like to have it a bit larger now.

Appendix 3: 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 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.