



MARGIN OF SAFETY FUND

Société d'Investissement à Capital Variable
R.C.S. B 88649

Audited annual report

at 31/12/09

MARGIN OF SAFETY FUND

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Subscriptions can only be received on the basis of the latest prospectus accompanied by the latest annual report as well as by the latest semi-annual report, if published after the latest annual report.

MARGIN OF SAFETY FUND

Management and Administration

REGISTERED OFFICE

5, Allée Scheffer
L-2520 Luxembourg

INVESTMENT MANAGER

Pastel & Associés S.A.
9-11, Avenue Franklin D. Roosevelt
F-75008 Paris

PROMOTOR

Pastel & Associés S.A.
9-11, Avenue Franklin D. Roosevelt
F-75008 Paris

AUDITOR

KPMG Audit S.à r.l.
9, Allée Scheffer
L-2520 Luxembourg

CUSTODIAN AND
CENTRAL ADMINISTRATION AGENT

CACEIS Bank Luxembourg
5, Allée Scheffer
L-2520 Luxembourg

MANAGEMENT COMPANY

Luxcellence Management Company S.A.
5, Allée Scheffer
L-2520 Luxembourg

Board of Directors

Chairman of the Board

M. John MILLS, Managing Director, Maitland Luxembourg S.A.

Members of the Board

M. David PASTEL, CEO of Pastel & Associés S.A.

M. Yves-Pascal PELCENER, Member of the Board of Pastel & Associés S.A.

M. Antoine GILSON DE ROUVREUX, Managing Director, Luxcellence Management Company S.A.

MARGIN OF SAFETY FUND

Information to the Shareholders

Supplementary information to Shareholders on Savings Directive 2003/48/EC

The Board of Directors resolves that the following Sub-Fund is out the scope of the Law for the realised and distribution income:

MARGIN OF SAFETY FUND - Fund 1 with 3.00% of its assets invested in debt-claims.

This update has been effective from May 1, 2009 and will remain in force until April 30, 2010 date at which the status will be updated again.

MARGIN OF SAFETY FUND

Manager's Report

Investment performance MARGIN OF SAFETY FUND – Fund 1

(cumulative figures after all fees and expenses)

Class P shares

In 2009, the Fund's NAV increased by 65.19%, resulting in a cumulative performance since inception on February 2nd, 1998, of 240.0%. As a result, while USD1,000 invested at inception in Margin of Safety Fund P Class (USD) would now be worth USD3,400, the same USD1,000 invested in the MSCI World index in USD (with dividends reinvested) would now equal USD1,557.

Class I shares

In 2009, the Fund's NAV increased by 66.67%, resulting in a cumulative performance since inception on February 2nd, 1998, of 223.9%. As a result, while USD1,000 invested at inception in Margin of Safety Fund I Class (USD) would now be worth USD3.239 the same USD1,000 invested in the MSCI World index in USD (with dividends reinvested) would now equal USD1,557.

Management report

In 2009 our investment methodology proved its mettle, as it had already done in the earlier financial crises of 1998 and 2001-2003.

The recent period has once again shown how difficult, if not impossible, it is to forecast the extent and timing of stock prices movements. This is why our investment approach focuses instead on the concept of what the intrinsic value of a business is. An approach that has proved particularly rewarding and robust over time, as demonstrated by the track records of MARGIN OF SAFETY FUND – Fund 1.

We believe that, in the current economic and market environment, the concepts of intrinsic value, margin of safety, and independent research and financial analysis are all the more relevant. In 2010, we will continue to manage the portfolio with the same discipline, the same methodology and the same indifference to the fashions and themes of the moment as we have for the last 12 years.

We will remind investors that the Funds' portfolio is currently made up of companies that tend to share some common features:

- Their financial structure is solid and debt levels are reasonable in light of their ability to generate cash through economic cycles.
 - Their business model has proved its profitability over long periods, as illustrated by their superior levels, over an economic cycle, of operating margins as well as returns on equity and employed capital.
 - They hold strong and sustainable competitive positions which should allow them to keep, or even increase, market share against competitors that might be weakened by a lengthy economic slowdown.
 - They are headed by experienced managers, whose personal wealth is often invested in their company's capital and therefore tied to its long-term future.
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MARGIN OF SAFETY FUND

Manager's Report

Moreover, the shares of these high-quality companies are trading today at attractive, and even in many cases at bargain, prices when compared to our estimates of intrinsic value.

To sum up this report, the out-performance of the Fund in 2009 has only confirmed the extreme undervaluation of our portfolios at the depth of the crisis, but should not, at least in our view, be construed as detracting in any way from their future return potential.*

Evolution of the portfolio structure in 2009

In 2009, the structure of the portfolio underwent a certain number of changes.

During the year, new positions were built or reinforced such as Johnson & Johnson, Lowe's, Uponor and USG Corp.

At the same time, a number of positions were entirely or partially disposed of, such as Carpetright, Nordstrom and Randstad.

As a result of these transactions, the Fund's equity portion represented 97.0% of the net asset value. As was already mentioned in previous reports, Euro and Sterling-denominated portfolio assets are partially hedged back into the US Dollar through forward currency sales.

As of December 31, 2009, the geographic breakdown of the Fund's portfolio, before currency hedging, was as follows (2008 figures are provided for comparison purposes):

	2009	2008
- Euro Zone:	36.3%	33.7%
- United Kingdom:	25.1%	32.8%
- United States:	38.6%	33.5%

As of December 31, 2009, the breakdown by industry sector of the equity portion of the Fund's portfolio was as follows (2008 figures are provided for comparison purposes):

	2009	2008
- Business to business services:	41.7%	43.0%
- Durable goods:	17.2%	9.1%
- Industrials:	17.2%	17.3%
- Healthcare:	4.7%	0.0%
- Holdings:	4.2%	0.0%
- Media:	1.3%	1.1%
- Non-food retailing:	13.7%	25.2%
- Transportation:	0.0%	4.3%

Regards,

David Pastel,
Pastel&Associés S.A.

* This report does not contain any forecast of future rates of return. It only conveys the opinions of its author at the time of writing this report. These opinions may change at any time without any notice to be given. Moreover, they may be proved wrong as circumstances change and as additional facts become publicly known. In addition, they are not meant to be used as elements in making a decision to buy or sell shares of the Fund or any other securities.

MARGIN OF SAFETY FUND

Report of the Réviseur d'Entreprises

To the shareholders of
MARGIN OF SAFETY FUND
5, allée Scheffer
L-2520 Luxembourg

Report on the financial statements

Following our appointment by the general meeting of the shareholders, we have audited the accompanying financial statements of **MARGIN OF SAFETY FUND** (the "SICAV"), which comprise the statement of net assets and the securities portfolio as at December 31, 2009 and the statement of operations and changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory notes to the financial statements.

Board of directors of the SICAV responsibility for the financial statements

The board of directors of the SICAV is responsible for the preparation and fair presentation of these financial statements in accordance with Luxembourg legal and regulatory requirements relating to the preparation of financial statements. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Responsibility of the Réviseur d'Entreprises

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing as adopted by the "Institut des Réviseurs d'Entreprises". Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the judgment of the Réviseur d'Entreprises, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the Réviseur d'Entreprises considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the board of directors of the SICAV, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of **MARGIN OF SAFETY FUND** (the "SICAV") as of December 31, 2009, and of the results of its operations and changes in its net assets for the year then ended in accordance with Luxembourg legal and regulatory requirements relating to the preparation of the financial statements.

MARGIN OF SAFETY FUND

Report of the Réviseur d'Entreprises

Other matter

Supplementary information included in the annual report has been reviewed in the context of our mandate but has not been subject to specific audit procedures carried out in accordance with the standards described above. Consequently, we express no opinion on such information. However, we have no observation to make concerning such information in the context of the financial statements taken as a whole.

Luxembourg, XXXX, 2010

KPMG Audit S.à r.l.
Réviseurs d'Entreprises

Nathalie Dogniez
Partner

Patrice Perichon
Director

MARGIN OF SAFETY FUND

- Fund 1

MARGIN OF SAFETY FUND - Fund 1

Financial Statements at 31/12/09

Statement of net assets at 31/12/09

Expressed in USD

Assets			19,785,565.63
Securities portfolio at market value	Note 2		19,100,418.91
<i>Cost price</i>			18,916,524.80
<i>Unrealised profit on the securities portfolio</i>			183,894.11
Cash at banks and liquidities			187,843.90
Brokers receivable			255,953.37
Unrealised profit on forward foreign exchange contracts	Note 6		217,665.20
Other assets			23,684.25
Liabilities			96,747.15
Accrued management fees			45,385.64
Other liabilities			51,361.51
Net asset value			19,688,818.48

Changes in number of shares outstanding from 01/01/09 to 31/12/09

	Shares outstanding at 01/01/09	Shares issued	Shares redeemed	Shares outstanding at 31/12/09
Class I Capitalisation shares	7,610.77	62.00	1,909.00	5,763.77
Class P Capitalisation shares	577.71	38.00	316.04	299.67
Class HI Capitalisation shares	6.82	-	6.82	-
Class HP Capitalisation shares	0.64	-	0.64	-

Key figures relating to the last 3 years

	<i>Year ending at:</i>	31/12/09	31/12/08	31/12/07
Total Net Assets	USD	19,688,818.48	15,993,851.10	29,829,973.98
Class I		USD	USD	USD
Capitalisation shares				
Number of shares		5,763.77	7,610.77	8,455.33
Net asset value per share		3,239.19	1,943.49	3,129.76
Class P		USD	USD	USD
Capitalisation shares				
Number of shares		299.67	577.71	999.81
Net asset value per share		3,399.99	2,058.26	3,344.14

MARGIN OF SAFETY FUND - Fund 1

Key figures relating to the last 3 years

	<i>Year ending at:</i>	31/12/09	31/12/08	31/12/07
Total Net Assets	USD	19,688,818.48	15,993,851.10	29,829,973.98
Class HI		EUR	EUR	EUR
Capitalisation shares				
Number of shares		-	6.82	6.82
Net asset value per share		-	1,274.55	2,107.85
Class HP		EUR	EUR	EUR
Capitalisation shares				
Number of shares		-	0.64	0.64
Net asset value per share		-	1,348.76	2,250.42

MARGIN OF SAFETY FUND - Fund 1

Securities portfolio at 31/12/09

Expressed in USD

Quantity	Denomination	Quotation currency	Market value	% of net assets
Transferable securities admitted to an official stock exchange listing and/or dealt in on another regulated market			19,100,418.91	97.01%
Shares			19,100,418.91	97.01%
	<i>Austria</i>			
13,683.00	PALFINGER	EUR	307,108.75	1.56%
	<i>Finland</i>			
52,166.00	UPONOR OYJ	EUR	1,127,255.09	5.73%
	<i>France</i>			
10,356.00	CIMENT VICAT SA	EUR	3,459,653.36	17.57%
26,631.00	EUROPACORP	EUR	877,228.59	4.46%
32,140.00	GROUPE CRIT	EUR	250,137.31	1.27%
26,200.00	LEGRAND SA	EUR	833,415.91	4.23%
13,300.00	SODEXO SA	EUR	735,058.95	3.73%
	<i>Germany</i>			
7,000.00	A.S.CREATION TAPETEN	EUR	763,812.60	3.88%
5,700.00	FUCHS PETROLUB AG	EUR	753,757.93	3.83%
	<i>The Netherlands</i>			
25,684.00	RANDSTAD HOLDING	EUR	255,735.31	1.30%
	<i>United Kingdom</i>			
59,402.00	CARPETRIGHT PLC	GBP	498,022.62	2.53%
281,569.00	ELECTROCOMPONENTS PLC	GBP	1,291,312.93	6.56%
481,000.00	HAYS	GBP	1,291,312.93	6.56%
55,300.00	PERSIMMON PLC	GBP	4,801,633.96	24.39%
688,089.00	PREMIER FARNELL PLC	GBP	907,681.56	4.61%
	<i>United States of America</i>			
28,300.00	CINTAS CORP	USD	738,544.04	3.75%
14,000.00	JOHNSON AND JOHNSON	USD	812,226.86	4.13%
34,000.00	LEUCADIA NATIONAL CORP	USD	421,155.30	2.14%
55,596.00	LOWE'S COMPANIES INC	USD	1,922,026.20	9.76%
15,478.00	MOHAWK INDUSTRIES INC	USD	7,359,696.89	37.37%
31,000.00	PATTERSON COS INC	USD	737,215.00	3.74%
10,890.00	TJX COS INC	USD	901,740.00	4.58%
114,543.00	USG CORP	USD	808,860.00	4.11%
			1,300,390.44	6.60%
			736,752.80	3.74%
			867,380.00	4.41%
			398,029.50	2.02%
			1,609,329.15	8.17%
Total securities portfolio			19,100,418.91	97.01%

MARGIN OF SAFETY FUND - Fund 1

Statement of Operations and Changes in Net Assets from 01/01/09 to 31/12/09

Expressed in USD

Income				407,667.12
Net dividends				407,667.12
Expenses				363,824.22
Management & management company fees		Note 4		223,184.40
Custodian & sub-custodian fees				14,091.72
Taxe d'abonnement		Note 3		8,669.68
Administrative expenses				18,905.19
Domiciliation fees				8,600.09
Professional fees				24,612.79
Legal fees				17,445.34
Brokers fees				34,152.01
Other expenses				14,163.00
Net income from investments				43,842.90
Net realised loss on sales of investment securities				-348,005.58
Net realised loss on foreign exchange				-1,277,766.09
Net realised loss on forward foreign exchange contracts				-594,450.65
Net realised loss				-2,176,379.42
Movement in net unrealised appreciation / depreciation on forward foreign exchange contracts				125,827.95
Movement in net unrealised appreciation / depreciation on investments				11,364,793.35
Increase in net assets as a result of operations				9,314,241.88
Subscription capitalisation shares				299,873.84
Class I				195,886.90
Class P				103,986.94
Redemption capitalisation shares				-5,919,148.34
Class I				-5,006,704.34
Class P				-899,428.59
Class HI				-11,844.07
Class HP				-1,171.34
Increase in net assets				3,694,967.38
Net assets at the beginning of the year				15,993,851.10
Net assets at the end of the year				19,688,818.48

MARGIN OF SAFETY FUND

Notes to the financial statements

MARGIN OF SAFETY FUND

Notes to the financial statements at December 31, 2009

1. General

MARGIN OF SAFETY FUND is a “société anonyme” with the status of a “Société d’Investissement à Capital Variable” under the Luxembourg law of December 20, 2002 on Collective Investment Undertakings and under the law of August 10, 1915 on Commercial Companies. The Fund is incorporated with limited liability for an unlimited duration. The Fund is submitted to Part I of the Law.

The Fund was incorporated under the name “Margin of Safety Fund Limited” with limited liability on January 19, 1998 in the British Virgin Islands as an open-ended investment company. The decision to transfer the Fund’s head office to the Grand Duchy of Luxembourg was taken by way of a resolution of the Board of Directors dated May 15, 2002, and the Fund was transformed into a Luxembourg SICAV by way of an extraordinary General Meeting held on August 14, 2002. At the same time, preference shares of the Fund were converted into Class B shares of the SICAV.

The Fund is registered under the number B 88649. Its registered office is in Luxembourg, 5, Allée Scheffer, L-2520 Luxembourg.

As from April 28, 2006, the Fund has designated Luxcellence Management Company S.A. as management company in the meaning of article 13 of the Luxembourg law dated December 20, 2002.

As at December 31, 2009 only the sub-fund MARGIN OF SAFETY FUND - Fund 1 is open. This sub-fund has issued four Classes of Shares: Class I (in USD), Class P (in USD), Class HI (in EUR) and Class HP (in EUR). All Classes may be issued as accumulation shares or distribution shares at the investor’s discretion. Class I and Class P shares are also expressed in EUR for the purpose of subscriptions and redemptions.

As at May 12, 2009, the Board of Directors resolved to suppress the classes HI and HP.

The sub-fund is expressed in USD, consequently, the financial statements of the SICAV consist in the financial statements of the Fund 1 sub-fund.

2. Summary of significant accounting principles

The financial statements have been prepared using accounting principles generally accepted for funds in Luxembourg including the following significant accounting policies :

1. Valuation of investments

The value of any transferable securities which are listed on a Stock Exchange or dealt on a regulated market shall be determined according to their last available price. If such prices are not representative of the fair value, securities will be valued at a fair value at which it is expected that they may be resold, as determined in good faith by and under the direction of the Board of Directors.

In the event that any transferable securities held by the Fund at the valuation day are neither quoted on a Stock Exchange nor dealt in on another regulated market, they are valued at their probable realisation value on the relevant Valuation Date, determined prudently and in good faith.

Forward foreign exchange contracts are valued at the previous day closing price.

2. Realised profit and loss on investments

The profits and losses on sales of investments are determined on the basis of average cost.

MARGIN OF SAFETY FUND

Notes to the financial statements at December 31, 2009

2. Summary of significant accounting principles (continued)

3. Foreign exchange

The combined financial statements of the Company are established in USD. The combined financial statements are the sum of the sub-funds' financial statements converted in USD at the rate of exchange ruling at the year end.

The market value of the investments and other assets and liabilities expressed in currencies other than the base currency of each sub-fund have been converted at the exchange rates as at the year end date.

The costs of investments in currencies other than the base currency have been converted at the exchange rates as at the purchase date. Gains and losses arising on foreign exchange transactions are included in the result of operations.

As at December 31, 2009, the following significant exchange rates were used:

1 EUR	=	1.4406 USD	1 CAD	=	0.9522 USD
1 GBP	=	1.6221 USD			

4. Income from investments

Dividends are recognised as income on the date securities are first quoted ex-dividend, to the extent that information thereon is available to the Company. Interest is accrued on a weekly basis.

3. Tax Considerations

Under legislation and regulations currently prevailing in Luxembourg, the Fund is subject to a capital tax on its net assets at an annual rate of 0.05 % ("Taxe d'abonnement"), calculated and payable quarterly on the basis of the value of the net assets of the Fund at the end of the relevant quarter.

4. Management and Management company fees

For its services the Investment Manager receives a management fee payable quarterly, at an annual rate calculated on each Class's quarterly average Net Asset Value. The annual management fees are as follows:

Class I:	maximum 0.90%
Class HI:	maximum 0.90%
Class P:	maximum 2%
	effective 1.80% (since January 1 st , 2008)
Class HP:	maximum 2%
	effective 1.80% (since January 1 st , 2008)

In addition to the management fees, the Fund shall pay a management company fee to the Management Company, payable monthly, at an annual rate of 0.05% per annum with a minimum of EUR 40,000.00 per annum which shall be calculated on the Fund's average Net Asset Value.

As of December 31, 2009, no HI and HP shares were in issue.

5. Performance fees

The Fund shall pay to the Investment Manager an annual performance fee of up to 20% of the annual increase in the aggregate net assets of the Class I shares, Class P shares, Class HI shares and Class HP shares over a 12% annual benchmark as defined in the prospectus. For the year ended December 31, 2009, no performance fee was paid by the Fund.

MARGIN OF SAFETY FUND

Notes to the financial statements at December 31, 2009

6. Open positions on forward exchange rate contracts

At December 31, 2009, MARGIN OF SAFETY FUND - Fund 1 had the following open positions:

Sale	Purchase	Maturity date	Unrealised Appreciation/ Depreciation in USD
-2,956,100.00 EUR	4,400,154.85 USD	12/02/2010	141,812.56
-2,195,500.00 GBP	3,636,406.65 USD	12/02/2010	75,852.64
		TOTAL	217,665.20

7. Statement of changes in Portfolio

The statement of changes in portfolio is available free of charge at the Fund's head office.