FORUM

European Smallcaps GmbH

Memorandum

To : Forum Staff

From : BW

Date : October 16th, 2013

Subject : FORUM European Smallcaps Q III 2013 Results

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1. Results in Q III 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 III 2013 **the value of our portfolio at market prices went up by 5,4%.**

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

a) **Net Earnings Power Value ("N-EPV") increased by 8,7% 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 23,2%.** 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 the **Margin of Safety stood at a negative 7%** due to the high level of market valuation - i.e. the portfolio at market values stood at 107% (down from 109% at the end of Q II 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 increased to 132% from 113% at the end of the last quarter - implying an upside potential of 32%.

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 III 2013 this index was up by 13%. Thus our portfolio at market values underperformed this index at market values by ca. 8%.**

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 III 2013 it was up by 8%.

1.2.2 Results since Inception

At the end of Q III 2013 **our cumulated performance in the 11 3/4 years from January 1st, 2002 – the date of our inception** – to September 30th, 2013 **was 20,0% p.a. – a total increase to 850% 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 850% of starting value since inception on Jan. 1st, 2002 compares with IRRs **for this period** of

a) **8,4%** p.a. for the **HSBC index in €** – a total increase to **282% of starting value**

b) **9,2%** p.a. **for the Ennismore fund in € –** a total increase to **257% of starting value.**

2. Development of Portfolio Mix

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

a) The % of assets allocated to our **strategic holdings** at 86% (June 30th: 85%) of AUM.

b) The **tactical portfolio** - excluding cash – at 5% (June 30th: 5%) of AUM.

c) **Cash and cash Equivalents** at 9% (June 30th: 9%) of AUM.

Thus except rounding differences the portfolio mix stayed unchanged.

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. 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. On October 10th, 2013 the company published an Interim Trading statement. Unfortunately our primary KPI - number of net placements of analyzers - dropped significantly to 16 in H1 of the current FY, down from 46 YoY. There was no news on actual or planned releases of assays. Thus we are "not amused". In Q III we updated the valuation of IDS, increasing both N-EPV and IV-T, largely due to higher cash levels at the end of March 31st, 2013

In Q III 2013 the **share price of IDS increased by 3%** to GBP 4,65 from GBP 4,50 at the end of June 2013. YTD the share **price is up by 46%.**

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 in a close dialogue with a long-term owner.

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

In Q III 2013 the company reported Results for Q II 2013, which were overall satisfactory: revenues are up by 6,5 and - more importantly - the company has invested into future growth. Thus we are looking forward to 2014 and beyond with increased confidence.

We had already adjusted our Intrinsic Value significantly upwards in QI 2013 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 III the share price of Pulsion dropped by 6% to € 12,15 from €11,50. Part of this drop is due to the payment of a dividend amounting to € 1,65. YTD the share price is up by 21% from € 10,01 to €12,15.

3.1.2 Tactical Portfolio

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

At the end of Q III 2013 it consisted of **7 positions** - up from 6 at the end of Q II 2013. They accounted for **ca. 5% of AUM –** unchanged from the previous quarter.

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

As of September 30th, 2013 the Tactical Portfolio at market prices had a **Margin of Safety based on N-EPV of 23% - slightly down from 25% at the end of the previous quarter.**

3.1.3 Cash and Cash Equivalents

At the end of Q III 2013 **cash and cash equivalents accounted for ca. 9% of AUM** – unchanged from 9% on June 30th, 2013.

As pointed out in the last Letters 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

In Q3 2013 we completely closed our short book as we have no person in charge of this asset class. Thus at the end of Q III 2013 our short book consisted of **0 remaining position totaling 0,0% of AUM - unchanged from 0,1% on June 30th, 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 – stood at a negative 7% at the end of Q III 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 seven companies in the tactical portfolio **only four are 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 III 2013.

5.1.3 Southern Europe Exposure Risk

Our **exposure to Greece** at the end of Q III 2013 stayed largely unchanged at ca. 0,8% (June 30th: 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 – it has increased in the last quarter: **IV-T stands at ca. 132% of the portfolio at market prices - implying an upside potential of 32%. If it materializes within two years it would yield an annual return of ca. 14% p.a. – which is our targeted return.**

6. Outlook

6.1 Macro Outlook

We refer to our Macro Dashboard for Q III 2013.Since our last Macro Dashboard both the level of profitability and valuations in the USA have edged up a bit. both are now at historically high levels - but not yet two standard deviations above historical ranges which is how we would define a bubble.

As a **conclusion of this Macro Outlook on our asset allocation** we have sticked to our previous conclusions:

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 (June 30th, 2013: 5) positions are in Greece.

b) 19 (June 30th, 2013: 16) positions are outside of Greece. This increase is largely the result of our increased research capacity. Of the 19, only 6 are in Italy, Spain 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 III 2013 the investment team consists of **the following professionals:**

a) **Five 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 up by one from the end of June 2013. We have signed on two additional professionals who joined us in September to strengthen our team.

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

c) BW as **portfolio manager.**

We lost one employee in QIII 2013. Thus churn YTD is 20%, slightly below the level of previous years.

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 and a bike tour in Q II, we had a barbecue and an Oktoberfest day in Q III.

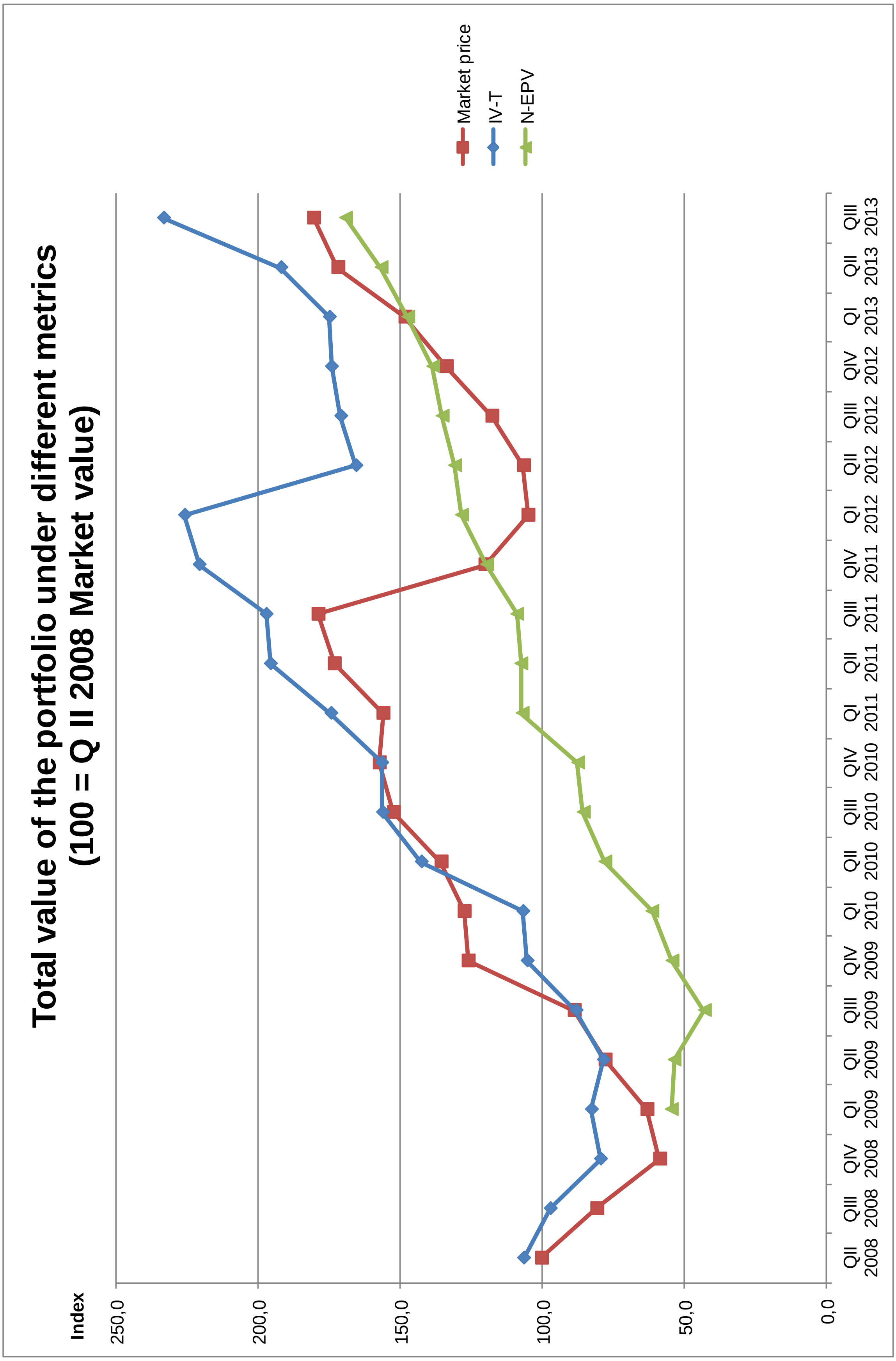
A new addition has been a **systematic introductory program** for new staff. We think such a defined process fosters a faster and more satisfactory ramp-up phase for them - rather than leaving it to coincidence or a philosophy of "throw them in the water and see who can swim."

7.3 Fund for External Investors

A fund for external investors has been set up by another FORUM company. Regulatory requirements do not allow us to comment any further on it as it is restricted to qualified investors.

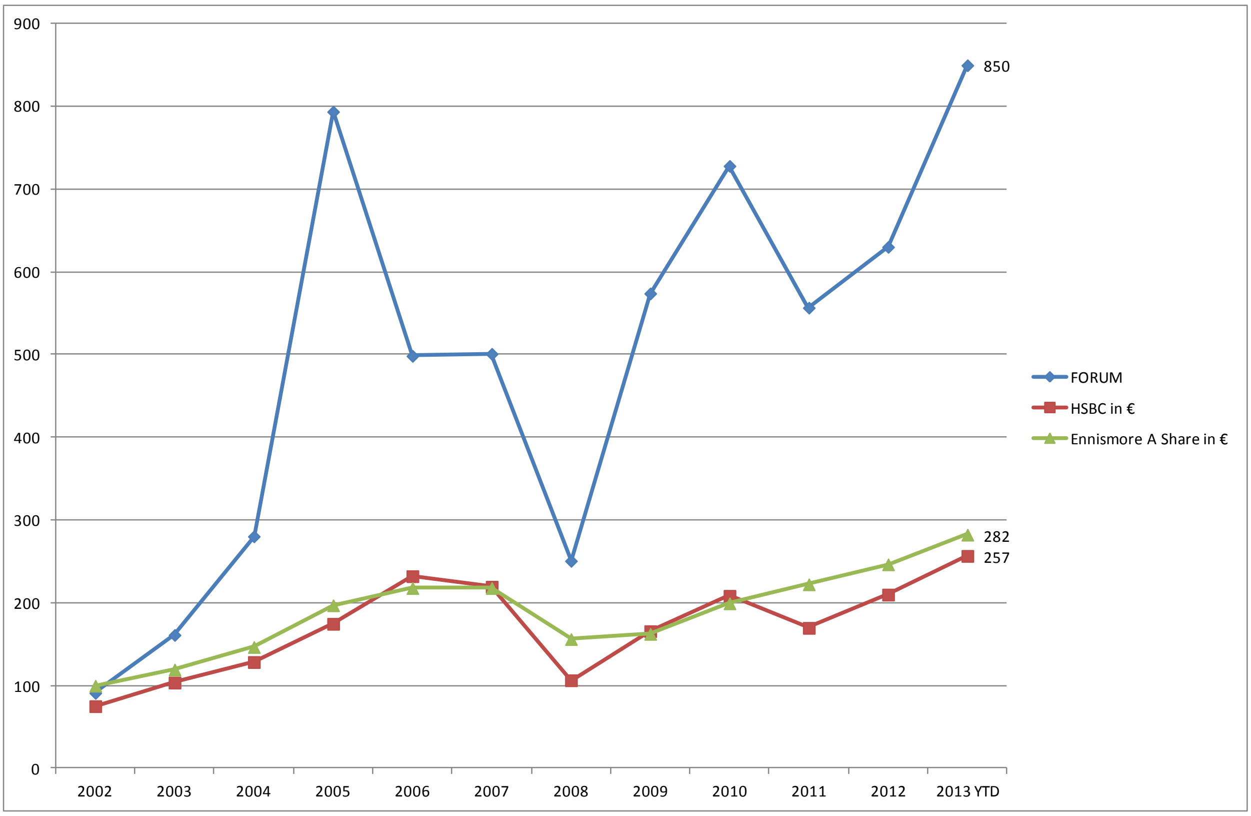
Appendices

Appendix 1: Portfolio's Development

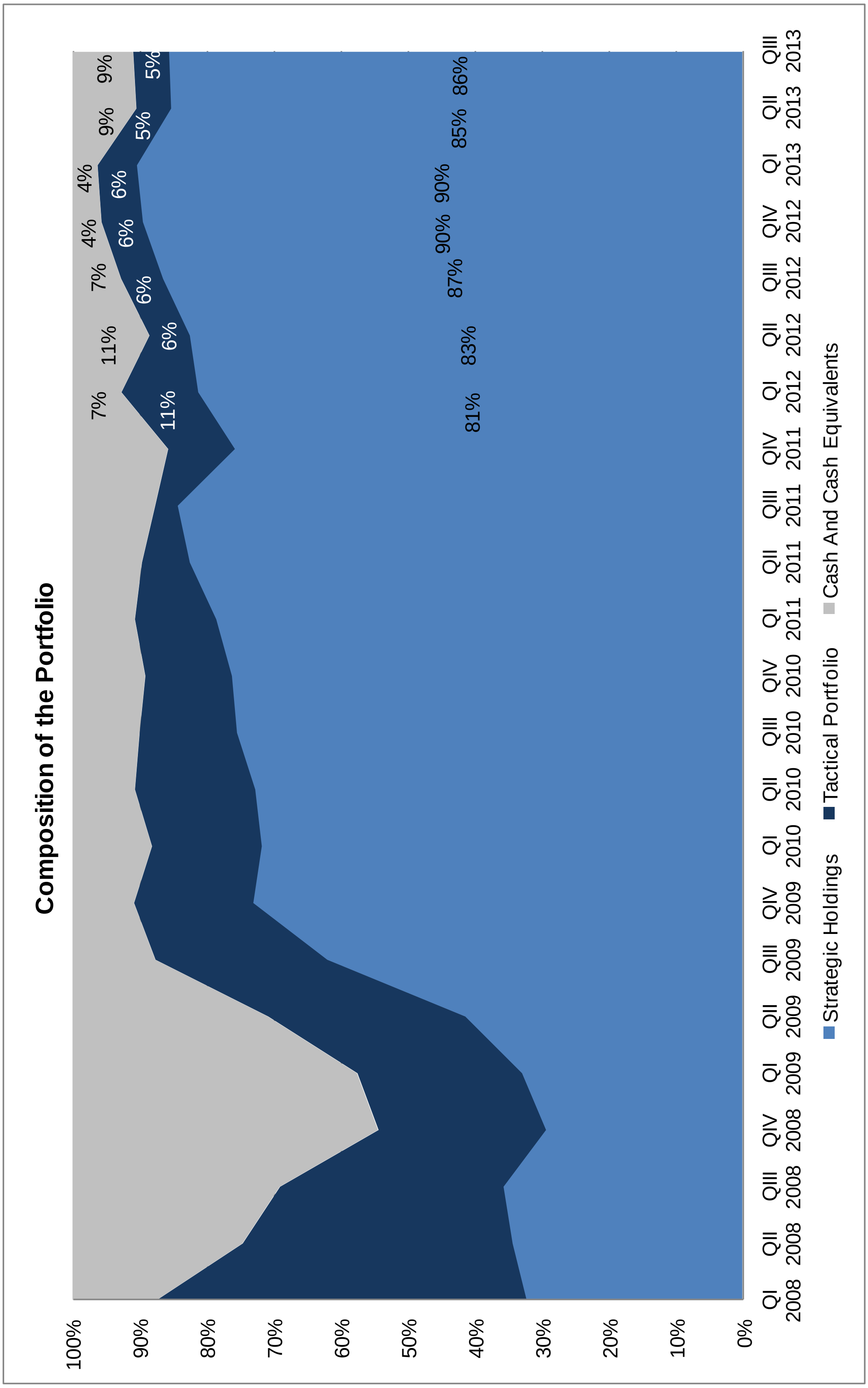


Appendix 2: Benchmarking of Results

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	5%	850	13%	257	8%	282
2013 QIV						
IRR 2002 - YTD	**20,0%**		**8,4%**		**9,2%**	



Appendix 3: Development of Portfolio Mix



Appendix 4: Development of Watchlist Prio 1 End of Quarter

	Q III 2012	Q IV 2012	Q I 2013	QII 2013	QIII 2013
Greek	5	6	5	5	5
Non-Greek	6	13	18	16	19
Total	**11**	**19**	**23**	**21**	**24**