

Letter to the Shareholders

Dear shareholders and business associates,

We did not make any new investments in 2015 and were able to sell one company only with some effort. We have learned to accept this with equanimity. Failures offer the advantage of learning something from them. You can only achieve long-term investment success by taking an honest look at your mistakes. Because they are living entities, businesses cannot really be valued. As so often in life, an uncertainty principle is at work here: the moment you try to measure something, it changes. As hard as we try, we simply cannot reach more than a 60% probability of success when we make our decisions. And we can be even more wrong when it comes to estimating future profits. Ultimately, we only want to take opportunities that offer an asymmetrical risk/reward profile. These included in particular the acquisitions for very low purchase prices. The trick is to make your own wager dependent on the chances of a win and how confident you are in our own estimate. In contrast to our beginnings, however, we now have increasing liquidity that, in light of current negative interest rates, is actually costing us money!

What did we do with it last year?

At the end of 2015, we had invested EUR 55.2 million in shares. Profits on financial assets amounted to EUR 7.5 million, of which EUR 5.9 million were not realised. Profits on active currency transactions amounted to EUR 4 million. We repurchased our own shares for EUR 7.3 million. The returns to our shareholders including dividends have therefore totalled EUR 83 million since the IPO in January 2006. We received a net amount of EUR 10 million back then; there have been no subsequent capital increases.

How successful were we really?

If we had invested all our free liquidity in the DAX index ETF, the profit would have been around EUR 10 million, and therefore, exceptionally, less than the profit of EUR 11.5 million from our investment decisions, but we only invested around half of our liquidity in shares.

What were our biggest mistakes?

Our purchase of Manito Energy made us our biggest loss of EUR -0.9 million. At the time of the purchase, the Brent oil price was around 70 dollars; it was already 30% lower than the previous highs. The valuations reflected twice the cash flow before investments, so a gross yield of 50%. What did we do wrong? We did not consider the prospect of a lower oil price. The argument was: "It has already fallen so far and cannot fall any further" and we ignored the obligations of a fracking company to continue drilling, coupled with the existing debt. Finally, the valuation depended solely on a single external factor, the oil price, which cannot be reliably predicted and thus precludes a real value investment. Overall, we lost a total of EUR 2.6 million on our investments in various commodity stocks in 2015.

Were there any fluke successes?

One example of an unexpected financial success was our hedging of the dollar. The original idea was to maintain our international purchasing power, because our income in the Group is primarily denominated in euro. The sharp rise in the dollar earned us around EUR 4 million. We have now dissolved the hedge, as we now have more dollar risks in the Group (e.g. from our investment in BB Government Services).

What shares did we invest in?

As at 31 December, our biggest positions and their performance in 2015 were as follows:

(EUR million)	Value	Performance
Berkshire Hathaway	12,3	-0,2
Inv. AG TGV	6,2	1,4
Brederode	6,5	1,7
Euler Hermes Group	5,9	0,3
EL.EN	2,3	0,3
Sum	33,2	3,5

We explained in more detail how we value a company in our last letter to shareholders. The assessment hinges upon whether their figures can really be trusted. In particular, the following questions are raised:

Does the management admit mistakes or simply highlight successes and blame all deviations from planning on external factors (“the weather, the appreciation of the dollar, the decline in the oil price”)?

Does the management believe in its own company and buy shares, for example, or does it regularly advertise the company and use every opportunity to sell its own shares or dilute the value of the shares through capital increases or, problematically, convertible bonds, which hang over the future development of the company like a sword of Damocles?

What kind of language is used in the annual report? Does it talk, for example, of EBITDA, which is very popular because the earnings are so much higher than when talking about EBIT (which includes depreciation and amortisation) or even net earnings (after taxes)? Does it discuss, for example, a “conservative” measurement of its own investments? A glaring example is when loss-making companies acquired for nothing are included in the calculation of net asset value with many millions via the discounting of expected future profits.

How profitable are the investments really? Are the profits fictitious, because they are based on write-ups or reversals of restructuring provisions recognised on purchase? By the way, a sure indication of profitability is whether the companies actually paid tax (which nobody likes to do) and how much, which can be seen in the cash flow statement.

Is there hidden debt? For example, are sold receivables frequently not recognised as financial liabilities, even though they are financial liabilities? A comparison of trade receivables and payables allows a quick check of whether receivables have been sold: if the cost of materials is around 50% and similar payment terms have been agreed (both the case at many manufacturing companies), the ratio should be 2:1. If the receivables ratio is lower, receivables have been sold, which reduces the enterprise value.

How have our investments actually performed operationally?

Overview of the development of net earnings:

(EUR million)	2014	2015
Serial Production / Automotive	9,5	14,2
Plant Engineering & Construction	0,6	3,0
Business Services	-6,3	-8,4
Investee Companies	3,8	8,8
Others	-1,8	16,6
Consolidation	4,5	4,3
Consolidated Group	6,4	29,7

Our investments earned a total of EUR 8.8 million and therefore EUR 5.1 million more than in the prior year (EUR 3.8 million). As in previous years, the Series Production business had the biggest share at EUR 14.2 million and Plant Engineering and Construction contributed EUR 3 million to earnings, while Business Services negatively affected earnings with minus EUR 8.4 million.

How has the value of BAVARIA performed?

The book value per share (which corresponds to Group equity) has increased by 17.8% p.a. in the 10 years since the IPO in early 2006, but decreased by 2.7% last year. Financial assets are reported at cost and investments at equity; hidden reserves are not included.

There is no “true” value of our investments: only the sale allows a snapshot. We have chosen the following option for calculating directors’ bonuses: We multiply the EBIT generated by the profitable firms by seven and deduct financial liabilities or add free funds. Loss-makers are recognised at zero¹ – regardless of how rosy the future prospects appear or how much cash is in hand.

The following table summarises the development of investments and financial assets:

(EUR million)	2014	2015	%
Portfolio Companies ¹	153,9	216,3	41%
Financial Assets	111,4	126,0	13%
Sum	265,3	342,3	29%

The value of the investments climbed by 41%, the market value of financial assets by 13%. In addition to the growth in share value (EUR 7.5 million), we had currency gains of EUR 4 million and other inflows of EUR 3.1 million.

In conclusion, it should be pointed out that in the 2015 financial year, we again made donations for social causes. Of a total of EUR 140,000, EUR 20,000 was donated to the Boxgirls International foundation and EUR 120,000 to three other foundations (Against Malaria Foundation, Deworm the World Initiative and GiveDirectly). As in the previous year, we thus followed the suggestion of givewell.org.

BAVARIA Industries Group AG is in a good position. We are therefore looking ahead at further development this year with confidence. We depend on trust and positive cooperation. We remain open to suggestions and proposals for improvement. We are grateful for pointers towards new transactions.

Yours sincerely



Reimar Scholz
Chief Executive Officer



Harald Ender
Chief Operating Officer

¹ We do not recognise a negative figure because, unlike many corporations, we do not conclude profit-transfer agreements and are therefore not committed to automatic loss compensation.