FORUM

European Smallcaps GmbH

Memorandum

To : Forum Staff

From : BW

Date : February 18th, 2020

Subject : FES Chief Investment Officer Report on 2019 Results**_V_2.1**

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 Report covers the period from **January 1st, 2019 to December 31st, 2019.**

A. Overview – FFOVF Results 2019

1. Results at Market Values

As of December 31st, 2019 the NAV of the FFOVF stood at **€ 136,16 per share**. Compared with the NAV of € 116,06 as of December 31st, 2018 this implies **a gain at market prices of 17,3% in 2019**.

In 2019 our benchmark index **MSCI Europe IMI** increased by 23,0%. Thus we have delivered **a relative underperformance of 4,6%** (remember we take the geometric difference)**.**

Performance (QI 2008 = 100), p.a.	**FES**	**OMSCI Europe IMI Performance**	**Over/(Under) Performance vs.**
	Percent	Percent	Percent
2008	-41,4%	-36,5%	-7,6%
2009	115,1%	30,4%	64,9%
2010	24,8%	11,3%	12,2%
2011	-24,9%	-13,7%	-13,0%
2012	12,6%	15,4%	-2,4%
2013	73,7%	17,4%	47,9%
2014	-14,6%	5,0%	-18,6%
2015	-20,1%	6,3%	-24,8%
2016	-4,4%	-0,6%	-3,8%
2017	14,2%	9,1%	4,7%
2018	-25,1%	-13,9%	-13,0%
2019	20,7%	23,0%	-1,9%
IRR QI 2008 - YTD	**3,8%**	**2,7%**	**1,0%**
Cumulative Gain since Inception	**29,1%**	**12,3%**	**14,9%**

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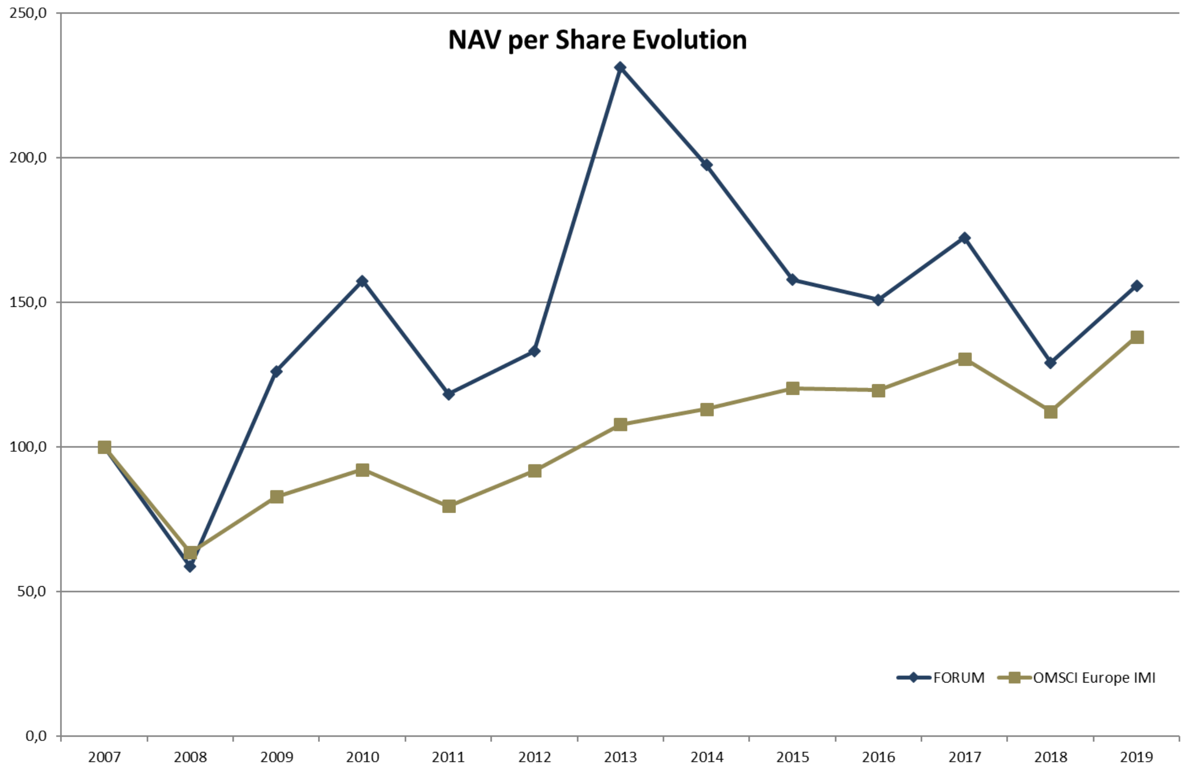
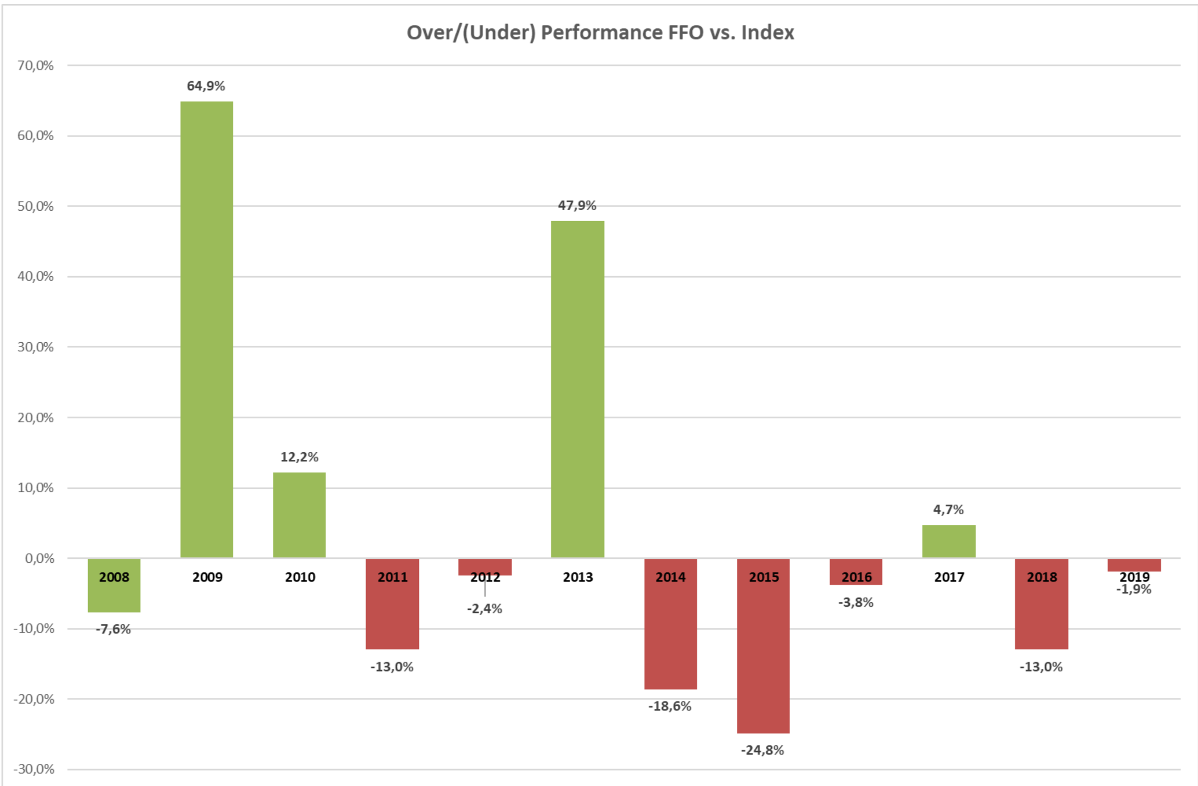
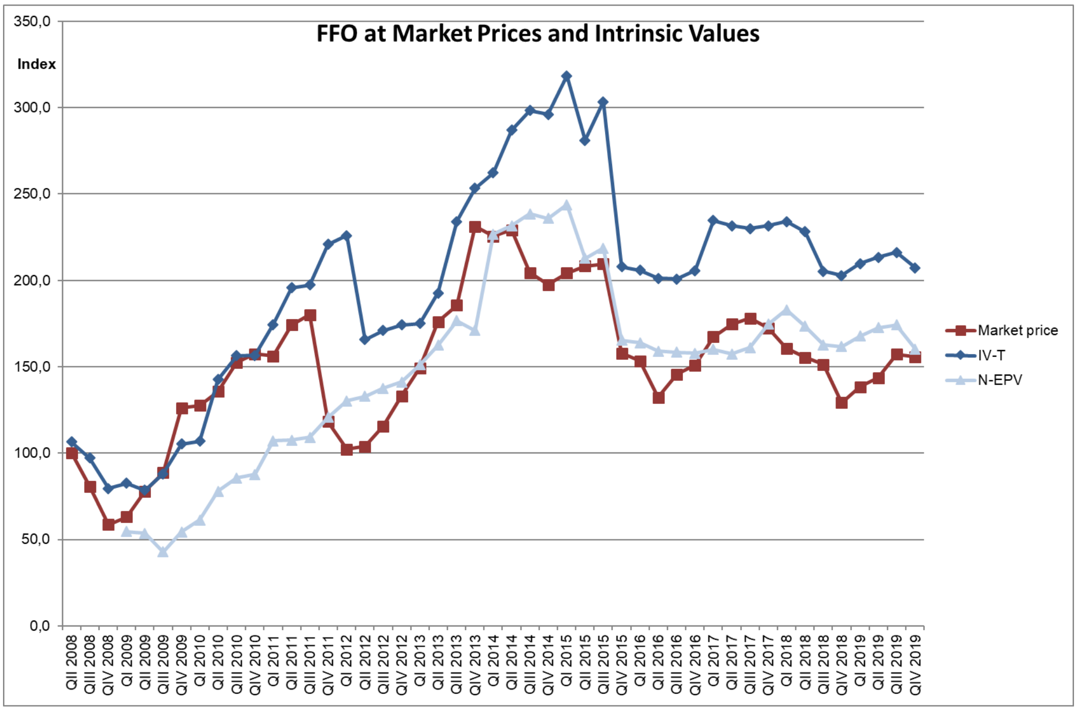




2. The Intrinsic Value Perspective

The chapters below compare the evolution of the NAV with the valuation at Intrinsic Values.



2.1. Net Earnings Power Value (N-EPV)

The light blue line in the chart below depicts N-EPV. N-EPV captures the Earnings Power Value of a business **in a steady-state situation – i.e. does not attribute any value to growth.** We calculate it by:

- simulating how much cash the business would generate if there was no re-investment into growth. We refer to this cash flow as "Owner Earnings".

- capitalizing this cash flow.

Thus this is **a very conservative valuation** – making no assumptions about future growth which will always be uncertain. In restructuring cases we assume a "normalized" profitability and discount it back by the number of years we expect it to take to reach this level.

In 2019 Net Earnings Power Value ("N-EPV") increased from € 155,73 to € 168,33, i.e. **by ca. 8%.** This increase is the net effect of the following:

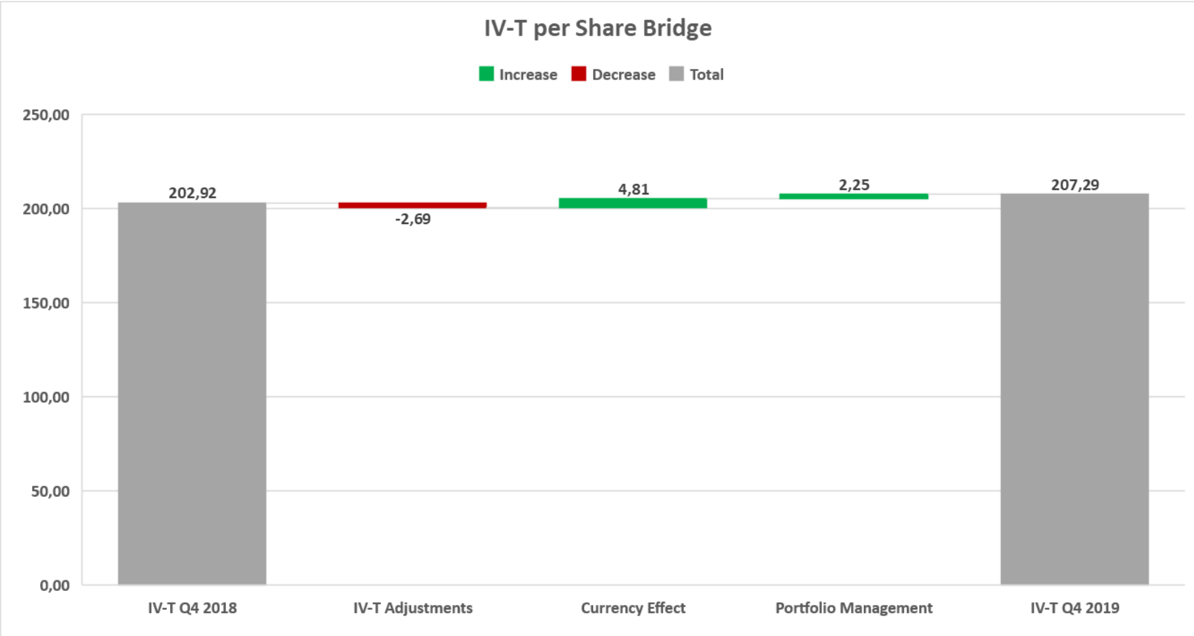
a) we **reduced N-EPV for two companies,** one of them being the largest position in the portfolio (connect group). We did **not increase N-EPV for any holdings.**

b) **we did active portfolio management**, selling down companies which had reached their Intrinsic Values and re-investing the funds into companies with a discount from Intrinsic Value.

2.2. Total Intrinsic Value (IV-T)

The line in dark blue shows the value of the portfolio at IV-T – i.e. including the value of growth. In 2019 **IV-T increased** from € 219,09 to € 237,76 per share, i.e. **by ca. 9%**.

The bridge chart below breaks up the increase in IV-T into its components**:**



IV-T at unchanged portfolio mix would have decreased by € 30,72 per share resp. 14,0% (2018: 8,8%). This is result of reductions in the IV-t of three holdings and no increase. The three reductions refer to the two companies where we decreased N-EPV as well.

In our last Annual Letter we stated that we would evolve our Investment Philosophy more towards "Steady Compounders" and Franchise Business, **i.e. businesses which run their course, where there is little change in trajectory required for our investment thesis to work.**

Of the three additions added to the portfolio during the year and still in the portfolio by the end of 2019 **two are "steady compounders"** with a strong underlying growth trajectory (Sdiptech, Berkshire). As we have also sold down some Franchise Businesses due to valuations **the share of such "steady compounders" has slightly decreased to ca. 33% in 2019.** We do not manage "tops-down", always requiring a discount from Intrinsic Value for investing, thus we will have to wait for an opportunity in the 2020 – the goal is unchanged.

Changes in **exchange rates** have added € 6,76 to the IV-T per share in the year, mainly the British Pound strengthening.

Finally, **portfolio management added € 42,63 (2018: € 39,32) per share to the IV-T of the portfolio**. As described in the chapter on N-EPV this was achieved by a combination of re-shuffling the portfolio from shares trading close to or even above IV-T and re-investing the proceeds in shares with a higher upside in their IV-T.

2.3. Putting it all Together

The best summary of where FFOVF stands is still the first graph in this chapter 2 with the evolution of the fund at different values:

a) In 2019 we have increased the fundamental earnings power of our portfolio by 8% (N-EPV) resp. 9% (IV-T). If you were an investor in a private company and would try to calculate how the value of your holding had evolved, you would probably use a similar methodology and arrive at this result.

b) Market prices of our companies have increased above that rate – as the stock market is enthusiastic and willing to grant higher multiples.

c) Most importantly the **market prices of our portfolio are still significantly below the N-EPV,** i.e. the value of our companies excluding the value of any growth. To get into the inner space defined by the two Intrinsic Values the NAV of the portfolio would have to increase by ca. 23%.

Thus stay with us – selling today makes no sense for us or for you: we would sell far below the values of our holdings. I am confident that **over time this abnormality will correct itself and the red line (Value at market prices) will end up between the two blue lines – above N-EPV/light blue and IV-T/dark blue.**

B. Portfolio Strategy – Long Book

1. Portfolio Evolution by Asset Class

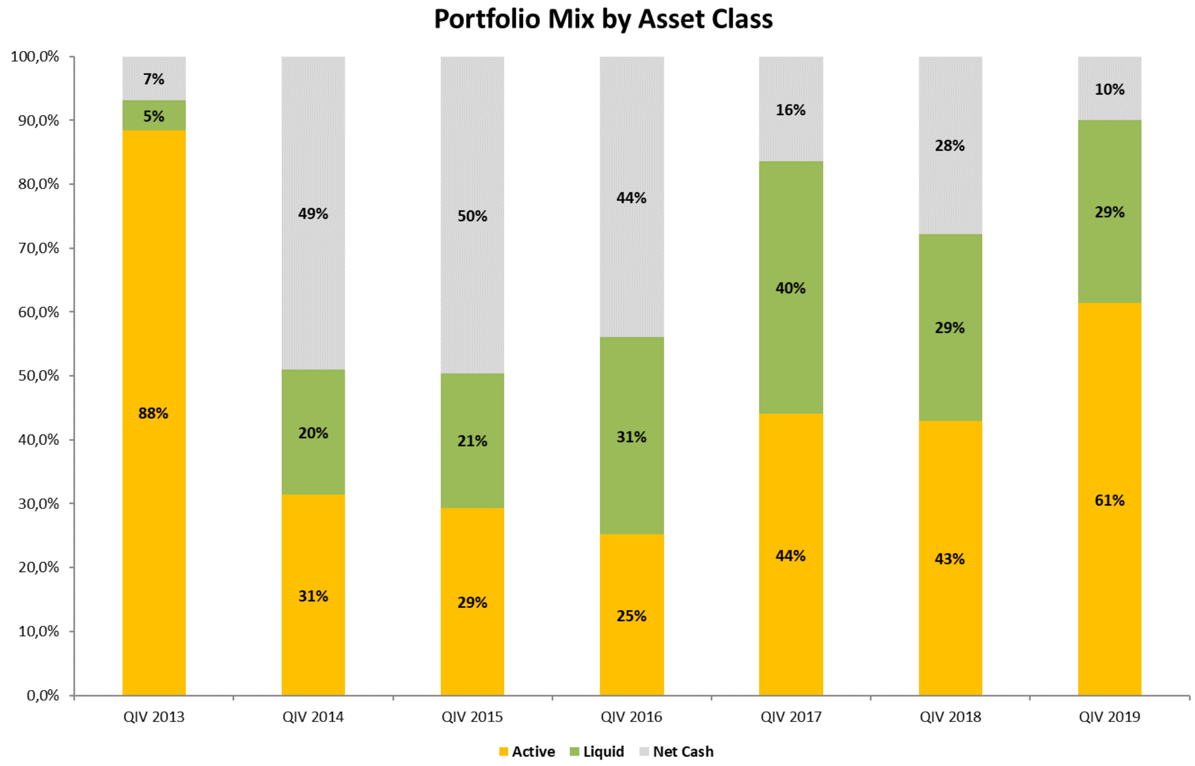
Our portfolio is comprised of **three different asset classes:**

a) **Active Ownership** – significant positions in companies, combined with Board involvement in which we hope to enable positive changes. Thus we are active owners, but unlike the likes of Cevian or Elliott Advisors **we work constructively with our holdings and try to achieve long-term, sustainable change.**

b) **Liquid Positions** – positions that we can build and exit at fairly short notice. We normally own 8 – 10 of such liquid investments.

c) **Cash and Cash Equivalents** – i.e. short-term bonds.

The chart below shows the evolution of our portfolio by type of class:



Below we will give you an update on these asset categories:

1.1. Active Ownership Holdings

In this category we have **2 positions:**

a) Genomma Lab in Mexico

b) Ids Immundiagnostic Systems Holding plc. in the UK.

1.1.1. Genomma Lab

Our **two goals** for the company are:

a) **Accelerating lfl. revenue growth to at least 10% p.a. in MXN**

b) **Improving Free Cash Flow after currency adjustments**, but before the investment in the new plant to **a level of at least MXN 1,2 bn.**

In 2019 the company made some progress on both metrics: based on the results of the first 9 months:

a) **Revenues in MXN increased by 9%.** In the Q III letter to Clients (which was based on Q II interims) we showed you a graph with the evolution during the three phases the company went through, and the third quarter has confirmed my expectation that we are on a good track and should expect more to come.

b) **Free Cash Flow** is evolving more slowly as we have to tackle a complex tax situation (in a country desperate for tax proceeds!). In Q 3 2019 Free Cash Flow – defined as Cash Flow from Operations minus cash interest, forex losses and investments turned positive for the first time in 2 years at MXN 85m. Adding back the cash outflow for the new factory, Free Cash Flow before investment in the new plant reached MXN 200m, a reasonable number.

Thus we are happy with the outcome and the capital market appears to think similarly: in 2019 **the share price of GenommaLab increased from MXN 11,67 to MXN 18,71, i.e. by 60%.**

We have not made changes to the **Intrinsic Values** yet, for that we would like to see more evidence of a more permanent change in momentum.

1.1.2. ids Immundiagnostic Systems plc

This is a tiny position, accounting for only 1% of AUM. The market for this stock is extremely illiquid, and as I am the Chairman of the company FFOVF is limited to when it can buy or sell shares.

The turnaround progressed largely to plan. In the year **the share price increased from 183p ro 273p, i.e. by 49%.**

Again we have made no changes to Intrinsic Value yet.

1.1.3. Summary of Active Ownership: Performance Attribution

In summary our two holdings in the Active Ownership category **kept their Intrinsic Values unchanged in 2019.**

At market prices this asset class has gone up by ca. 58%. But remember that in 2018 market prices dropped by **40% with this asset category.** Thus mathematically we have not even gone back to the level at the end of 2017. The obvious questions one would ask from these data are:

a) Did you get in too early?

b) Why did you not increase your shareholding at the end of 2018 after share prices had come down so much.

The answer to the first question is undoubtedly "yes": we were very confident on the turnaround, probably overconfident and should have waited for an even lower entry price/higher upside/bigger Margin of Safety.

The answer to the second question is as follows: Yes, I did increase our position in Genomma at the end of 2018 slightly. To keep the exposure to Mexico unchanged we exited our second position (Grupo Hotelero) completely. **No,** beyond this re-shuffling of our Mexican holdings I did not want to increase our exposure to LatAm anymore.

At the end of 2019 the two positions in this bucket accounted for 15% of AUM, up from 10% a year ago.

1.2. Liquid Portfolio

This part of the portfolio increased from 73% to 77% of AUM. It is comprised of 8 (December 2018: 11) positions.

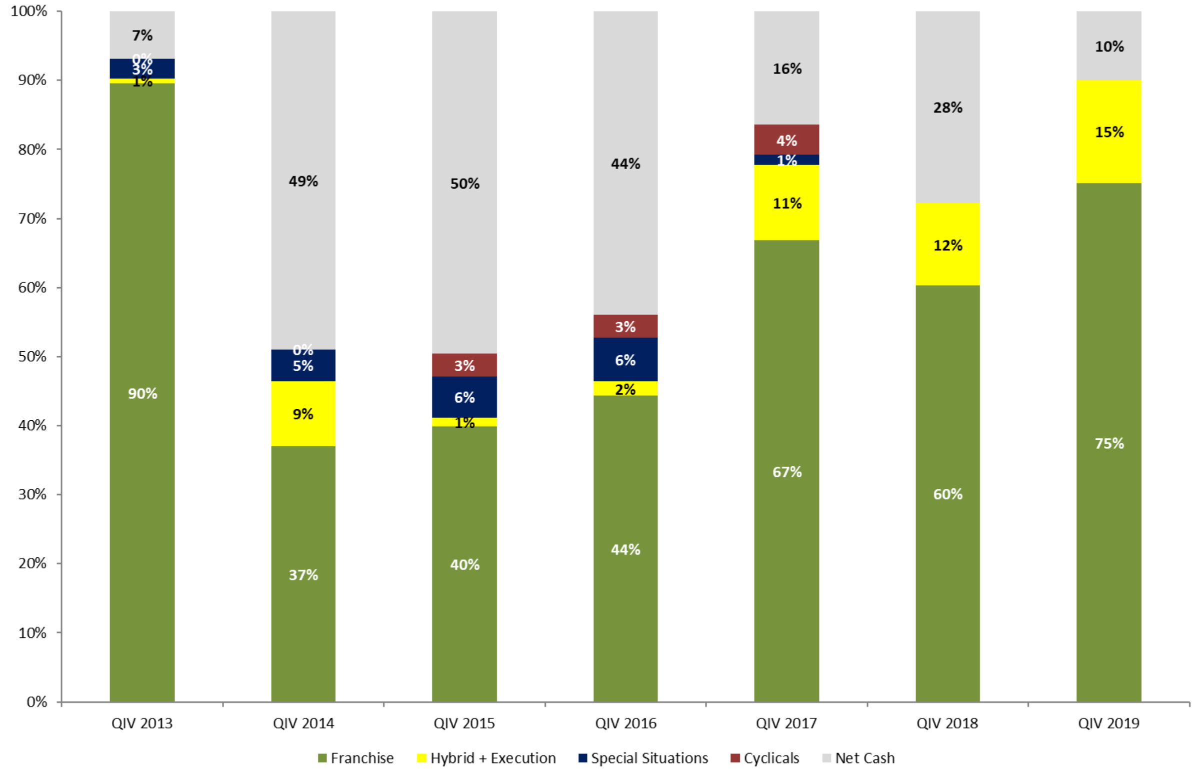
1.3. Cash and Cash Equivalents

At the end of 2019 our **net cash position –** i.e. the cash we would have left after covering all of our short positions - including the cash generated from shorting **- stood at 8% (31.12.2018: 18%).** This is at the low end of the range in which we want to keep it and we are waiting to dispose 1 - 2 peripheral positions.

2. Portfolio Evolution by Business Quality

2.1. Overview

We think **business quality** is the most important determinant of risk and return in public equity investing. Below we will therefore discuss the evolution of our portfolio along this dimension. In doing so, we will **combine the positions in the active ownership and liquid portfolio buckets, i.e. look at the total the invested part of AUM.**



In 2019 the share of Franchise Businesses dropped for the second year in a row, this time to 27% from 35% at the end of 2018. As in 2018 we felt compelled to sell some positions after they had reached valuations at which we did not feel comfortable with the risk/reward balance.

Our Investment Philosophy stays unchanged that Franchise Businesses should account for ca. 50% of AUM. But we always need a Margin of Safety – that is Prio 1.

2.2. Franchise Businesses

These are **businesses of highest quality - combining high customer stickiness with a strong competitive advantage**. Historically they have been at the core of what FORUM does, mostly accounting for 40 – 60% of the invested part of our portfolios.

With **27% of net AUM** this class of businesses went to a relatively low allocation.

As we have explained to you in the Interim Letters 2019 this drop is largely due to the sale of a single position: **Novo Nordisk.** It is a wonderful company, but ca. 40% of earnings are generated from the US. Prices in the US are 50 – 100% higher than e.g. Europe. The pricing and reimbursement system is under strong pressure and insulin gets a lot of media attention **as many patients cannot afford their insulin anymore – with terrible consequences to their health.**

We saw a significant risk that in the run-up to the US Presidential elections in 2020 either Donald Trump would pick this subject – it affects 5 -7% of the electorate – and just legislate price decreases. **When he started pinpointing this topic in his tweets, we decided we did not want to be exposed to that risk.** So far he has not gone any further, thus the share price kept going up – but that is “hindsight analysis”.

Thus today our portfolio consists of **3 Franchise Businesses:**

a) Genomma Lab

b) Immunodiagnostics Systems

c) EDP-R

In 2019 the **IV-T of the companies in this category in the portfolio at the beginning of the year (i.e. all three) stayed unchanged. Their market value increased by a weighted 45%,** mostly due to the share price increase of Genomma Lab mentioned above. This should give you a feeling for the **willingness of the equity market to re-price “bond-like quality” year after year to valuation levels not seen in decades.**

2.3. Hybrid and Execution Businesses

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 fashion jewellery. In these businesses the quality of **management is immensely important and we spend a lot of time in our Due Diligence to verify it**.

At the end of 2019 we had **6 (31.12.2018: 7) companies in this group**.

In 2019 the market value of this group increased by 8,8%, thus dragging down over overall result. The main reason **was**

a) slippage in the turnaround processes at the **problem division at Connect Group plc**

b) an additional deterioration at the loss-making business for disposal **at Semperit**.

We still have fairly high conviction that the improvement in earnings at both companies is a question of “when” and not of “if”, thus expect the turnaround to materialize in 2020.

At **connect Group plc.** the last round of “bad news” triggered the capitulation of some shareholders, who have apparently given up on the company. Conversely, we took advantage of the resulting share price drop and increased our position significantly.

2.4. Special Situations

This category is comprised of **companies undergoing some sort of transition**. E.g. there may be a conglomerate divesting peripheral activities and re-focusing on the core. Or an activist investor who we know and trust tries to replace a poor management.

At the end of 2019 we had **no names in this category**. The two positions reported at the end of 2018 (Mauna Kea Technology and Schaltbau) were sold, **the combined profit based on the entry price was ca. € 960k resp. ca. 2,5% of AUM.**

2.5. Cyclicals

We add cyclicals to our portfolio as we believe they can add good returns if picked at "deep value" valuations - e.g. a mining supplier when a significant part of the commodity supply is losing money on a cash basis.

And we believe **we can build an edge combining our frameworks on long-term profitability of businesses with the psychological edge – vulgo guts** – required to buy when the institutional mainstream believes the world is going under. The share of businesses with a cyclical component is significant, ranging from cars over capital equipment to products with commodities as ingredients, thus ignoring cyclical businesses does not seem a wise limitation - it implies ignoring the cyclicality of many businesses.

At the end of 2019 we had one company in this category, **Duerr AG.** We had included our Essence of Investment Thesis in the Q III 2019 Letter to Clients.

C. Short Book

1. Overview

At the end of 2019 we have **6** (31.12.2018: **7) open short positions from a diverse range of industries.** In total our **short exposure at the end of 2019 was 11,9% of AUM.** Thus, we increased our exposure from the 6,5% at the end of 2018.

Our strategy is to **invest in autonomous shorts only**, i.e. companies with a catalyst for a share price drop. We prefer to find these companies in industries which undergo a profound structural change.

The short portfolio is **composed 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. The only exception to this principle is a short position in a textile retailer, we are particularly negative about the brand erosion of this retailer.

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

2. Results

In 2019 the short book contributed **a negative result:**

a) The weighted prices of the shorted shares **increased collectively by ca. 23,0%**

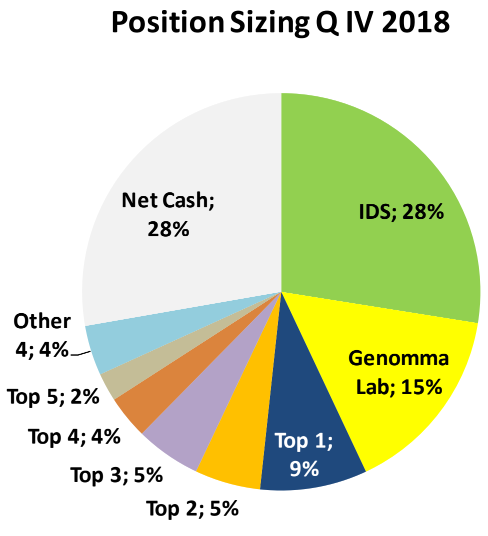
b) This gain **contributed negatively by ca. 2,4% to the result of the fund overall.**

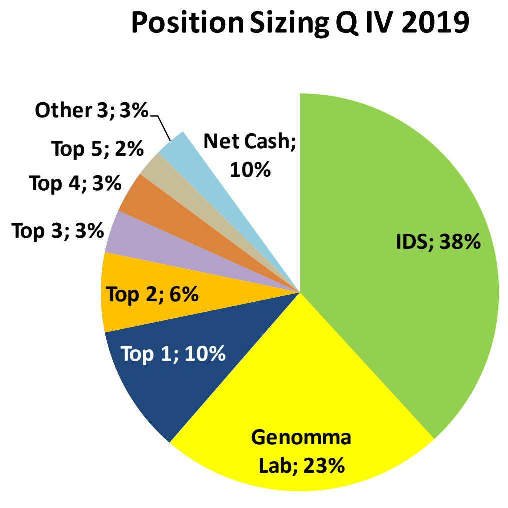
This negative result is largely due to **share price increases > 50% at two companies** which we consider massively overvalued. One of them is Tesla, and I am sure you understand our short thesis – we were betting on competition eroding the pricing power of the company and requiring more cash. We keep on to this position, do not think we have seen the end game.

D. Additional Perspectives on Portfolio Mix

1. Portfolio Concentration

Please look at the two pie charts below to show the **evolution of the portfolio by position sizing:**





As you can see in the course of 2019 we have **increased the concentration of our portfolio significantly**. The main reason is that we added to the "conviction bet" we have, i.e. Connect Group plc. By the end of 2019 we had allocated ca. 28,4% of AUM to it.

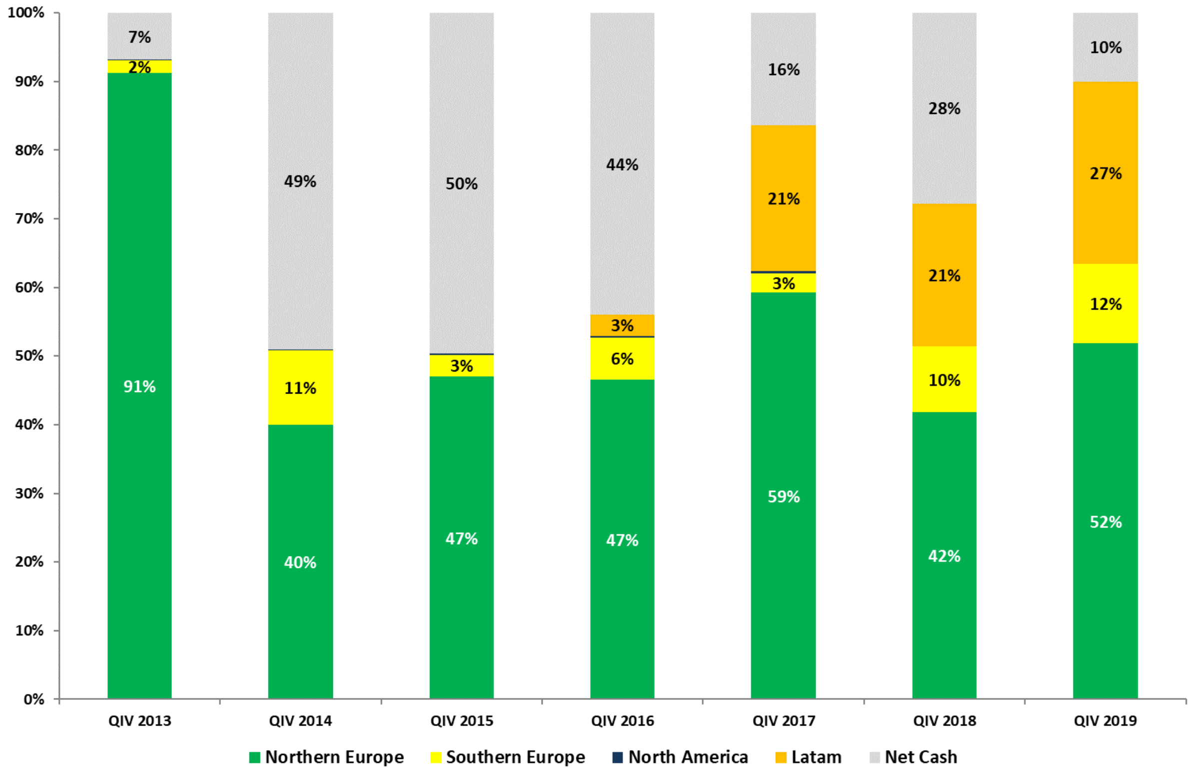
The number of names with an allocation of 10% or more has stayed unchanged at 4. **The top 3 position combined account for 55% of AUM, up from 39% a year ago.**

Conversely, we have **reduced the "tail end"** of the portfolio – positions 6 and below - from 8 to 5 positions.

Overall this is positive: at the beginning of 2015, our best year in terms of outperformance over our benchmark, the largest position accounted for 38% of AUM and the top 3 positions for 66% (vs. 55% today). **In the end portfolio concentration is an expression of conviction, and a high concentration indicates high conviction.**

2. Regional Portfolio Mix

Please see the chart below for the evolution of portfolio mix.



There was little change in the regional composition of our portfolio:

a) 62% (31.12.2018: 56%) is invested in **Northern Europe**

b) 11% (31.12.2018: 13%) is invested in **Southern Europe**. These are attributable to EDP-R. EDPR itself has ca. 50% if its assets and earnings outside of Southern Europe. **Thus economically our exposure to Southern Europe is only ca. 6%.**

c) The share of **LatAm decreased from 15% to 14%.** We will not make any new investments in this region until we have made good money with our existing investment.

This mix suits our tops-down preferences.

E. Risk Exposure of Fund

1. Mexico Risk

With a Mexico exposure of ca. 14% based on headquarter location and ca. 10% based on revenue mix, we continue to be exposed to the general political/institutional risk in that country as well as currency risk. I am worried about this **as LatAm across the continent appears to be deteriorating simultaneously in institutional stability**. The example of Argentina shows that in case of a country-specific financial crisis evolving investors can easily lose 50% of their value just from the devaluation of the currency.

2. Global Macro and Political Risks

There are several macro risks in the world economy and we have discussed them in various Letters to Clients. They are largely unchanged from the last year:

a) **A recession in China,** magnified from the ever-increasing level of debt in the country.

b) A full-fledged **trade war between the USA and China**

c) The risk of a **massive stock market correction in the USA**. This could have secondary effects onto the real economy and be the trigger for a recession.

d) Finally, the risk from the **ever-increasing level of debt in the world economy**. The world bank has just issued a report on this risk, great reading, here is the link: https://data.worldbank.org/products/ids

F. Review of Errors in 2019

A good review of a year should always include a review of **what went wrong** – to learn from the consequences. Such **a post-mortem is a key building block for an organization built with the ideal of learning mindsets**. Below please find our take on it – differentiated by errors of commission – those we did – as well as errors of omission – what we missed by not acting according to our Investment Philosophy and Process.

1. Errors of Commission

1.1. New Names

I tried hard to find mistakes in the investments we made. We added the following new names:

	Company	% Allocation	Change in IV Since	Change in Price Since
a)	Sdiptech	10%	-	+48%
b)	Berkshire	5%	+4%	+13%
c)	Dürr AG	5%	-	+23%
d)	**Total New**	**20%**		**+33%**

Thus the three new names cover ca. 20% of AUM. In 2 of the 3 cases we have not increased the Intrinsic Value since the investment – which is fine since the holding period was less than a year. In terms of share prices **the group as a total has contributed +33%, thus improved the average which was +17%.**

In terms of timing the entries I am also quite happy: we picked Sdiptech and Berkshire in dips at prices which were near their lows in the +/- 6-months period. We bought Dürr on the way down at € 25,-, and the share price continued to drop to ca. € 21,-. We had a limit of € 20,- to double our position, but this price was not reached, after the low at € 21,- the share price recovered steadily to today´s level > € 30,-.

In terms of **conviction we would definitely do all three investments again at our entry prices if history were to repeat itself.**

Thus in summary I cannot find an error in the investments we did. There were errors in not making investments which would have performed even better (errors of omission), and I will discuss them below.

1.2. Additions to Existing Positions

In 2019 we made the following **additions to existing portfolio positions**:

Company	% Allocation	Entry Price	Share Price Dec. 31, 2019	% up
Connect Group	7%	28p	36,2p	19%

Again, little to complain about, we would do it again at the entry prices if the opportunity arose.

1.3. Decisions to Sell Names

Finally we made the following decisions to sell shares:

Company	% Allocation	Sale Price	Share Price Dec. 31, 2019

a)	Bayer	5%	€ 60,-	€ 71,-
b)	Novo Nordisk	10%	DKK 325,-	DKK 370.

Both of these sales are debatable, not just because share prices are up since we sold, but because **both companies are good Franchise Businesses:**

a) We sold **Bayer** because we felt it was very unwise for the company to enter settlement negotiations at such an early phase of the legal battle, with Bayer having lost all three court rulings to date. We felt the company was under too much pressure to accept a bad compromise, just to have peace of mind.

   From today´s perspective **I have some regrets on this decision**. Even if the actual settlement reaches US-$ 15bn. instead of the US-$ 5 – 7bn. as anticipated by us, the stock is still undervalued and would get back to a level of € 90 – 100,- (instead of € 100 – 120).

   In terms of the terminology of mental biases **I may have been suffering "short-term bias" –** being afraid of a short-term loss, therby giving up a potential solid long-term gain.

b) We sold **Novo Nordisk** because of the US election: we have explained to you before that Novo derives a high share of its profit from US insulin prices which are significantly higher than in the rest of the world. In 2016 presidential candidate Donald Trump announced that he would regulate such drug prices if he became president. And in the 2 weeks after the election result **the share price of Novo dropped from DKK 400,- to 240,- - which gave us an opportunity to get in at an attractive price.**

   In 2019 I was afraid that the campaign for the presidential elections in 2020 presented a similar risk. Both left-wing candidates (Sanders and Warren) have announced that they would reduce drug prices with diabetes treatment at the forefront. **When Donald Trump started to address the issue of drug prices in his tweets ca. in September 2019** I pulled the trigger – I felt an immediate risk evolving.

   Again I have some regrets because the company is diversifying its revenue base from the traditional injectable insulin to other drugs like GLP1, obesity treatment and oral insulin – the latter being a monopoly for them. **Thus the quality of the business improves steadily – and the political risk decreases as it would mostly hurt the injectable insulin.**

   Put differently, in 3 – 5 years Novo will be a much stronger company. An investor may lose money in the meantime during the current electoral cycle – but with a 5-year perspective the positive effects will nearly certainly compensate this risk.

   Thus in terms of framing a mistake **I may have had "short-term bias" once more – avoiding short-term risk of a share price correction against solid long-term upside.**

2. Errors of Omission

2.1. Purchases

I think we were **slow and indecisive** in not buying the following positions:

Company	Entry Price	Share Price Dec. 31, 2019	Change %
The Gym Group	240p	280p	+17%
Instalco	SEK 90,-	SEK 131,-	+46%
Datagroup	€ 40,-	€ 56,-	+40%
Total (unweighted)			**+34%**

2.2. The Gym Group

The Gym Group is a low-cost gym operator in the UK. This business is **wonderful everywhere in the world, e.g. in Germany McFit has been making 30+% EBIT margins for a decade**. The picture looks similarly in the rest of Europe. In this company we spent weeks and months debating the right valuation metric. By the time we had come to a conclusion at another meeting with the company CEO the share price had gone up by nearly 20% (and has climbed further since then).

Thus in terms of our learning **this is a "toolbox mistake"** – we just did not see the essence of the investment case in the noise of many numbers. **It was my personal mistake** to let the team debate – instead of taking a day to form my own opinion from reading the primary sources myself.

2.3. Instalco

Instalco is a Swedish roll-up which consolidates the craftsmen involved in housebuilding. In selecting his targets he focusses on the players which have a USP and the associated higher margins. These **USPs may be a proprietary process or a small twist to a technology,** i.e. the typical competitive differentiation in an Execution Business. Yet the track record was clean, no risk from profit erosion visible.

We **did not invest** because Sweden is in a construction bonanza and the whole construction sector is earning peak margins, 40 – 60% above normalized margins. In a recession these margins will contract significantly

But the business adds low-price acquisitions so fast, that the inherent earnings potential is growing quite fast, **building some Margin of Safety for a correction in the construction cycle.**

Thus some regrets – but probably the right decision. From hindsight it looks like a poor decision **because the recession risk has not materialized to date** – but that is not a proof that the decision was wrong.

2.4. Datagroup

This is **another roll-up candidate**, this time about IT system houses and located in Germany. The last 5 years generated a great track record, but we had already looked at the company in 2012, and at the time the company had overpaid for a series of acquisitions. That made us very careful.

In 2019 we took a fresh approach, but had difficulties finding interview partners giving us an insight track into the company. Therefore our Due Diligence dragged on and on, and in the meantime the share price started climbing.

If there is a learning it is about our internal organization, it is about defining clear priorities in the planning of the workweeks of our staff.

2.5. Sales

This leaves **two positions not yet mentioned in this paper where we had to both impair Intrinsic Values and the share price dropped in 2019 – this is as bad as it gets.** Together they account for ca. 5% of AUM at year-end. I suspect that at least in the smaller of the two we had “Loss-taking Aversions” – should have sold after the last meeting with management – which was plainly disappointing.

G. Outlook

As a result of our assessment of the risk/reward balance of the Macro assessment we target the following allocation top-down**:**

a) **Net cash** (i.e. after offsetting gross cash in the accounts against our short exposure) should be ca. 20% (it was at 16% at the end of 2018).

b) We are targeting **a short exposure of 10 - 15%**. We will continue to restrict ourselves to "autonomous shorts" - i.e. investments with a clear company-specific catalyst for re-valuation. This makes it difficult to reach this allocation.

Thus our net long exposure should decrease to 65 - 70% - below the 84% we had at the end of Q IV 2018.

And as always we will be driven by opportunities - bottoms up - if an attractive investment opportunity emerges we will take it. In fact, at the end of January 2020 our net cash position is down to 11% as we increased our exposure to 2 of our top 3 positions again.

H. Conclusion

2019 was a year with a solid performance, both with respect to the underlying Intrinsic Values of the fund (up by 8 resp. 9%) and even more with respect to the **increase in NAV (up 17%).**

We think the **portfolio is well-positioned for another year**, with a good ratio of Margin of Safety and upside potential – think about the curves in Appendix 2. Thus I am optimistic that 2020 will generate a good increase in NAV. The obvious target we have is to beat the benchmark again.

I would like to take the opportunity to thank all of you for your continued support and commitment. We hope we will continue to generate solid increases in your wealth. And we are always glad to answer any questions you might have about the fund and your investment.

....
Burkhard Wittek

Appendix 1: 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.

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 2: 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.

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.