Memorandum

To : Forum Staff

From : BW

Date : February 7th, 2018

Subject : FES Chief Investment Officer Report on FY 2017 Results

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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 **FY 2017** period**.**

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

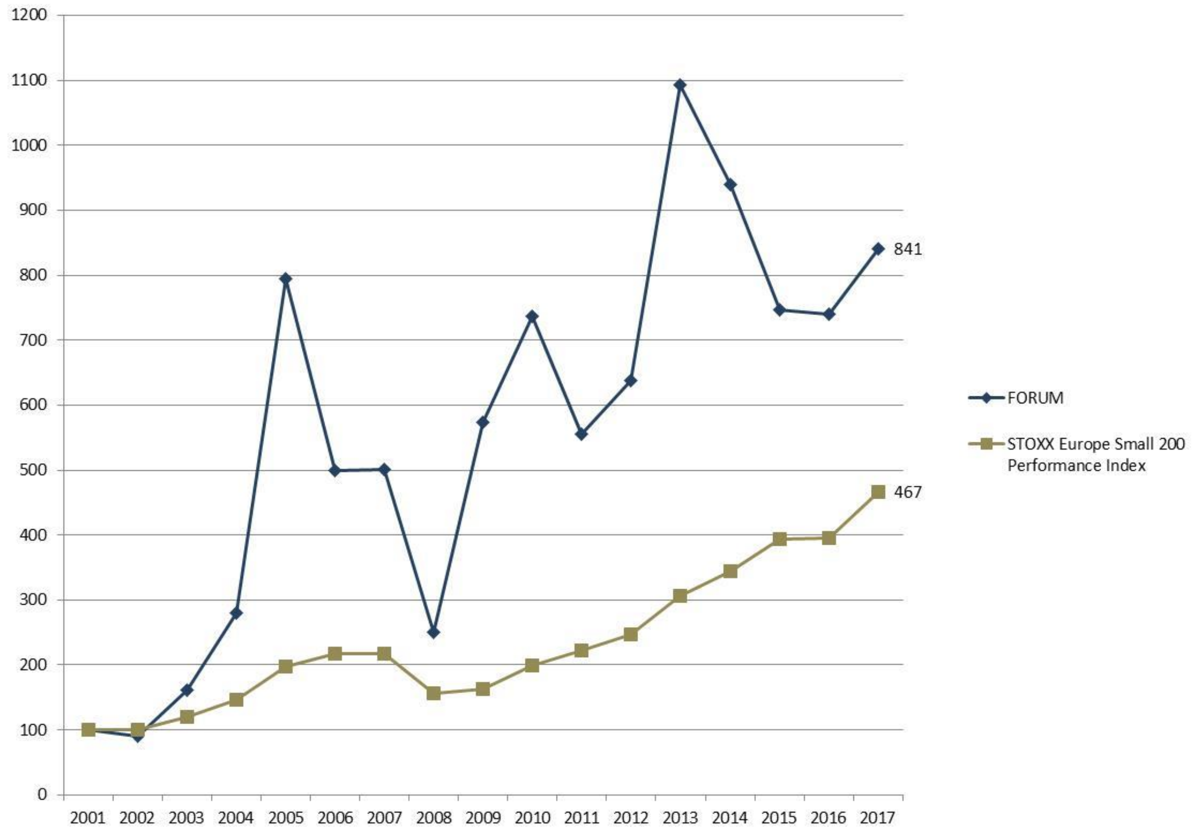
c) Appendix 3: Glossary

1. Results in FY 2017

1.1 Results at Market Prices

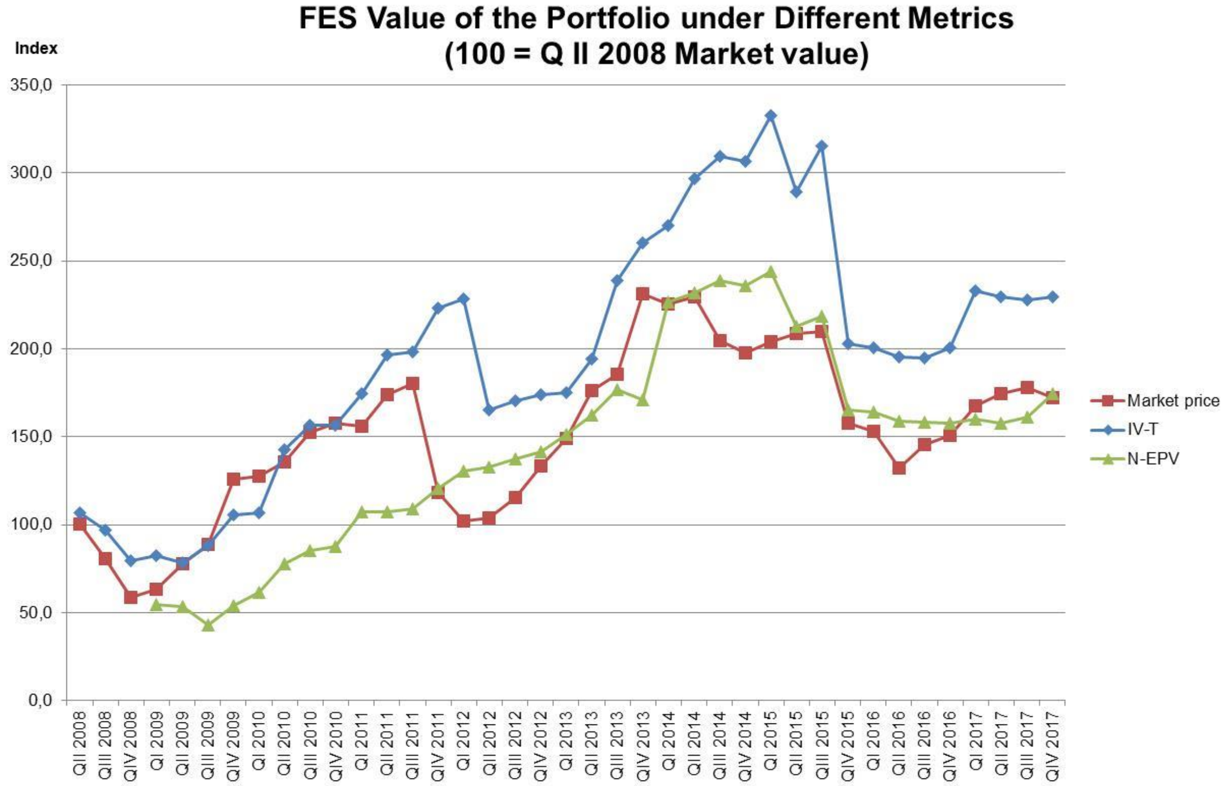
In FY 2017, **our NAV increased by 13,7%**, vs. the STOXX Europe Small 200 index increasing by 18,0%. This is an **underperformance of 3,6%.**

This brings the **IRR of the fund since inception to 14,2%** p.a. - compared with the benchmark index generating an IRR of 10,1% p.a. **As a result we have turned € 100,- into € 841,- vs. € 467,- an index fund would have produced.**



1.2 Results at Market and Intrinsic Values

Please see the graph in **Chart 2 below** for an overview of the portfolio 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.** We calculate it by

- simulating how much cash the business could generate if there were no re-investments into growth and
- capitalizing this cash flow.

Thus this is a very conservative valuation – making no estimates about future growth which will always be uncertain.

In 2017 **N-EPV increased by 10,7%.**

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

In 2017 **IV-T increased by 14,7%.**

The increase of IV-T at the beginning of the year is linked to the addition of companies with higher upside to IV-T. Conversely the increase in N-EPV at the end of the year is linked to the disposal of companies trading significantly above N-EPV; turning these positions into cash mechanically increase the N-EPV.

1.3 Margin of Safety

To interpret **Margin of Safety** of the fund, look at **Chart 2** 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

NAV reflects the prices paid by the market for our stocks. **N-EPV** is the value we assign to our holdings for the steady-state businesses.

As the stock market puts some value on growth, it is **normal that NAV is above N-EPV**. At the end of the last quarter **NAV was ca. 1% above N-EPV.**

Inverting this ratio, N-EPV is at ca. 99% of NAV. A simplified interpretation of this ratio would be to say that **ca. 99% of the NAV of the fund is covered by N-EPV - i.e. the capitalized cash flows of our businesses, modelling them as ex-growth businesses.**

Historically at Forum, 91% of the NAV of the fund were covered by N-EPV, **hence this aspect of the Margin of Safety is slightly below the historical range.**

1.3.2 NAV vs. IV-T

IV-T measures the value of the businesses we own including the value of growth. We would like to see NAV below this value, as the difference between the 2 metrics gives an indication of the upside which is not (yet) priced into the share prices.

At the end of 2017 **IV-T was 44% above NAV.** Historically, the upside from NAV to IV-T has been around 32%. Hence the full value of our holdings is a bit higher relative to market prices than historically.

Remember that **IV-T is calculated by discounting the future expected value of the business back to today.** Our discount rates are in the 8 – 12% p.a. range. Thus if the market price of a share reaches IV-T, you can expect an IRR of 8 -12% p.a. by holding this position.

If in addition IV-T is above NAV- which is the situation today - there is potential for additional returns from higher valuations. Thus we feel comfortable with this metric for protection/upside as well.

1.3.3 Summary of Margin of Safety

With:

a) 99% of NAV underpinned by N-EPV, giving good downside protection

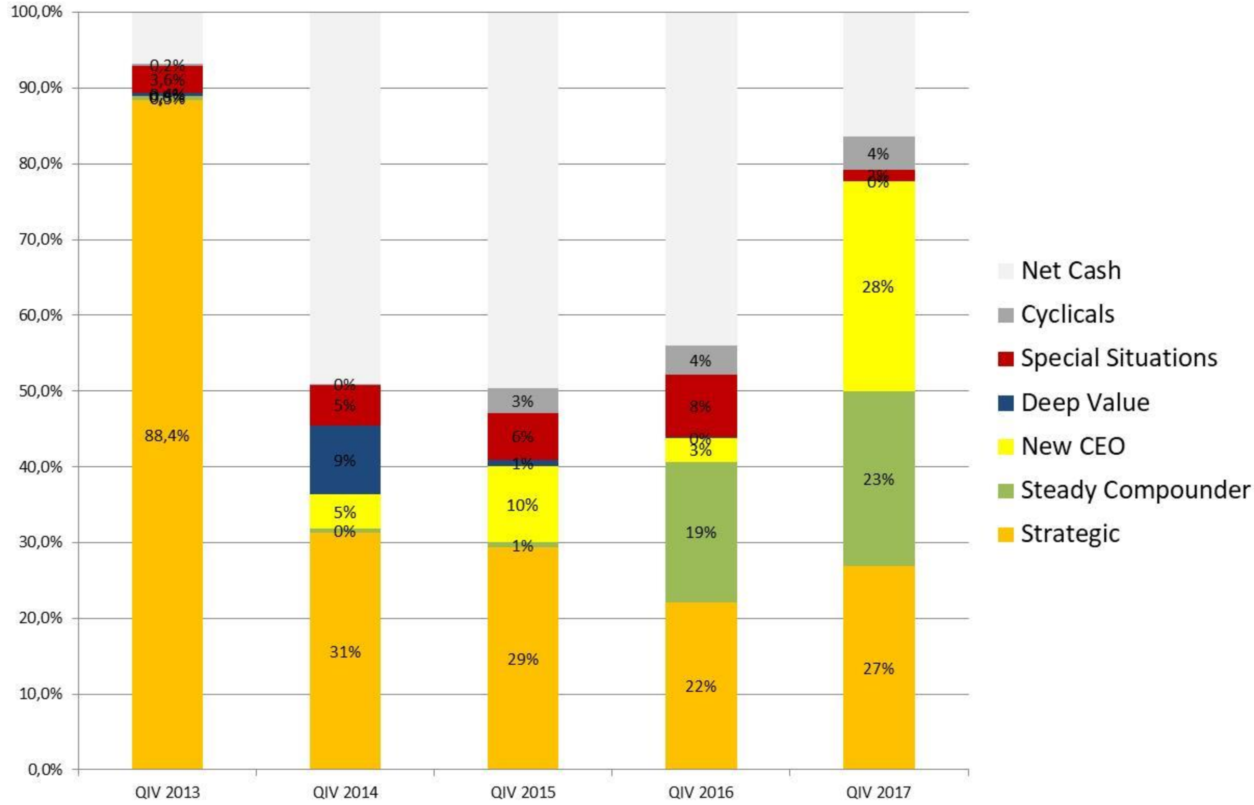
b) IV-T ca. 44% above NAV, signaling that the market prices have room to increase before they reflect the full value of what we own

our Margin of Safety is close to the historical average, making us confident for the future.

2. Asset Mix and Results by Investment Thesis

2.1 Evolution of Asset Mix

The chart below is a modification of the way we categorize our businesses: it focusses on the essence of the investment thesis, **i.e. the drivers for our expected return.** We will comment on them below.



Previously we would have shown a categorization of our businesses by their quality. But that does not capture so well what you should expect from these investments – it looked comforting to own a high share of Franchise Businesses – but as they are getting increasingly into overvaluation territory they may not be good investments.

In 2017 we significantly increased our allocation to companies where a new CEO recently joined. The rest is fairly unchanged.

At the end of the quarter, the portfolio mix is:

	% Portfolio
a) Strategic	27%
b) Tactical Portfolio	57%
c) Cash and Cash Equivalents	16%
d) **Total**	**100%**

Net long exposure is 16% (the short exposure currently is negligible at 0,2% of AUM).

3. Strategic Holdings (27% of NAV)

We have one position in our strategic holdings – IDS. The company is making progress in recovering to its old strength. For details we refer to the reporting of IDS itself.

In 2017 IDS share price was up ca. 28,6% and contributed to ca. 8,2% of FES performance.

4. Tactical Portfolio (57% of NAV)

4.1 Steady Compounders (27% of NAV)

These are **businesses with a very predictable profitable growth.** Nearly all of businesses in this category are **Franchise Businesses**, i.e. businesses of the highest quality - combining high customer stickiness with a strong competitive advantage.

At the end of the year this group accounted for **ca. 27% of AUM**. The biggest positions within this group are **Wessanen and Novo Nordisk. In 2017, the share price of these 2 companies increased by 29% and 38% respectively.** They will continue to create value from compounding at the rate of 10 – 15% p.a.

Share prices of this group went up by 29% in 2017, contributing 8,4% to FES performance.

4.2 New CEOs (28% of NAV)

These are **businesses with a new CEO** and we expect him/she to improve the business significantly in the first 2 – 3 years of his/her tenure. This can lead to improved fundamentals and often a multiple expansion as well.

The key edge we seek in this type of businesses are speed in getting to meet the new CEO and an elaborate process to assess him/her, mainly from an analysis of the track record and extensive reference checks.

At the end of 2017 this category accounted for 28% of our portfolio, comprised of 3 positions. This position has increased its weight. The underlying businesses can be of any quality.

The **largest position in this bucket is GenommaLab in Mexico** where Max Juda is the CEO. Personally I find this combination of an outstanding CEO and a Franchise Business my favorite investment case. It worked perfectly in the case of Wessanen, let´s see how this case is working out.

In 2017 the "New CEO" category **delivered a loss of ca. 7,9% (before currency impact), generating a -2,9% return for Forum**. We will keep you posted on the performance of this group of stocks.

4.3 Deep Value (0% of NAV)

In this bucket we aggregate all businesses where the investment thesis is based on **a very low valuation.** This bucket represents largely the Graham style of investing, thus the quality of the companies tends to be low – we make our money from a re-valuation of these companies. There is compelling evidence that this style of investing works. **The key is to invest when the businesses are "really cheap" resp. "dead-cheap" – not just cheap.**

At the end of 2017 this asset class accounted for **0% of AUM**.

4.4 Cyclicals (4% of NAV)

We add cyclicals to our portfolio as we believe they can add good returns when the market has written them off - e.g. a mining supplier when a significant part of the commodity supply is losing money on a cash basis.

At the end of 2017 this asset class accounted for 4% of AUM. It is comprised of one company.

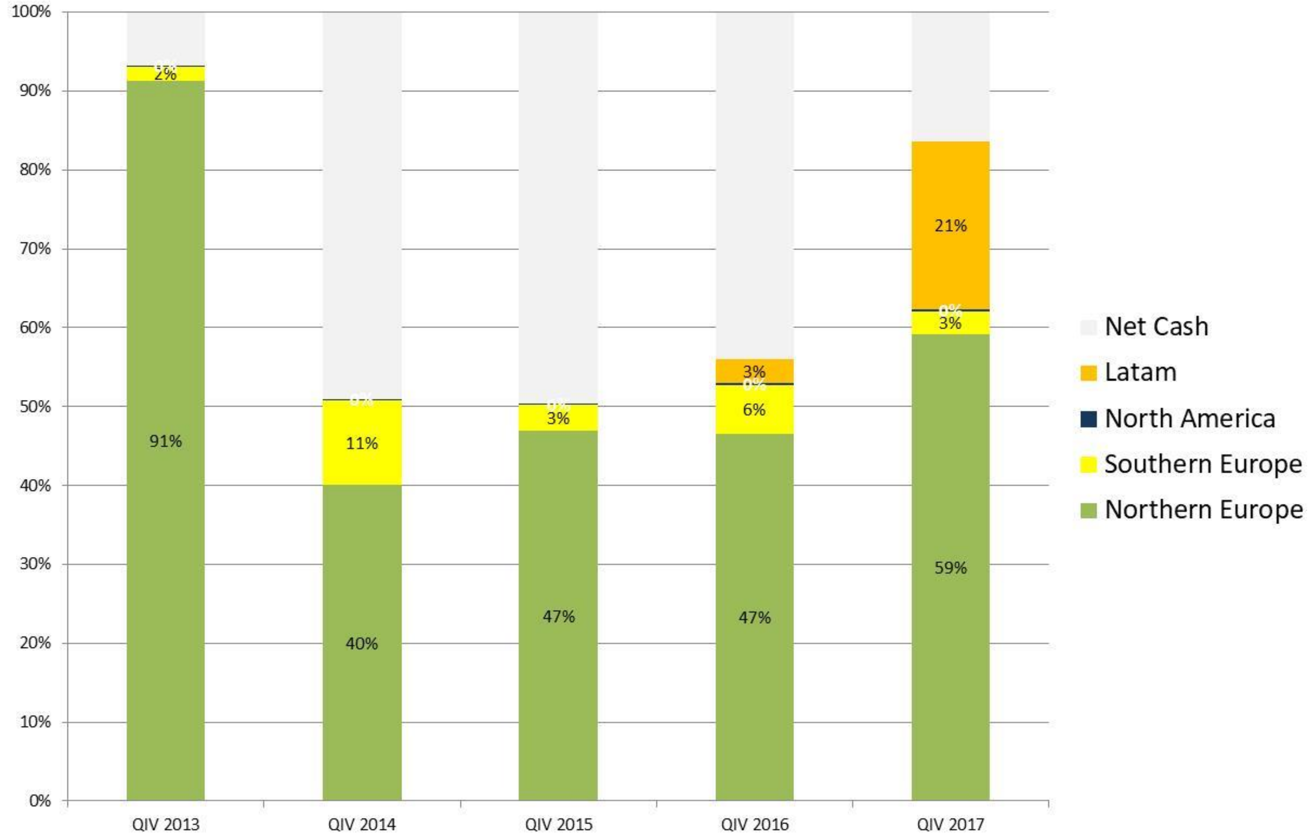
In 2017, the share price of this company increased by 34%, contributing 1,5% performance at Forum level.

4.5 Special Situation (1% of NAV)

In this category we have two companies with which we started building-up positions during the Due Diligence phase. But at the end we decided not to ramp them up – and will most likely exit soon.

5. Regional Portfolio Mix

Please find below an overview of FES allocation by regional area (depending on Headquarter location):

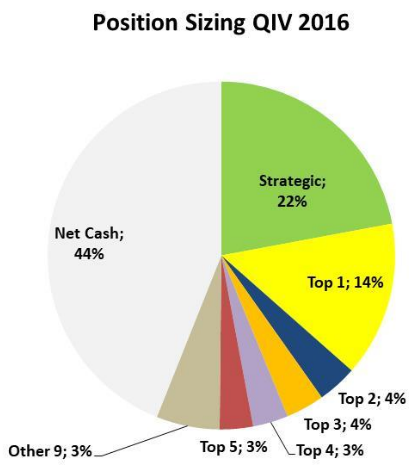


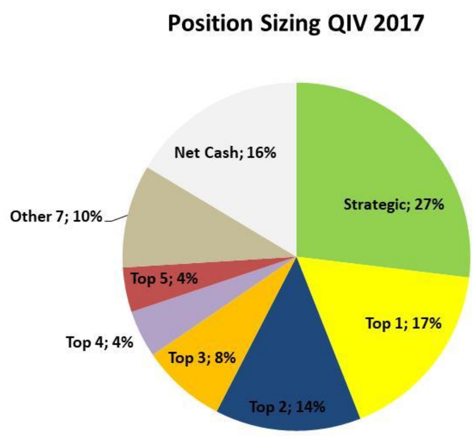
The major event in 2017 is the **build-up of an allocation of 21% of AUM to Mexico via two investments.**

Other than that we continue to be strongly **invested in Northern Europe.**

6. 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 2017 we have **increased the concentration of our portfolio**. Conversely we have a tail end which we will clean out.

7. Short Book

At the end of 2017 FES had 1 short position. The weight of the short position accounts for 0,2% of AUM, thus it is not significant. We intend to increase this weighting.

8. Risk Report

8.1 Company-specific Risks

8.1.1 Political and Currency Risk Mexico

With a Mexico exposure of ca. 21% based on headquarter location and ca. 13% based on revenue mix we are exposed to the general political/institutional risk in that country as well as currency risk. There will be elections in May 2018 and a candidate of the PRI is pinned against a leftist candidate whose agenda is unclear.

Following Greece for two decades by now has also taught us **that in the long-run good management is a very strong hedge against these risks.**

8.2 Macro and Political Risks

There are several macro risks in the world economy and we have discussed them in various Letters to Clients and Macro Dashboards. The main ones are

a) The unresolved € currency risk

b) The political risk stemming from Donald Trump

c) The risk of a massive market correction in the USA. Conceptually this would not lead to a permanent loss of capital, but to negative returns for many years.

d) China imbalance risk, e.g. from the financial system

e) Finally the risk from the ever-increasing level of debt in the world economy. This has to be viewed against the interest cycle turning, at least starting in the USA.

8.3 Risk of a Market "Crash"

As you are probably aware of there is a massive overvaluation in most markets. We like Shiller´s CAPE as an indicator for the fundamental valuation of markets, it is defined as the valuation of the stock market relative to the average earning per share of the last decade.

Below please find the data:

	Hist. Average	**Dec. 31st, 2015**	**Dec. 31st, 2016**	**Dec.31st, 2017**
Europe	17,7x	15,4x	16,0x	18,4x
USA	16,8x	24,2x	27,7x	32,4x

Thus **European valuations** are slightly above historical averages.

The "elephant in the room" is the **valuation of the US equity markets**: **US CAPE** is ca. 93% above its historical averages. It has only been as high twice before: 1929 and 2001 - both with strongly negative returns in the following 5 - 7 years.

We believe that **value investing offers a good protection** against a possible crash in the USA - looking at fundamental earnings and not overpaying for the future. Historically we have always outperformed our benchmarks in times of a downturn - we have cash, shorts and a portfolio with a strong Margin of Safety - which we increased in 2017.

And we will continue to look for businesses with a strong momentum in increasing their intrinsic earnings. This is where we expect good contributions from our bets on new CEOs.

9. Outlook

9.1 Macro Outlook

We refer to our **Macro Dashboard for Q IV 2017**. Since our last Macro Dashboard:

a) little has happened **in Europe**: corporate profitability has stayed around its historical averages, valuations have gone up slightly.

b) Both profit levels and valuations **in the USA** have expanded once more: profits are now 20 – 30% above their historical averages and both of the metrics we use for **-** Shiller´s CAPE and market capitalization as % of GDP – **are at ca. 180% of their historical averages, implying standard deviations of 2,1-2,2x**. **This is what we define as a bubble.**

Thus we feel **with our focus on Europe we sit in the right region in the world to deliver reasonable investment results**. But if the overvaluation in the USA starts to correct it will definitely also affect our European holdings - **in price, but not in Intrinsic Value – which is the ultimate indicator for the value of what we own.**

9.2 Portfolio Positioning

As a result of the balance between upside and risk 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 19% at the end of the last quarter).

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. This makes it difficult to reach this allocation.

Thus net long exposure should decrease to 65 - 70% - below the 84% we had at the end of 2017.

And as always we will be driven by opportunities - bottoms up - if an attractive investment opportunity emerges we will take it.

10.The Firm

FORUM is made up of the team it has. We have

a) five talented and motivated professionals doing the research and

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

In the course of 2017 none of our team members left us and one member joined. We also made an offer to a summer intern who will join us mid-2018. At that time we will have a full team again.

Feel free to visit us to get to know them – it should give you confidence in what we do (and thus take away pressure from us to reveal individual holdings)!

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 the fund.**

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Burkhard Wittek

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 Forum 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".**

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.