Letter to the Shareholders

Dear shareholders and business associates,

To invest well means to act contrary to human nature. Humans have survived because they have learned to avoid losses and to orient themselves to the needs of the group. However, one only achieves outperformance as an investor if one acts differently from the majority and consciously takes losses into account. Ultimately, the probability that one's assessment will prove correct falls far below 100%, and the chance that a share's price will initially drop after the purchase is nearly 50%.

With the sale of TriStone, our largest holding, in February 2017, we took a major step toward reducing our risk concentration. Furthermore, due to the impending departure from the combustion engine, we anticipate substantial, long-term declines in sales for traditional automotive suppliers. Admittedly, this is increasing our investment pressure: with sales revenue of EUR 170 million, we now have over EUR 300 million available for reinvestment. Depending on the market situation, we will invest this in majority or minority stakes, including exchange-traded securities.

The way our holdings have performed operationally can be seen from an overview of the development of post-tax profits – in contrast to the significantly higher, frequently touted pre-tax earnings, only these are actually available for new investment.

(EUR million)	**2015**	**2016**
Serial Production / Automotive	14.2	17.9
Plant Engineering & Construction	3.0	-5.2
Business Services	-8.4	-16.0
Total Holdings	8.8	-3.4
Others	16.6	22.9
Consolidation	4.3	-1.9
Group	**29.7**	**17.6**

In total, our holdings have yielded a loss of EUR -3.4 million, while in the previous year, we achieved a profit of EUR 8.8 million. Profits from series production amounted to EUR 17.9 million, after EUR 14.2 million in the previous year. Without the TriStone Group (sale completed in February 2017) and without Austria Druckguss, which was deconsolidated in April, serial production showed a profit of only EUR 0.8 million in 2016. Our assessment of the value of our holdings and liquid assets, including financial investments, can be seen in the following overview:

(EUR million)	**2015**	**2016**	**% Change**
Holdings	216.3	234.8	9
Financial Assets	62.0	71.2	15
Cash	64.0	69.3	8
Balance	**342.3**	**375.3**	**10**

As of the end of 2016, we have assessed the value of our holdings at EUR 234.8 million, EUR 176.3 million of which could be attributed to the TriStone Group. The value of the remaining holdings amounted to EUR 58.5 million. Cash increased to EUR 69.3 million by the end of 2016, and the value of financial assets increased by 15% to EUR 71.2 million. The DAX equities index, as our benchmark, increased by 6.9% during the same period. The net value of the overall portfolio (“NAV”) amounted to EUR 375.3 million, and thus EUR 70.1 per share, at the end of 2016. Out of the Group book value of EUR 278.5 million, the TriStone Group only accounted for EUR 53.7 million. The book value of the BAVARIA Group falls above the NAV after the sale, since the other holdings were acquired at prices substantially below book value.

As at 31 December 2016, our largest positions in financial assets were as follows:

(EUR million)	Market Value	Performance	% Change
Berkshire Hathaway A	11.8	2.5	26.7
Euler Hermes Group S.A.	7.9	0.4	4.9
Brederode SA	6.7	0.3	4,9
Inv. AG TGV	6.3	0.1	1.3
Goldman Sachs	2.4	1.0	59.5
Total	**35.1**	**4.3**	**13.4**

In the last four years, we have achieved a cumulative return of 43.6% with our financial investments. This means that our weighted average has performed substantially better than the DAX (19.8%). Since we were only invested at 37% on average, and otherwise held cash for prudential reasons, we were only just able to keep up with the DAX in consideration of book profits from own-stock buybacks (since March 2013, we have bought back 16 million shares with an average price of EUR 35.8). It is likely that we will primarily invest in exchange-listed securities in the near future, since the prices for company acquisitions are currently very high. In this context, we would like to take advantage of the opportunity to explain our investment approach in more detail.

Our returns are primarily achieved through four different strategies:

1. Hidden gems

This includes investments such as the shares acquired in the period from March 2015 to February 2016 in El.En, a company that manufactures laser systems (particularly for medical applications such as tattoo removal). We acquired these shares for approximately EUR 2 million. In our opinion, the enterprise value was cheap: it amounted to less than seven times EBIT despite a return on equity of 10% and EBIT growth of approximately 8% p.a. in the last five years. Why was the EBIT multiplier so low, in spite of the company's growth? First, there was a weak phase in the market in February 2016, particularly among Italian stocks; furthermore, the official figures still did not include the sales revenue from shares of an American stock company (Cyanusure). Since then, we have sold the shares for a profit of EUR 2.64 million.

Unfortunately, gems like this are quite rare; in hindsight, of course, we invested far too little.

2. Cheap shares worldwide

Many shares worldwide are not cheap without reason, since they are subject to political and/or currency risks and are often quite cyclical. In the end, such holdings are more speculative, since thorough analysis is generally not possible. We have tried nevertheless, and on average, lost money by doing so. However, one can certainly earn money with a refined filter (free of charge and good quality, e.g. “Global FT Screener”), as our further investments have shown. For example, we have successfully filtered according to the following criteria: developed industrial countries with low EBIT multiplier (< 7) and long-term high return on equity (> 12%) with low debt (< 50% of equity capital) at the same time. We have purchased ten such shares at regular intervals with the same weighting. We excluded real estate, banking and commodity shares, and set a specific maximum figure of shares according to country. In recent years, smaller Japanese firms have been predominant due to the fact that their cash balances are very high in international comparison, which increases their company values (market capitalization plus net cash).

If it is not possible to sufficiently assess the companies, one should, for example, simply buy shares that exceed a previously determined loss threshold (e.g. -30%); profit earners, on the other hand, should be left alone. Unfortunately, we have not always kept to this. Since we generally prefer to buy at a reduced value, it is difficult for us not to simply sell stocks of companies that have reached their fair value. We view the fair value for companies with limited growth at an EBIT multiplier of 10.

3. Quality stocks

Ideally, one only holds stocks that can achieve an excess return over the long term (e.g. ROE of 12% and above) and that simultaneously have the option of reinvesting earnings and achieving growth. Unfortunately, these equities are generally significantly over-traded. They can actually only be purchased after profit warnings or during weak phases in the market (like in February 2016 most recently). In this situation, it is recommended to make a list of interesting firms for follow-up (the internet provides the opportunity here to easily work with email notifications).

3. Holding companies

Holding companies like Berkshire Hathaway and Brederode come the closest to our own business model. This field regularly sees substantial undervaluations, since the market valuation is only based on current results and expected earnings growth. Since holding companies frequently have fluctuating earnings due to purchases and sales, these tend to be somewhat undervalued (except when they are strongly promoting their own stock). In addition to a dividend return, it is our opinion that the decisive factor is whether the company is achieving equity capital growth or growth of the net asset value per share. In this context, one should carefully review how this has been determined by the management. Interesting shares are those such as Brederode SA, which has increased its book value per share by 10.6% in the last five years until 2016, in spite of a dividend return of 1.5%. A shareholder thus achieves a return of 12%, even though the stock currently sells at a 20% discount from the book value. If the return remains achievable in the long run, a premium of 50% on the book value would be appropriate in the event of an underlying long-term market return. Another good indicator is the fact that the management of Brederode SA shares this perspective, and buys back its own stock each year (why would the management buy external stocks if they know their own much better, and it is being traded with a substantial discount?).

Our philosophy

We spend a great deal of time reflecting on life and the contribution we can make to society. For one, we believe that by providing explanations of how we earn money, we are giving you the opportunity to do the same. We also believe in making a contribution through the preservation and creation of secure employment. Furthermore, by increasing BAVARIA assets, we offer our shareholders the opportunity to do something good with the profits. It should also be pointed out that in the 2016 financial year, we again made donations for social causes. The Against Malaria Foundation and the Schistosomiasis Control Initiative (SCI) have received EUR 150,000 and EUR 50,000, respectively. As in the previous year, we thus followed the suggestion of givewell.org.

I would like to expressly thank my Executive Board colleague, Harald Ender, for his many years of activity with BAVARIA Industries Group AG: over the course of ten years, he has made an important contribution to the Group’s growth in value.

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 toward new transactions.

Yours sincerely

Reimar Scholz

Chief Executive Officer