FORUM

European Smallcaps GmbH

Memorandum

To	: Forum Staff
From	: BW
Copy to	: July 8th, 2013
Date	: FORUM European Smallcaps Q II 2013 Results**_V_Homepage**

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1. Results in Q II 2013

As a starting point let me summarize our investment philosophy on performance:

a) We think **growth in Intrinsic Value** is the best metric for performance as it captures the value we own. What Mr. Market will pay in price for this value will fluctuate a lot – but in the long run it will oscillate around this fundamental value.

b) With respect to **performance at market prices** we believe that in public equity investing **any meaningful track record starts somewhere between 5 and 10 years**. Only after such a period an investment philosophy, an investment process and a team will have been tested against the vagaries of market cycles or luck from market timing or individual stock picks.

c) For performance at market prices **we target absolute returns over a cycle**: if a market is flat – e.g. many stock markets in the decade to the end of 2011 – having an outperformance of a few percentage points is not satisfactory. We ignore short-term returns at market prices.

1.1 Results of FORUM European Smallcaps

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.

In Q II 2013 **the value of our portfolio at market prices went up by 17,7%.**

In the same period the **Intrinsic Value of our portfolio** showed the following development:

a) **Net Earnings Power Value ("N-EPV") increased by 7,5% in the quarter.** N-EPV captures the earnings power value of the existing business in a steady-state situation, i.e. based on expected sustainable earnings over a cycle, without structural or management improvements and without growth. Thus it has a fairly high reliability, it measures "what is there".

b) Total Intrinsic Value ("IV-T) increased by 10,8%. IV-T captures the total value of the business which is the sum of its N-EPV, structural or management improvements of the business and the value of expected growth. As such it contains several critical assumptions on the future and is less reliable than N-EPV.

A key building block of value Investing is the **Margin of Safety**. We measure it by the ratio of the portfolio at market values to the value of the portfolio at N-EPV. In the quarter this **Margin of Safety turned negative to -9%** due to the strong increase in market values - i.e. the portfolio at market values stood at 109% (up from 101% at the end of Q I 2013) of N-EPV.

The ratio of the value of the portfolio at IV-T to the value of the portfolio at market prices is a measure for **the upside**. In the quarter it dropped to 113% from 120% at the end of the last quarter - implying an upside potential of 13%.

1.2 Benchmarking of Results

For an overview of **our results vs. our benchmarks** we would like to refer to **Appendix 2**.

1.2.1 Results in this Quarter

The key benchmark for our performance at market prices is the **HSBC Smaller European Total Return Index in €. In Q II 2013 this index was up by 1%. Thus our portfolio at market values outperformed this index at market values by ca. 16%.**

The second benchmark we use is the European Smallcap Fund of Ennismore Class A in € - the European smallcap value fund we deem best in class. In Q II 2013 it was down by 1%.

1.2.2 Results since Inception

At the end of Q II 2013 **our cumulated performance in the 11 1/2 years from January 1st, 2002 – the date of our inception** – to June 30th, 2013 **was 20,0% p.a. – a total increase to 813% of starting value**.

Thus in the 11 1/2 years as investors we have exceeded our target of a compounded return of 15% p.a. We believe these results should reflect investment performance independent of a certain market situation. We feel we have outgrown the saying "**markets make managers**".

Our IRR of 20,0% p.a. resp. to 813% of starting value since inception on Jan. 1st, 2002 compares with IRRs **for this period** of

a) **7,4%** p.a. for the **HSBC index in €** – a total increase to **227% of starting value**

b) **8,7%** p.a. **for the Ennismore fund in € –** a total increase to **262% of starting value.**

2. Development of Portfolio Mix

Please see **Appendix 3** for an overview over the evolution of our portfolio mix. In Q II 2013 the mix changed relative to the mix at the end of Q I 2013:

a) The % of assets allocated to our **strategic holdings** at 85% (March 31st: 90%) of AUM.

b) The **tactical portfolio** - excluding cash – at 5% (March 31st: 6%) of AUM.

c) **Cash and cash Equivalents** at 10% (March 31st: 4%) of AUM.

3. Development of Long Book

3.1 Strategic Holdings: Companies with a Significant Stake and Board Involvement

3.1.1 Immunodiagnostic Systems Holdings plc.

We have **a stake of 29%** in the company and BW is a **Non-Executive Board member** and member of the Remuneration, Nomination and Audit Committees.

The company offers diagnostic assays for labs, both manual and automated. The automated iSYS platform is targeted for low- to mid-volume applications and has a strong technical reliability in comparison with peer products. The lead product is vitamin D which accounts for ca. 60% of group revenues.

Our investment thesis is as follows:

- We own an emerging Franchise Business with an **increasing share of recurring revenues from automated systems**. In FY 2013 which ended on March 31st automated assays accounted for 37,1% of revenues, up from 27,8% in FY 2012. Peer and competitor Diasorin shows the path to get this to 80%.

- As an engaged long-term owner we can foster and support a process for **upgrading management and governance**. The key events in this respect are the joining of Patrik Dahlen as CEO and of Chris Yates as CFO as well as several additions below the Board level. Most recently the Board has been reduced in size to a 4 + 2 Board members, in line with standards of good Corporate Governance.

- Also, since 2010 the issuance of options – which amounted to 2 -3% of share capital p.a. before with very low hurdles attached to them – is moving towards the recommendation of the ABI of < 1% p.a.

The **two key drivers** for increasing the Intrinsic Value of IDS are:

a) **placing 80 - 100 new iSys analyzers p.a**. At average revenues per box of GBP 70.000,- this adds revenues of GBP 6 - 7m to the present revenue base of ca. GBP 50m. In this FY and to some extent in FY 2014 as well it will help to compensate the migration of manual assays to the "workhorses" as these assays - in particular vitamin D - become available.

b) **enlarging the menu of automated assays** from 11 in Europe/5 in the USA to a critical mass of 20 in a short time frame ("Project M20"). This number is required to convince potential customers to give us an additional piece of "lab real estate" which is increasingly hard to get.

On April 10th, 2013 the company gave a trading update on the last FY - which we have already commented in our last Letter to Clients.

In Q II 2013 the **share price of IDS increased by 58%** to GBP 4,50 from GBP 2,85 at the end of March 2013. YTD the share **price is up by 42%.**

3.1.2 Pulsion Medical Systems SE

We have a **54% stake** and **BW has been Chairman** of the company since 2009.

Pulsion is the No. 2 worldwide in hemodynamic monitoring and the No. 1 in the critical care segment of the market. It has just introduced its second major monitoring platform ("Pulsioflex/ProAQT") since inception and is in the process of rolling it out.

Our investment thesis is

- we own an emerging Franchise Business with a high and increasing share of recurring revenues from disposables linked to platforms

- **Patricio Lacalle is a CEO** with ambition plus a personality just suiting our philosophy of how to develop a business

- the company has the option to invest meaningfully into Corporate Development to set the company up for a new growth plan.

In Q II 2013 the company reported Results for Q I 2013, which were overall satisfactory: revenues up by 13%, EBIT margin at a new all-time high, eps in the quarter up by 20% YoY.

We had already adjusted our Intrinsic Value significantly upwards in the previous quarter and thus left it unchanged. It sits well above the current level giving us a Margin of Safety as well as a good upside.

In Q II the share price of Pulsion dropped by 11% to € 11,50 from €12,98. Part of this drop is due to the payment of a dividend amounting to € 1,65. YTD the share price is up by 15% from € 10,01 to €11,50.

3.1.2 Tactical Portfolio

This part of the portfolio is comprised of liquid, passive investments.

At the end of Q II 2013 it consisted of **6 positions** - up from 5 at the end of Q I 2013. They accounted for **ca. 5% of AUM -** down from 6% at the end of the previous quarter.

During the quarter we increased the N-EPV of two holdings.

As of June 30th, 2013 the Tactical Portfolio at market prices had a **Margin of Safety based on N-EPV of 26% - slightly down from 28% at the end of the previous quarter.**

3.1.3 Cash and Cash Equivalents

At the end of Q II 2013 **cash and cash equivalents accounted for ca. 10% of AUM –** up from 4% at March 31st, 2013.

As pointed out in the last Letter to Clients **we want to get back to a level of ca. 20% as**

- this is the **standard level of liquidity** we want to hold in order to be able to take up attractive opportunities which may arise any time.
- our Macro Dashboard suggests there are **above average risks to earnings and valuations.**

4. Development of the Short Book

As announced in the last Letter to Clients we continued to wind down our short book as we have no person in charge of this asset class. Thus at the end of Q II 2013 our short book consisted of **1 remaining position totaling 0,1% of AUM - unchanged from 0,4% on March 31st, 2013**.

In the quarter the short book contributed 0,0% to overall results.

5. Handicapping: Risk/Return Balance of the Portfolio

We would like you to refer to **Appendix 1** once more as for us it is the key tool to monitor the expected **risk/return balance** of the portfolio.

5.1 Risk Management

Our basic philosophy as value investors is **to look after the risk management of the portfolio first to avoid any permanent losses of capital – our definition of risk**. As you know by now we do not worry a lot about changes in market prices of our investments as long as we feel confident about the Intrinsic Value of what we own.

5.1.1 Margin of Safety

We believe the main protection against risks and uncertainties is the **Margin of Safety**. As mentioned above our **Margin of Safety - based on N-EPV - decreased to negative 9% at the end of Q II 2013.** This says that Mr. Market

a) prices the businesses we own **slightly above the steady-state Net Earnings Power Value** - i.e. just valuing today´s cash flows

b) puts **little value to growth in the future.**

As shown in our numbers we happen to have a strong believe that Mr. Market is pricing our holdings reasonably rationally, a bit on the low side.

Of the two strategic holdings plus five companies in the tactical portfolio we own **only one is trading slightly above N-EPV** – thus we feel well-protected.

5.1.2 Impairment of Intrinsic Values

There were no impairments to our Intrinsic Values in Q II 2013.

5.1.3 Company-Specific Risks

Our **exposure to Greece** at the end of Q II 2013 stayed largely unchanged at ca. 0,7% (March 31st: 0,8%) of AUM.

5.1.4 Risks from Portfolio Concentration

This risk is part of our Investment Policy.

5.2 Upside Potential

As you can see from the relation between the portfolio at market prices and IV-T the upside potential of the portfolio continues to be attractive - but has come down: **IV-T stands at ca. 113% of the portfolio at market prices - implying an upside potential of 13%. If it materializes within two years it would yield an annual return of ca. 6% p.a. – significantly below our target of a 15% p.a. return.**

6. Outlook

6.1 Macro Outlook

We refer to our Macro Dashboard for Q II 2013. The highlights from the US-perspective are:

a) The level of US **Corporate profitability continues to be at a historically high level.**

b) **At the same time valuations** stand at ca. 40% above historical levels.

c) This implies **expected 5 - 10-year returns on equities below average, ca. 0 – 2% p.a. in real terms**.

d) We continue to see **major risks to the global economy**.

As a **conclusion of this Macro Outlook on our asset allocation** we have changed the goals set in the last Macro Outlook as follows:

a) cash quota of 20%

b) net short position of 0 – 5%.

As always we will mostly be driven by such opportunities – and not by the tops-down allocation model.

6.2 Status of Watchlist

Our watchlist equities long prio 1 - which contains investment candidates trading below Net Earnings Power Value - has evolved as shown in **Appendix 4**. In total the number decreased slightly to 21 from 23. The key points are:

a) **5 (March 31st, 2013: 5) positions are in Greece**. We continue to be sceptical about Greek equities in general due to the macroeconomic risk.

b) **16 (March 31st, 2013: 18) positions are outside of Greece**. This increase is largely the result of our increased research capacity. Of the 16, only 5 are in Italy and France.

6.3 Target Structure of the Portfolio in one Year

At this point in time our goal in portfolio development is a **diversification of holdings.**

This involves the following actions – sorted by priority:

a) As a matter of policy we do not comment on our **Strategic Holdings.**

b) As our second priority - up from third - we plan to **re-build the Tactical Portfolio.** We are a full team now and have come up with promising candidates. We now need some market weakness to convert these ideas into investments.

c) Our third priority is the **build-up of our exposure to special situations**. As mentioned in the chapter on HR we are searching a professional to specialize on this space.

d) We continue to try to clean out some "**deadwood**" in the Tactical Portfolio which fits the saying "A long-term investment is failed short-term investment". We have two illiquid positions which fall into this category.

e) We would like to get **cash and cash equivalents up to our standard level of ca. 20% of AUM**.

7. The Firm

7.1 Professional Staff

At the end of Q II 2013 the investment team consists of **the following professionals:**

a) **Four analysts** covering Western Europe for equity long positions. They work on a T-model - combining full responsibility for several countries with in-depth knowledge and experience in sectors along regions.

   This number is unchanged from the end of March 31st, 2013. We have signed on two additional professionals who will join us in September to strengthen our team.

b) We are looking for an analyst covering **special situations.**

c) BW as **portfolio manager.**

There was no staff churn in the quarter and no churn YTD.

7.2 HR Development

In the quarter we continued to **build on our sector expertise** by developing training plans for all professionals. This process has not yet come to completion yet as the professionals have to get used to proactively think along these key issues and the best mix of training between various types of conferences.

The **quarterly feedback to all professionals** has been firmly implemented and well-received. It fosters learning and we identify specific training requirements.

Finally, we continue to expand our "**social events calendar**". After a great skiing outing in Q I we have continued with a bike tour in Q II. This weekend we will go on with a barbecue.

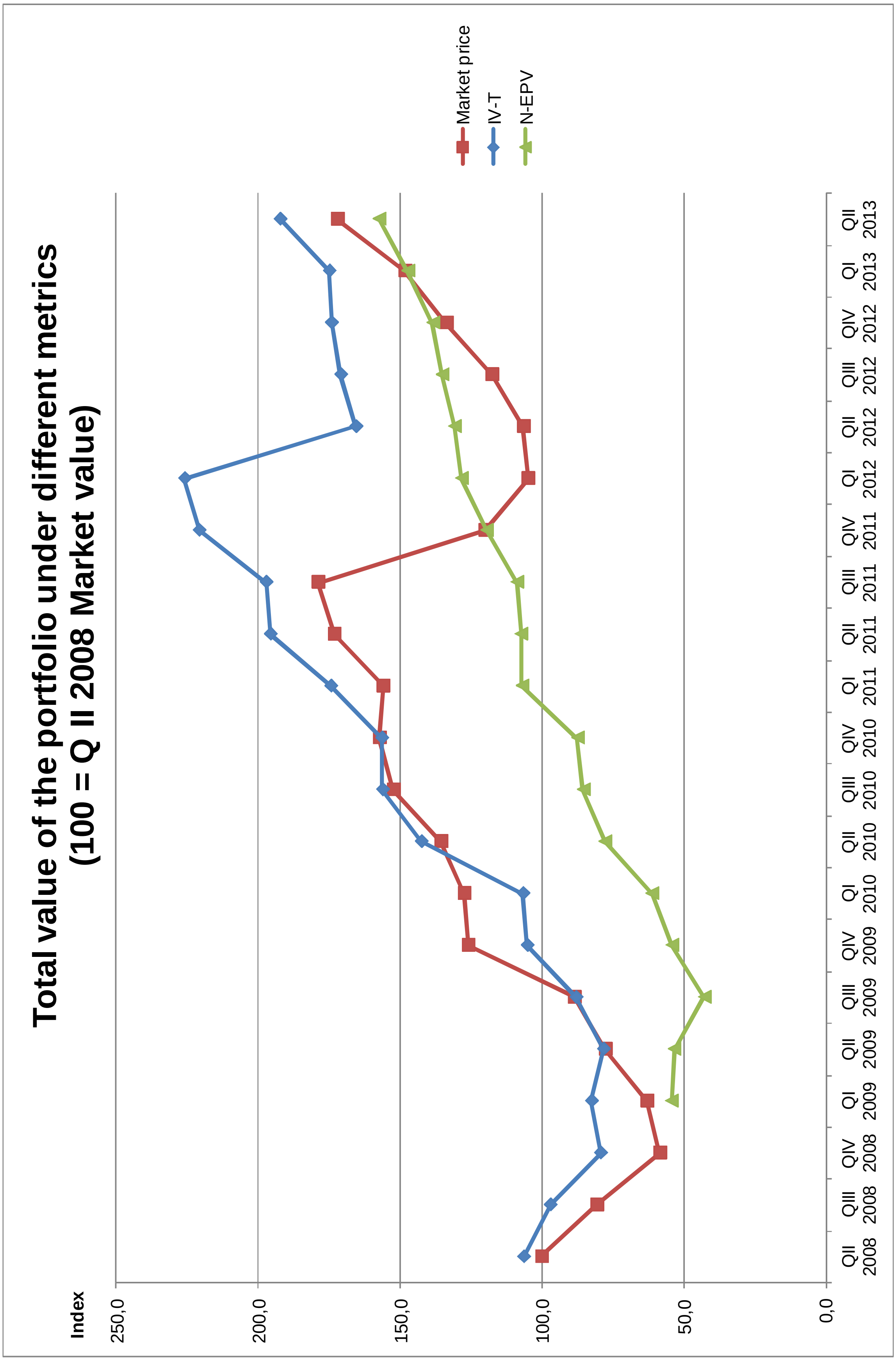
7.3 Fund for External Investors

Please hold your breath as I have sensational news on this front: **Our Luxembourg-based fund has started to trade!** After just 18 months we are rolling along and enjoying the chance to put some new money to work. We believe this will sharpen our focus on investment opportunities - as opposed to merely understanding companies.

As the first size level we continue to **target € 40m before June 30th, 2014.**

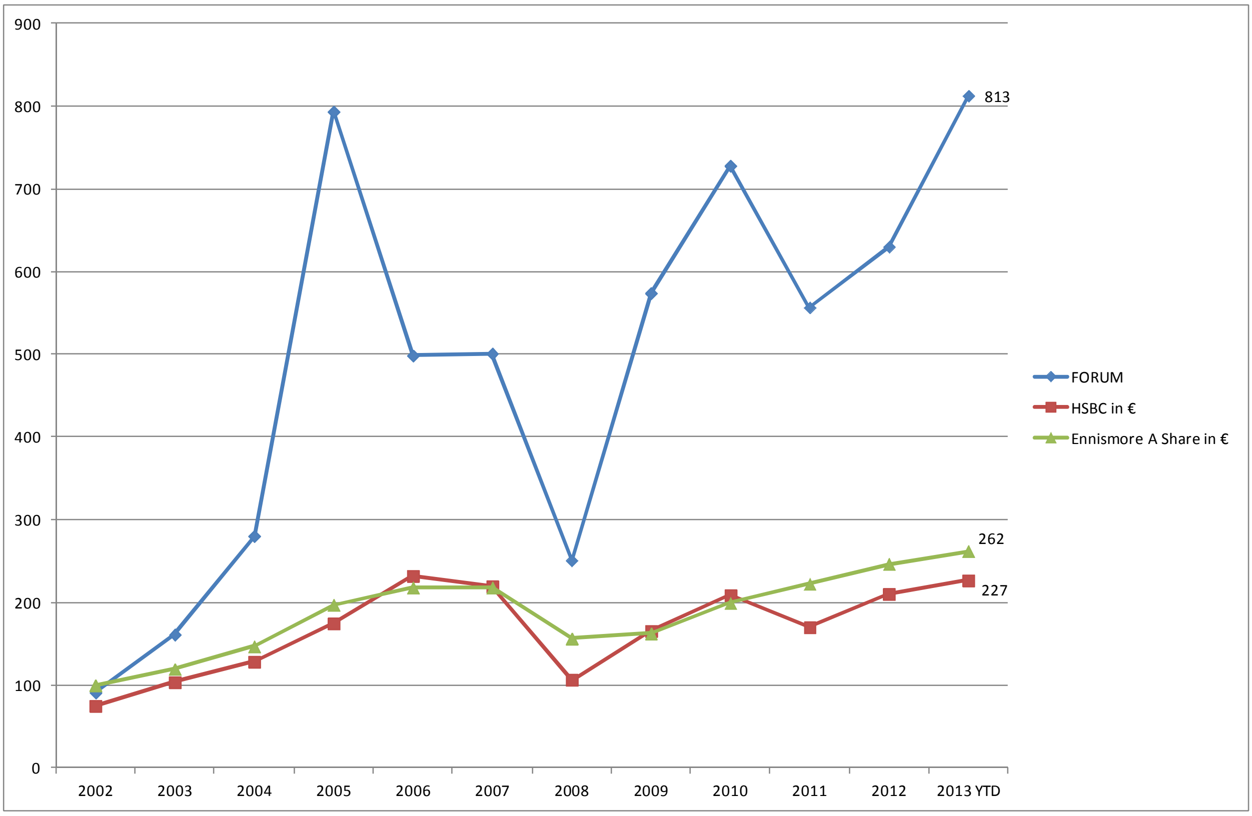
Appendices

Appendix 1: Portfolio's Development

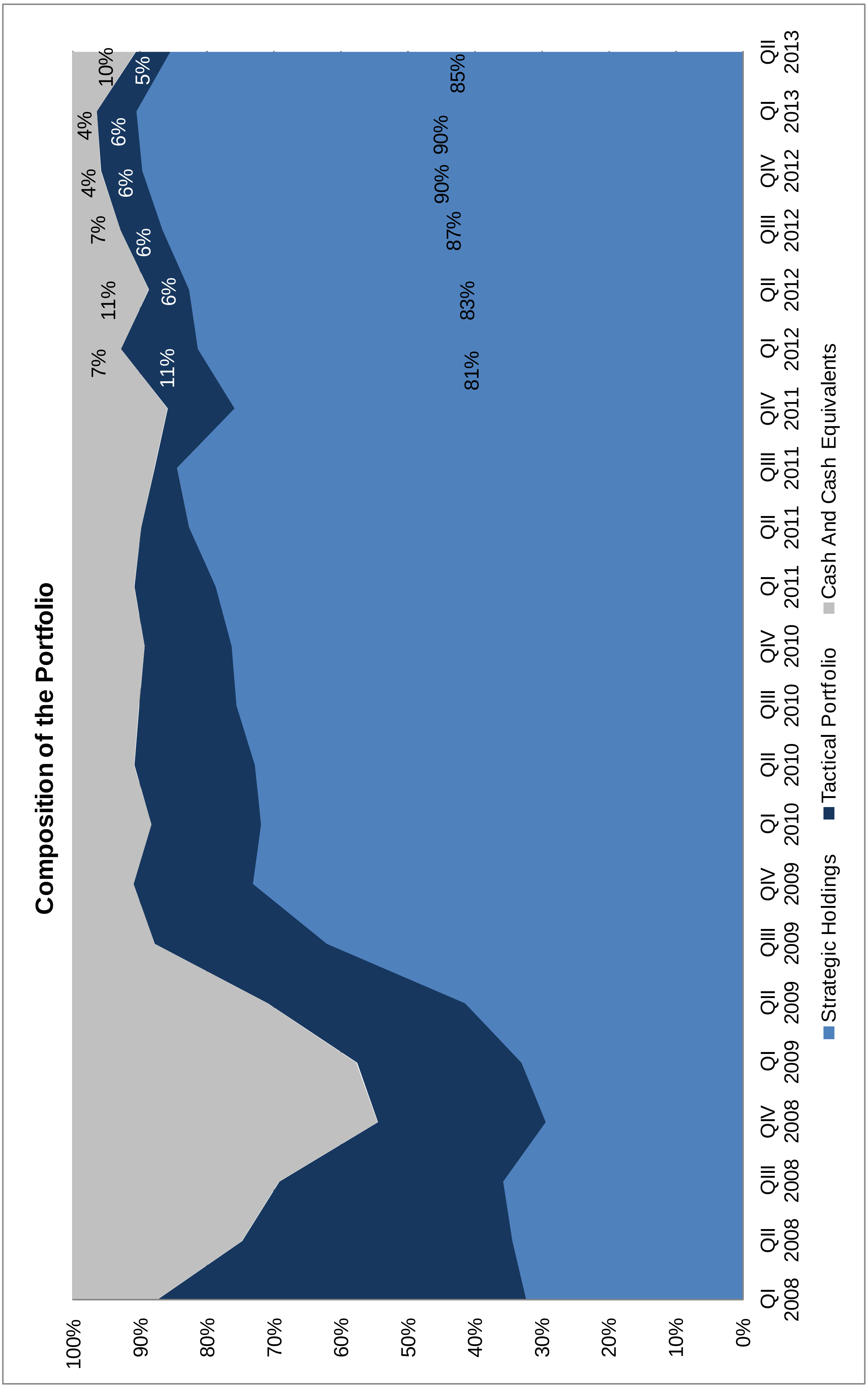


Appendix 2: Benchmarking of Results

Since Inception (2002), p.a.	FORUM		HSBC European Smallcap Index in €		Ennismore A Share in €	
	Percent	Index	Percent	Index	Percent	Index
2002	-9%	91	-25%	75	0%	100
2003	77%	161	38%	104	20%	119
2004	74%	280	24%	128	23%	147
2005	183%	794	36%	175	34%	197
2006	-37%	498	33%	232	11%	218
2007	1%	501	-6%	219	0%	218
2008	-50%	251	-52%	106	-28%	156
2009	129%	574	56%	166	4%	162
2010	27%	728	26%	208	23%	199
2011	-24%	557	-19%	170	12%	222
2012	13%	630	24%	210	11%	246
2013 QI	10%	692	7%	225	7%	265
2013 QII	17%	813	1%	227	-1%	262
2013 QIII						
2013 QIV						
IRR 2002 - YTD	**20,0%**		**7,4%**		**8,7%**	



Appendix 3: Development of Portfolio Mix



Appendix 4: Development of Watchlist Prio 1 End of Quarter

	Q II 2012	Q III 2012	Q IV 2012	Q I 2013
Greek	5	5	6	5
Non-Greek	6	6	13	18
Total	**11**	**11**	**19**	**23**