

Lupus alpha

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**SUSTAINABILITY
REPORT 2017**

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Dear
readers,

Sustainability has been more than just a buzzword for some time now. More and more people are placing a

greater emphasis on the environmental, ethical and social aspects of their activities. This may include responsible and environmentally-conscious consumption. As a result, many companies have chosen to focus on sustainability as an issue their clients not only acknowledge but also reward in the long term. The same is true for asset management. A growing number of investors have been demanding sustainable investments for several years.

According to Forum Nachhaltige Geldanlagen (the Forum on Sustainable Investment - FNG), sustainable investment products reached a new high of EUR 280.6 billion in German-speaking countries in 2017. The FNG expects this market to grow further over the next few years. In addition to a rising demand among institutional investors, changes to the regulatory framework are likely to provide additional momentum.

Sustainability has now become a key investment criterion for many of our clients. Lupus alpha has been committed to the principle of responsible investment ever since it was founded. For more than a decade, we have been working with Vigeo Eiris which is represented in Germany by the Institute for Market, Environment and Society (imug). Environmental, social and governance (ESG) criteria have since become an integral part of our investment process.

In 2017, we expanded our active shareholder policy regarding the field of European small and mid caps. Sustainable investment is an investment in the future and an ongoing task that requires continuous advancement. Hence additional sustainable fund concepts are planned for 2018 in areas such as our Advanced Fixed Income products.

In this report, we would like to give you an overview of our sustainability activities in 2017 and enable you to form an impression of our commitment in this area.

Kind regards,

2 Lupus alpha - Who we are

Lupus alpha was founded in October 2000 as one of Germany's first independent investment companies. Our partnership-based corporate structure and independence from banks offered an alternative to the competitors dominating the market even then. With their unique corporate philosophy, the founding partners of Lupus alpha created an environment that provides optimum support for a focus on quality and performance and offers long-term prospects for the Company's top performers.

Since Lupus alpha was founded, we have focused on investment approaches in asset classes with particular return drivers, starting initially with European small and mid caps. Our active investment process has proven successful for many years. Moreover, our portfolio managers analyse small and mid-cap companies across Europe aiming to identify assets where above-average performance is expected. With one of the largest and most experienced teams in Germany specialising solely in small and mid caps, combined with an active, fundamentally based bottom-up approach, Lupus alpha has succeeded in generating steady, sustainable added value for investors from the beginning.

As one of the first providers of absolute return concepts, Lupus alpha continued to specialise in 2003 and expanded its product range into the new area of alternative solutions. This development was triggered by a growing demand for alternative investment approaches among institutional clients and a wider statutory framework. Today, Lupus alpha offers a variety of liquid alternative investment strategies based on different return drivers that can map a broad range of risk-return profiles. In addition to equity-focused value protection concepts, the product portfolio includes investment approaches in the equity, volatility, convertibles and collateralised loan obligations asset classes. Lupus alpha is now one of the leading providers of liquid alternative investment strategies.

We will continue to serve as a specialist provider of asset management "Made in Germany" in the future. With more than 80 employees, including 30 portfolio management specialists, we use specialised, innovative strategies to systematically open up new alpha sources and sustainable risk premiums for our investors and create opportunities for them to further diversify their overall portfolio.

3 Corporate responsibility

Our corporate responsibility involves customising our services to the needs of our clients and monitoring possible risks. We can only fulfil our responsibility and achieve long-term success by maintaining a close dialogue with our clients, business partners, associates and employees.

Our understanding of responsible conduct and adhering to ethical business standards is guided by our most important stakeholder groups: our clients, business partners, employees and associates. As a company, we also have a social responsibility to make a valuable contribution to both the economy and the common good.

In the following sections, we have identified the following key topics and provided a report on our involvement in different areas.

3.1 Responsibility towards clients and business partners

Lupus alpha takes comprehensive measures to ensure compliance with laws and regulatory requirements. Compliance means acting in accordance with all applicable legislation. More specifically, this means working with clients, business partners and employees in a manner defined by fairness, solidarity and trust based on applicable laws and guidelines.

Lupus alpha expects its employees to behave with integrity towards clients and business partners to avoid conflicts of interest and act consistently in the interests of the clients. Furthermore, all processes are constantly monitored in accordance with relevant rules. Employees receive regular training on issues such as preventing money laundering and insider trading in order to become aware of these issues. Additionally, individual departments are subject to regular risk monitoring to ensure that operational and procedural risks are constantly monitored.

We offer our clients a personalised service. We place particular emphasis on maintaining a cooperative relationship with our clients to ensure that we can recognise their requirements as accurately as possible at all times. Our Clients & Markets team regularly analyses whether client and service requests are comprehensively covered. Furthermore, our clients receive regular reports and up-to-date information on our investment strategies to ensure maximum

transparency with regard to the investment process and performance.

Clients are informed of any changes or adjustments on the product side or to processes in a timely manner and kept up to date with the latest developments.

As part of our outsourcing partner's risk analysis, we assess the implementation of ESG criteria by our business partners. In case pre-defined criteria are not met we reserve the right to take further action and, when in doubt, terminate existing business relationships.

3.2 Responsibility towards employees

Lupus alpha's mission statement sets out the Company's aspiration to bring a new level of quality to asset management which means that we strive for quality in everything we think and do. Primary objective is to help Lupus alpha's clients to achieve their investment goals by delivering above-average product performance and exceptional service. Our clients can place reliance on Lupus alpha only offering products and services that provide a realistic opportunity to place them among the market leaders in their class. As a result our employees are our most important asset as their commitment and ongoing support for innovative products and services ensure the long-term success of Lupus alpha.

Dedicated, skilled employees make a decisive contribution to the long-term success of the company and help us to gain an important competitive advantage in the asset management sector. This means not only attracting the best talent but also motivating them to be top performers and keeping them at the company in the long term.

Lupus alpha therefore helps its employees to continually develop their professional and social skills and open up new professional prospects. We treat our employees as equals and invest systematically in young talent and leaders who actively take responsibility and drive Lupus alpha forward. A positive working environment is crucial, as are the areas of **professional development and wholesomeness**.

Lupus alpha's corporate culture is defined by open, constructive communication, a high degree of personal responsibility and the satisfaction of our employees.

Only highly motivated staff can deliver the best performance for our clients. The annual Open Forum employee survey was introduced back in 2000 to promote an open, critical exchange of views between employees, management and partners. This communication platform contributes to the internal discussion and helps us to form opinions about issues that are important to our employees, which in turn enables us to respond with specific measures where appropriate.

3.2.1 Professional development

When it comes to professional development, Lupus alpha offers various programmes tailored to our employees' individual roles. In addition to the 'Introduction Course', which provides an overview of all of the company's divisions, additional opportunities are also available to new employees. Every new joiner is assigned an experienced senior manager as part of Lupus alpha's mentoring programme. This programme promotes the systematic integration of new colleagues and introduces them to the company's unique corporate culture. New Lupus alpha employees can also get a taste of other departments at any time in order to gain a holistic view of the company and its staff. Internal 'lunch & learn' events where portfolio managers present products to their colleagues in detail are also held at regular intervals.

A special advanced training programme is also available to employees promoted into leadership roles. Combined with professional external training seminars, our Leadership Programme provides new leaders with the best possible preparation for their new role within the company and their team.

Employees also have the opportunity to make use of other professional development options such as the part-time CFA programme or MBA degree courses. The aim is to provide optimum personalised training for our employees that takes their personal wishes and needs into account yet while also being professionally necessary.

3.2.2 Wholesomeness

Actively promoting the health and wholesomeness of our employees plays an important role at Lupus alpha. Staff have access to a fitness studio where they can develop and prepare an individual training plan with a personal trainer. Several employee-organised

sports groups also meet regularly to prepare for in-house competitions or the J.P. Morgan Chase company challenge race.

In addition to nutrition and sports, healthcare is also a top priority at Lupus alpha. The healthcare programme has been running for many years. The programme is open to all employees aged 35 and over and includes a complete diagnosis day at the Helios DKD Clinic in Wiesbaden where a comprehensive check-up and specialist care modules are provided. Throughout the year, staff can also make use of a wide range of services provided by the Occupational Health Service (BAD), including eye and hearing tests, ergonomic sitting workshops and flu vaccinations.

3.3 Responsibility towards society

Since Lupus alpha was founded, we have regularly supported non-profit organisations such as Aktion Mensch, Schritt für Schritt - Hilfe mit System e.V., Oxfam and other regional institutions. In addition to making annual donations to nationwide organisations, we also support local causes close to our heart such as cancer charity Krebshilfe Frankfurt e.V.

One special campaign is the annual Christmas campaign run by children's charity Frankfurter Kinderbüro. Since 1996 we have provided financial support and participated in the Christmas campaign to make the wishes of children in Frankfurt living in precarious circumstances come true. In 2015 the campaign helped more than 4,000 children. Our employees gave a great deal of commitment to this campaign, enabling around 100 children to receive their own personal presents shortly before Christmas in 2017.

We also encourage and support any voluntary work carried out by our employees.

4 Responsibility in business

4.1 ESG issues as an integral part of the Lupus alpha investment process

Lupus alpha's specialist Small & Mid Caps team covers the entire spectrum of listed second-line equities in Europe - from micro caps and small caps all the way to mid caps. Around 60 to 80 stocks are selected from a universe of more than 1,000 investable companies to form a portfolio. The responsible portfolio manager addresses various ESG issues during the analysis process and by taking specialised external research into account. Depending on the investment strategy being used, this can have an impact on the portfolio construction process by using e.g. exclusion lists.

4.2 Fundamental investment process

Lupus alpha pursues a fundamental orientated investment process in the small and mid-cap segment. This process focuses on analysing individual companies based on their business model. The analysis process involves an intensive dialogue with companies usually represented by top management (CEO and CFO) and other company representatives such as those responsible for product development, marketing, sales or controlling. After an initial analysis, we have regular personal interaction with the company in question. The aim is to track the company's strategy and the consistency of development as much as establishing a sustainable relationship with the investee company. After analysing and valuing the company based on a close dialogue with its management, we make an investment decision depending on our findings.

Among the most important issues are those relating to corporate governance, particularly with regard to management structures and monitoring. In this area, we focus on the individuals acting on behalf of the company, its leadership structures, independence of supervisory bodies and avoidance of conflicts of interest. Issues concerning the configuration of incentive-based remuneration systems for management are equally important when it comes to aligning the interests of management with those of shareholders and other legitimate stakeholders. Questions concerning environmental sustainability of production, occupational safety and working conditions as well as compliance with legal standards – including the supply chain – also play a significant role. These issues can give rise to reputational risks that could pose a significant threat to a company's business model and

damage its brand considerably. The reputation of a brand can generate crucial competitive advantages. Conversely, unsustainable behaviour can also result in disadvantages for companies.

As a result, ESG criteria and risks have a part to play when selecting companies. Experiential the majority of ESG issues encountered by our portfolio managers can be placed into one of the following categories: management incentive systems (corporate governance), resource consumption (environmental), configuration of outsourcing relationships (social), production processes (environmental), growth plans (environmental), employee participation (social), energy efficiency (environmental) and corruption prevention (social).

4.3 Collaboration with Vigeo Eiris

Lupus alpha has been working with Vigeo Eiris to analyse companies for more than ten years. EIRIS was founded by church and charitable organisations in 1983 to incorporate its investment principles into the company selection process. In 2016, EIRIS joined forces with French ESG research firm Vigeo. The company is represented by the Institute for Market, Environment and Society (imug) in Germany. The Vigeo Eiris database provides access to more than 4,000 issuers analysed according to 250 criteria in six areas of interest. An ex-ante examination of individual stocks is conducted if this has been separately agreed with individual investors and the stocks excluded where appropriate based on Vigeo Eiris analysis, using a variety of criteria such as:

- the development, manufacture and distribution of nuclear, chemical or biological weapons or armaments making up a significant percentage of company revenue
- the genetic modification of food and seeds
- conducting or commissioning animal testing for cosmetics or intermediate products
- intensive livestock farming inappropriate to the species in question
- the operation of games of chance making up a significant proportion of company revenue
- the manufacture of spirits making up a significant proportion of company revenue
- inhumane working conditions and the violation of the ILO's core labour standards (no child labour, forced labour, discrimination or prevention of trade union activities)
- the manufacture of tobacco making up a significant proportion of company revenue
- the marketing of sexuality, and
- environmental pollution.

4.4 Exclusion lists

In addition to observing ESG criteria as part of the investment process and ESG audit using the Vigeo Eiris database as outlined above, an ESG-compliant focus can also be maintained by using individual exclusion lists. The particular values of individual Lupus alpha investors also play a significant role. When comparing the exclusion lists of different investors, a common set of negative criteria for investment decisions often emerges. However, there are frequently cases of certain companies that are not acceptable to some investors for individual reasons. Lupus alpha works with the SimCorp Dimension software during the portfolio implementation process. Excluded companies can be consistently blocked with the help of this software, meaning the acquisition of shares in blocked companies by portfolio managers and implementers can be excluded.

4.5 Summary

There is a number of ways to take ESG issues into account during the portfolio construction process for European small and mid caps. With the three key methods outlined above (integration in the fundamental investment process, collaboration with Vigeo Eiris and exclusion lists), Lupus alpha has various tools at its disposal for incorporating ESG issues into the portfolio construction process as necessary to achieve a positive and informed outcome.

5 Our commitment

5.1 BWT - Austrian water technology company

Located in Austria and operating across Europe, this water technology company is one of the leading providers of water treatment systems for home, building and industrial technology sectors. Apart from offering water treatment technology for public baths, swimming pools and thermal baths, BWT also sells fixed water filtration systems to consumers and for professional use in cafés and restaurants.

In 2016, Lupus alpha sought a dialogue with the water technology company to stave off an attempt by its major shareholder to delist the shares or make an appropriate offer to buy out the company. The major shareholder wanted to merge the company with an unlisted subsidiary without submitting a suitable valuation report. Together with other small shareholders, Lupus alpha took legal action against the major shareholder to challenge the delisting without a company valuation and a fair buyout offer. This delisting would have significantly limited selling opportunities for the shares. Although the courts initially ruled in favour of the small shareholders, the major shareholder won the case on appeal. The proceedings were reopened in 2017, this time in front of the Austrian Supreme Court, and resulted in the major shareholder being barred from proceeding with the delisting. For the reasons outlined above, Lupus alpha also voted not to discharge the CEO of the company, who is also the major shareholder, in 2015 and 2016 as part of the Annual General Meeting.

BWR has been the subject of steady development for several years. The company has made considerable investments during this growth phase, and earnings have been low. Earnings have risen more recently, and in 2017 we accepted the improved takeover offer for half of the shares in our portfolio. The revised offer was more than 40% higher than the original offer.

The major shareholder is currently continually attempting to force all other shareholders out of the company. The latest takeover offer submitted is still below an appropriate enterprise value for the company.

It is still necessary to actively exercise our shareholder rights in this case.

5.2 Constantin Medien - German media company

Located in Germany, this international media company primarily focuses on the sports and film segments and is present in the sports and event marketing sectors via its stake in a listed Swiss media company. The sports segment includes the company's television activities and the web portal as well as extensive production services.

The film segment focuses on international film production and distribution activities. In addition to films, the company also creates fictional and non-fictional products for German and foreign broadcasters.

Constantin Medien's involvement in the sports and event marketing sectors includes the global marketing of major international sporting events. As one of the world's leading agencies in this area, the company exclusively markets the UEFA Champions League, UEFA Europa League and UEFA Super Cup on behalf of the Union of European Football Associations (UEFA).

At two shareholder meetings in 2016, substantial differences in opinion emerged between different shareholder groups, with one group proposing the sale of the entire film business, leaving only the sports rights business. Lupus alpha, on the other hand, voted against the sale of the film division at the shareholder meeting, as it believed (and continues to believe) the company's diversification being crucial to its future development. The film business is a successful strategic pillar of the media group in the medium term.

The major shareholders won a lawsuit opposing the sale in 2017. This followed a buyout offer of EUR 2.30 per share after the share price hovered at around EUR 1.70 per share. The defeated shareholder group subsequently withdrew completely from the company and is now facing several claims for damages.

5.3 GRAMMER - German company in the automotive industry

This globally-positioned company specialised in the development and manufacture of components and systems for car interiors as well as driver's and passenger seats for off-road commercial vehicles, trucks, buses and railways. It is seeking to strengthen its innovative leadership in the Automotive and Commercial Vehicles segments.

Founded in 1880, the Group has been active in the automotive industry since 1954. The Group comprises more than 40 GRAMMER companies with more than 12,000 employees worldwide.

At the beginning of 2016, the Hastor family from Montenegro became a major shareholder in the company with an interest of around 23%. The family is well known in the automotive industry, having been responsible for several high-profile production stoppages at their own major customer VW in the past. Two German subsidiaries of the automotive supplier recently caused the VW production lines to grind to a halt as an official protest against its procurement practices. This kind of production downtime is a worst-case scenario for any vehicle manufacturer. As a result, most German carmakers avoid the Hastor family due to the uncertainty they have caused in the industry.

Various incidents also caused Lupus alpha and other GRAMMER shareholders to be concerned about GRAMMER AG's business dealings with their largest single customer, VW, particularly as it looked as though the Hastor family's decisions were partly motivated by personal reasons. Lupus alpha was present at GRAMMER's Annual General Meeting in order to protect our investment. We sought to use our active involvement at the Annual General Meeting to minimise the influence of major shareholder Hastor (approx. 23%) and make the other shareholders aware of their problematic relationship with its main customer VW.

As a result, all of Hastor's motions were rejected at the Annual General Meeting as it was clear that they would not have been in the best interests of the company or its stakeholders. Although there is now another major shareholder (approx. 25%), they are unlikely to have any negative impact on the operational development of GRAMMER and are thus regarded as a 'normal' investor. The blocking minority means that the Hastor family can no longer take over GRAMMER. All things considered, this should also resolve the reluctance to award contracts to GRAMMER that VW have shown since the Hastor family became a major shareholder in the company.

5.4 Frauenthal - Austrian conglomerate focusing on the production of components for the European commercial vehicle industry

Through its automotive division, Frauenthal supplies most of the European commercial vehicle industry and selected automobile customers. The Group's products include connecting rods, camshafts, distributor boards and sheet metal processing equipment in the automotive sector and quality components primarily made from steel in the non-automotive sector.

The Frauenthal Trade division is the number one wholesaler of sanitary, heating and installation technology and offers a wide range of products for municipal infrastructure (gas, water, sewers, etc.) as well as for large industrial plants.

The Austrian company operates all across Europe and China with more than 3,200 employees.

In 2016, the major shareholder, acting the part of the Chairman of the Executive Board, made a takeover offer valued at EUR 11.06 per share. As we believe this takeover offer is not adequate because it is below the appropriate enterprise value, we rejected the offer. Recently we support a special audit proposal currently being tabled by another group of shareholders. It therefore remains important for us to actively exercise our shareholder rights and seek a dialogue with the Group.

6 Sustainability targets and achievements in 2017

Our 2017 sustainability targets include the integration of ESG issues into our investment processes and shareholder policy as well as the establishment of company-wide sustainability targets by our Lupus alpha Sustainability Team.

An active corporate governance policy is an integral part of our sustainability targets. At Lupus alpha, we believe that responsible corporate governance is the key to achieving sustained growth in the value of our investments. We focus on representing and safeguarding our investors' interests and voting rights vis-à-vis stock corporations. Voting rights are among a shareholder's most valuable rights and should be handled responsibly. Lupus alpha acts exclusively in the interests of the relevant investment fund.

The company exercises its shareholder voting rights on behalf of its investors using the clearly defined criteria set out in its 'Principles for Exercising Voting Rights'. We exercise our shareholder and creditor rights irrespective of third-party interests and exclusively in the interests of investors in the relevant investment fund.

Lupus alpha stays in close contact with the respective company. If regular company analysis shows that involvement is essential as part of active corporate governance, the engagement process begins and Lupus alpha exercises its voting rights.

In 2017, Lupus alpha voted at 61 shareholder meetings in the European small and mid-cap sector. Lupus alpha attended two shareholder meetings in person to observe proceedings and carry out personal assessment. The company actively made ESG decisions and exercised its voting right in the following cases: BWT, Constantin Medien, GRAMMER and Frauenthal. Our involvement as active shareholders and the implementation of ESG criteria in our shareholder policy are the primary focus of our sustainability targets. In 2017 we actively exercised our shareholder voting rights at the aforementioned shareholder meetings based on our ESG criteria and in accordance with our voting rights policy.

Moreover, we regularly analysed and evaluated documents, data supplies and business dealings with regard to the ESG criteria in the same year. We used ESG aspects to define strategic direction of the field of Alternative Solutions and outlined our influence on the investment process in this area.

We positively assessed the ESG data supplied by our existing data providers and decided to analyse the existing options for expanding our data supply.

In 2017, we analysed approximately 35 new signatories to the UNPRI and their implementation reporting in order to review our own sustainability criteria and compare these with the implementation of sustainable principles in the investment sector.

In addition to integrating ESG targets into the Alternative Solutions investment process and analysing and evaluating our data providers, business partners and reporting, Lupus alpha also enhanced the presentation of its ESG activities on the homepage and published its annual PRI report.

7 2018 outlook

In its 2018 company strategy, Lupus alpha set itself the objective of developing a company-wide corporate social responsibility concept. This will be developed in 2018 and implemented in the following years.

Regarding Alternative Solutions, the ESG targets will be further integrated into the strategic direction and incorporated into the investment process.

We have also set ourselves the objective of enhancing our reporting to investors by integrating the ESG principles.

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