Letter to the Shareholders

Dear shareholders and business associates,

On average the incomes of wage-earners have stagnated for many years or even declined in some developed industrialized countries. Many are afraid of the future and are turning to demagogues who offer simple solutions. You know something is wrong, just what?

The bursting of the credit bubble 10 years ago has left violent traces in the private households. As a result of the fall in real estate prices, many households in the USA, England and the Mediterranean countries are submerged: the debt taken out for the purchase of real estate significantly exceeds private assets, which means that these households are avoiding consumption and saving more. Fear of the inadequate pension is still an important factor for many: many pension insurance schemes are covered by the lower interest rates: commitments are no longer covered by interest payments. The economy lacks demand.

The policy of lowering interest rates to zero by the major central banks led to the fact that falling interest rates (most savers only invest in fixed-income securities and not in equities) even increase the savings rate. The demand for loans is boosted by low interest rates, but in the wrong sector: 80% of all new loans – even encouraged through tax breaks - are being used for real estate loans, leading to a rise in real estate prices worldwide and the emergence of a new credit bubble. Added to this is the increasing concentration of wealth: only those who can afford to speculate become richer. The real goal of low interest rates to promote investment in productive assets is not taking place since demand is simply lacking. Credit volume increases by around 10% per year, but only 2% of this is generated by real growth. More and more loans are buying less and less real growth. Companies use low interest rates to repurchase their own shares instead of investing with new borrowings. It is no wonder that the most important stock exchanges rise almost daily to new highs.

Already in the last 10 years before the bursting of the real estate bubble in 2009 the real income in the USA stagnated. More loans to private households covered the lack of purchasing power. Economic growth was bought with increasing indebtedness of private households. Since the beginning of the crisis in 2009, the state has compensated for a portion of the lack of private demand through higher expenditures, thus enabling a small reduction in private debt. On balance, however, total debt has risen in all major industrialized countries. An important exception is Germany, which steals foreign demand with an export rate of 7% of the total output and thus increases the indebtedness of the recipients of the

exports (formerly the countries of the European Union now primarily USA). The Germans are forgiving consumption and exporting their savings. In this way, they acquire sometimes or mostly valueless foreign debt securities. The Germans feel morally as the victors: but without the willing creditor, there is no debtor.

Our budgetary support is currently EUR 21 per hour, including the employer's share. Of this amount, after all deductions from the state and the social insurance funds, it remains only EUR 11 per hour - a shrinkage of almost 50%. We, on the other hand, pay only 1.5% tax on the millions of proceeds from our company sales. Since we can only invest a small fraction of this in productive investments, our savings rate is almost 100%. No wonder, that there is not enough private demand! Debt interest - whether for company purchases or real estate purchases - can also be deducted completely from the tax and real estate income can be tax-free if the retention period is at least 10 years. Banks like to lend money, and the rising real estate prices promise a good security. Investors are getting richer, while the majority of people have no gain in purchasing power! In addition, the global wage competition and the increasing efficiency gains through the use of more artificial intelligence will probably exclude wage growth in the next few years.

How could a way out of the mess look like?

In order to increase purchasing power and make work more rewarding, negative taxes are needed for low-wage earners; They should get money from the state instead of being punished for work. Tax on any kind of speculative gains, higher transaction taxes on real estate purchases, and the elimination of debt relief could finance this. Instead of saving money in Germany (to give an example to countries like Greece), Germany should use the surpluses in the public funds for infrastructure investments. Germany has been living on the substance for many years, while new investments are below depreciation. Eurozone membership must either be developed into a solidarity community (at least partly e.g. through jointly guaranteed Eurobonds) to help the poorer countries, or the Federal Republic should leave the Eurozone area to return to the Germans the purchasing power of a rising DM and to reduce our trade surpluses by the purchasing for foreign goods and thus contributing to the worldwide demand.

The question also arises as to whether the privilege of monetary printing should remain with the banks through the lending privilege and the associated money multiplier. In the boom years, too much money is usually created, while in the crisis, too little credit is made available. The cycles of the economy are also strengthened by innovative credit instruments and increasing off-balance sheet financing. One example is that the largest German bank before the crisis had boosted its balance sheet so that despite all the capital measures now

taken, equity is only around 4%. Reasonable would be the historically norm of 20% because of the importance of the banks for the well-being of all. Banks should be compared with utility providers and similarly regulated. The state can jump into the breach through infrastructure spending paid by newly created central bank money. However also here under strict regulations and controls!

The solutions are not all simple, but a rethinking must be done if one does not want to leave the game to demagogues peddling with catchphrases (leaving the European Community, kicking out of foreigners and the like). For those who would like to read more, the book "Between Debt and the Devil" by Adair Turner, the former head of the British banking regulator can be recommended.

In the first half of the year, we sold the TriStone Group and sold BB Government Services to a European construction group. In July, we sold the SIDES for a more symbolic purchase price of EUR 100,000 to a strategic French investor.

We estimate the value of our investment portfolio at EUR 33.6 million on the basis of the last twelve month financials. At the end of 2016, we assumed a value of EUR 45.5 million for these investments. The net profit for the first half of this year compared to the first half of 2016 fell by EUR 6 million to EUR -9.7 million. The value of other financial assets increased to EUR 329.1 million as at 30 June 2017 after EUR 140.5 million at the end of the year. The cash position of the holding companies increased in the first six months from EUR 70 million to EUR 211.5 million.

The value of the equity investments was EUR 117.6 million as at 30 June 2017:

(EUR million)	**2016**	**HY 2017**	**%**
Direct Investments	234.8	33.7	-86%
- current	*45.5*	*33.6*	
Passive Investments	140.5	329.1	134%
- of which equities	*70.5*	*117.6*	
Total	**375.3**	**362.8**	**-3%**

The value of our five largest equity positions rose by 6.3% to EUR 53.8 million compared to the end of the year. The two ETFs were only acquired in the second quarter:

(EUR million)	market price	performance	% change
Ishares Core Dax Ucits ETF	13.7	0.0	0.1%
Berkshire Hathaway A	11.4	-0.4	-3.5%
Vanguard F ETF	9.9	0.0	-0.1%
Euler Hermes Group S.A.	9.8	2.4	30.2%
Brederode SA	9.0	1.3	16.6%
Total	**53.8**	**3.2**	**6.3%**

BAVARIA Industries Group AG will continue to invest cautiously. We appreciate openness and welcome your suggestions and suggestions for improvement. We are always grateful for transaction proposals.

Best regards

Reimar Scholz

Executive Board