



Margin of Safety Fund Limited

Chairman's report and
financial statements

Year ended **31 December 1999**



Margin of Safety Fund Limited

Financial statements

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Margin of Safety Fund Limited

Management and administration

Directors	Franklin Craig John Mills Philip Boylan Gilles Bazy-Sire
Auditor	KPMG Chartered Accountants 5 George's Dock IFSC Dublin 1 Ireland
Secretary and registered office	Midocean Management and Trust Services (BVI) Limited 9 Columbus Centre Pelican Town Road Drive Tortola British Virgin Islands
Custodian and bankers	Fortis Bank Luxembourg S. A. 12-16 Avenue Monterey L-2163 Luxembourg
Investment manager	MS Investment Management Limited 9 Columbus Centre Pelican Drive Road Town Tortola British Virgin Islands
Investment Advisor	Pastel et Associes S.A. 116 Champs Elysees 75008 Paris France
Accounting administrator	BMS 35 Wicklow Street Dublin 2 Ireland

Chairman's report to the shareholders of Margin of Safety Fund Limited

Investment performance

In 1999 the Fund returned 42% in US\$, which was significantly more than its stated benchmark of 15% per annum. Over the same period, the S&P500's performance, with dividends reinvested, was +21.04%.

However comforted we are by this significant outperformance, especially after a difficult inception year in 1998, we must remind our investors that the Fund invests for the long haul and that it is only on a three to five year time horizon that its financial performance should be reasonably assessed.

In 1999, the Fund's investment return resulted from the portfolio's high degree of exposure to a selected group of stocks, in line with the investment methodology developed by our investment advisors, Pastel & Associates S. A. One must single out the following companies as being key contributors to the performance achieved:

- Carpetright (UK) whose stock price moved up by 140% over the year
- DFS (UK) whose stock price moved up by 91% over the year
- Gucci (US) whose in-portfolio performance (computed on the basis of its beginning of the year stock price and the average price at disposal) moved up by 40% over the year
- Manpower (US) whose stock price moved up by 49% over the year
- Premier Farnell (UK) whose stock price moved up by 190% over the year

Review of operations

In 1999, our investment advisors took a limited number of investment actions. However, we believe that the impact of these actions was quite material, both in terms of the structure of the portfolio and in terms of its performance.

We have listed below only what we consider to have been the most significant moves of the year:

- The McDonald's (US), Gucci (US) and SEB (France) stakes were entirely disposed of;
- The positions in Manpower (US) and Premier Farnell (UK), that were started in 1998, were significantly built up;
- New equity positions were added to the portfolio: Charles Baynes (UK), Devro (UK), Fairfax (Canada), Markel (US), Progressive (US), Renold (UK) and Safeway (UK).

All the companies currently present in the portfolio share some common features: they are cash generative and generally enjoy high rates of return on capital and equity. Moreover, their management and/or their board of directors tend to be significant shareholders.

Portfolio structure

At year end, the equity portion of the portfolio was made up of:

- 43% invested in North American securities
- 56% invested in British securities
- 1% invested in French securities

Chairman's report to the shareholders of Margin of Safety Fund Limited

Outlook

As we already stated last year, we won't indulge, here in making market or economic forecasts as we do not consider these to be either reliable or useful with regard to the investment process implemented by the Margin of Safety Fund.

However, we believe that the market prices of most large and profitable companies listed on the major exchanges of North America and Europe remain outrageously high. But at the same time, the constant movement of capital from sector to sector and company to company keeps providing tremendous investment opportunities as periodically the stock prices of very good companies, fallen out of favor, get driven to irrationally low levels.

Regarding the Fund, we consider that no security making up its portfolio is currently overvalued and that most remain undervalued. We remain confident that by keeping to the value oriented methodology implemented by our investment advisors, Pastel & Associates S.A., the Fund will continue to achieve very satisfactory results over the next few years.

Franklin Craig
Chairman



Chartered Accountants

5 George's Dock
IFSC
Dublin 1
Ireland

Auditors' report to the shareholders of Margin of Safety Fund Limited

We have audited the accompanying statement of net assets of Margin of Safety Fund Limited as of December 31, 1999 and the related income statement, statements of changes in shareholders' equity and cashflows for the period ended December 31, 1999. These financial statements are the responsibility of the Fund's directors. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the directors, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, these financial statements present fairly, in all material respects, the financial position of Margin of Safety Fund Limited as of December 31, 1999 and the results of its operations and changes in its shareholders' equity for the period then ended in accordance with International Accounting Standards.

KPMG
Registered auditors
Chartered Accountants

14 March 2000



Margin of Safety Fund Limited

Statement of net assets

as at December 31, 1999

	<i>Note</i>	December 31, 1999 US\$	December 31, 1998 US\$
Assets			
Investments	4	31,992,720	12,757,238
Cash at bank		1,852,777	2,491,563
Accrued dividends		32,330	4,473
Deferred formation expenses		10,453	30,243
Accrued interest		47,442	-
Prepaid fees		150	-
		<hr/>	<hr/>
Total assets		33,935,872	15,283,517
		<hr/>	<hr/>
Liabilities			
Subscriptions received		-	1,000,000
Unsettled trades		-	637,534
Accruals	3	1,448,575	55,160
		<hr/>	<hr/>
Total liabilities		1,448,575	1,692,694
		<hr/>	<hr/>
Net assets		32,487,297	13,590,823
		<hr/>	<hr/>
Shareholders' equity			
Class 'A' preference shares of US\$0.01 each issued and fully paid up		223	133
Share premium		24,018,459	13,281,852
Redemption reserve	8	(282,202)	-
Retained earnings		8,750,817	308,838
		<hr/>	<hr/>
Total shareholders' equity		32,487,297	13,590,823
		<hr/>	<hr/>

The notes on pages 10 to 13 form an integral part of the financial statements.

On behalf of the board

John Mills
Director

Philip Boylan
Director

Margin of Safety Fund Limited

Income statement

for the year ended December 31, 1999

	December 31, 1999	December 31, 1998
	US\$	US\$
Income		
Deposit interest	262,513	208,252
Dividend income	761,585	189,912
Unrealised gain on investments	7,321,380	90,729
Realised gain on investments	1,899,371	1,526
	<u>10,244,849</u>	<u>490,419</u>
Operating expenses		
Management fee	3 311,689	148,532
Directors fees	7,033	-
Incentive fee	3 1,335,386	1,009
Custody fees	17,048	8,990
Accounting and administration fees	38,061	17,552
Operating expenses	47,107	2,061
Formation expenses amortised	19,790	6,787
Audit fees	6,012	6,000
Legal fees	2,000	-
Foreign exchange loss/(gain)	18,744	(9,350)
	<u>1,802,870</u>	<u>181,581</u>
Net income for the period	8,441,979	308,838
Retained earnings at beginning of period	308,838	-
Retained earnings at end of period	<u><u>8,750,817</u></u>	<u><u>308,838</u></u>

The notes on pages 10 to 13 form an integral part of the financial statements.

Margin of Safety Fund Limited

Statement of changes in shareholders' equity

for the year ended December 31, 1999

	December 31, 1999 US\$	December 31, 1998 US\$
Shareholders' equity - beginning of year	13,590,823	-
Shares issued during the year	10,736,697	13,281,985
Shares redeemed during the year	(282,202)	-
	<hr/>	<hr/>
Capital	24,045,318	13,281,985
Net income for the year	8,441,979	308,838
	<hr/>	<hr/>
Shareholders' equity - end of year	32,487,297	13,590,823
	<hr/> <hr/>	<hr/> <hr/>
Outstanding class 'A' preference shares	22,313.11	13,256.79
	<hr/> <hr/>	<hr/> <hr/>
Net asset value per share at end of year	1,455.97	1,025.20
	<hr/> <hr/>	<hr/> <hr/>

The notes on pages 10 to 13 form an integral part of the financial statements.

Margin of Safety Fund Limited

Statement of cashflows

for the year ended December 31, 1999

	December 31, 1999 US\$	December 31, 1998 US\$
Cash flow from operating activities		
Net income for the period	8,441,979	308,838
Adjustment for:		
Unrealised gain on investments	(7,321,380)	(90,729)
Realised gain on investments	(1,899,371)	(1,526)
Formation expenses amortised	19,790	6,787
Add/(deduct)		
Purchase of investments	(17,718,507)	(12,051,570)
Proceeds from sale of investments	6,784,040	24,121
Increase in accrued dividends	(27,857)	(4,473)
Formation expenses incurred	-	(37,030)
Increase in accrued interest	(47,442)	-
Increase in prepaid fees	(150)	-
Increase in management fees due	48,082	40,768
Increase in accruals	10,956	13,383
Increase in incentive fees due	1,334,377	1,009
	<hr/>	<hr/>
Cash flow from financing activities	(10,375,483)	(11,790,422)
Proceeds from the issue of share capital	9,736,697	14,281,985
	<hr/>	<hr/>
(Decrease)/increase in cash and cash equivalents	(638,786)	2,491,563
	<hr/> <hr/>	<hr/> <hr/>



Margin of Safety Fund Limited

Schedule of Investments as at December 31, 1999

Quantity or principal	Description	Market value (US\$)	% of total assets
Equities (all listed)			
89,270	Nike Inc - B Shares (US\$)	4,424,444	13.04%
1,092,200	Premier Farnell (GBP)	8,106,175	23.89%
641,033	DFS Furniture Company (GBP)	3,693,522	10.90%
113,500	Manpower Inc (US\$)	4,270,438	12.58%
54,350	Arrow Electronics (US\$)	1,455,255	4.29%
5,995	Thermador (Euro)	276,432	0.81%
269,200	Carpwright (GBP)	2,329,880	6.86%
1,700,000	Brazil Bond (US\$)	1,098,625	3.25%
269,500	Harvey's Furnishings (GBP)	658,045	1.93%
369,000	Devro (GBP)	603,638	1.77%
4,810	Markel (US\$)	745,550	2.20%
636,000	Charles Baynes (GBP)	486,895	1.43%
3,065	Fairfax Financial Holdings (CAD)	521,020	1.54%
275,000	Renold (GBP)	449,866	1.33%
15,000	Walt Disney (US\$)	438,750	1.29%
282,500	Safeway (GBP)	965,247	2.84%
31,900	Leucadia (US\$)	737,688	2.17%
10,000	Progressive Corp. (US\$)	731,250	2.15%
		<hr/>	<hr/>
		31,992,720	94.27%
		<hr/>	<hr/>
	Other assets	1,943,152	5.73%
		<hr/>	<hr/>
		33,935,872	100%
		<hr/> <hr/>	<hr/> <hr/>



Margin of Safety Fund Limited

Notes

forming part of the financial statements

1 Organisation and nature of business

Margin of Safety Fund Limited (“the Company”), a limited liability company, was incorporated as an international business company on 19 January 1998 under the laws of the British Virgin Islands.

The company was established to achieve capital appreciation through investments primarily in equity securities.

2 Summary of significant accounting policies

These financial statements are prepared in accordance with International Accounting Standards and are expressed in United States dollars, “US\$”.

Use of estimates

The preparation of the financial statements in conformity with International Accounting Standards requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates.

Investments

Investments are valued at last sale price on the date of valuation.

Unrealised gains or losses on investments represents the annual appreciation or depreciation in the holdings of those investments. Any movements in unrealised gains and losses are recorded in the income statement. Losses realised on original cost are recorded in the income statement in the period of sale.

Income taxes

Under current British Virgin Islands legislation, the fund is not subject to income tax.

Margin of Safety Fund Limited

Notes (continued)

2 Summary of significant accounting policies (continued)

Income

Dividends, net of foreign withholding taxes, where applicable, are included as income when the security is declared to be ex-dividend. Interest is recorded on the accruals basis.

Foreign currency

Assets and liabilities denominated in foreign currencies are translated into United States dollars at exchange rates prevailing at the period end date. Transactions in foreign currencies are translated at the rate ruling on the date of the transaction. Gains and losses on foreign currency translation are included in the income statement as part of the net realised and unrealised gain/(loss) on investment.

Formation expenses

Formation expenses are written off on a pro-rata basis until 30 June 2000.

3 Incentive and management fees, administrative and custodian fees

The Fund's investment manager is MS Investment Management Limited (the "Manager"), a company licensed in the British Virgin Islands. The manager receives a monthly fixed fee of 1.25% per annum of the net assets of the Class 'A' preference shares. The manager also receives a performance fee of 20% of the annual increase in the aggregate net asset value of Class 'A' preference shares over a 15% annual benchmark as defined in the prospectus. The management fee for the year amounted to US\$311,689 (1998 US\$148,532) and the incentive fee to US\$ 1,335,386 (1998 US\$1,009). Management fees payable at year end were US\$ 88,850 (1998 US\$40,768) and incentive fees payable were US\$1,335,386 (1998 US\$1,000).

The accounting administrator is paid a fixed fee of 0.15% p.a. on the aggregate net asset value of the fund per Class 'A' preference shares subject to a minimum of US\$6,000. The custodian is paid a fixed fee of 0.08% pa effective from 1 July 1999, on the average aggregate assets of the class 'A' preference shares held over the dealing period by the custodian. Prior to 1 July 1999 the percentage was 0.1%.

4 Investments

Investments held at year end are valued at US\$31,992,720 (1998 US\$12,757,238) compared with a cost of US\$24,580,611 (1998 US\$12,666,509). Investments are comprised of equities. (See schedule of investments)

Margin of Safety Fund Limited

Notes (continued)

5 Shareholders' equity

Investments in the Fund are made monthly by subscription agreement subject to acceptance by the Fund, at the net asset value per share at the end of the month. A shareholder may request and receive redemption of Class "A" preference shares on any dealing day upon 15 days notice.

Authorised	1999 US\$	1998 US\$
1,000,000 ordinary shares of US\$0.01 each	10,000	10,000
1,000,000 preference 'A' shares of US\$0.01 each	10,000	10,000
1,000,000 preference 'B' shares of US\$0.01 each	10,000	10,000
1,000,000 preference 'C' shares of US\$0.01 each	10,000	10,000
	<hr/>	<hr/>
	40,000	40,000
	<hr/> <hr/>	<hr/> <hr/>
 Issued and fully paid up		
2 ordinary shares of US\$0.01 each	-	-
Class 'A' preference shares of US\$0.01 each	223	133
	<hr/>	<hr/>
	223	133
	<hr/> <hr/>	<hr/> <hr/>
 Share premium		
Class A preference shares	24,018,459	13,281,852
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Ordinary shares carry the right to vote and will participate upon a winding up of the company only in the surplus remaining after the payment to the preference shareholders and only to the extent of the par value of the ordinary shares.

Preference shareholders shall in the event of a winding up of the company, have a preferred claim in respect of the assets of the company and shall have divided between them the surplus remaining after the payment to the ordinary shareholders. Preference shareholders have restricted voting rights.

Margin of Safety Fund Limited

Notes (*continued*)

6 Fair values and financial instruments

Substantially all of the Company's financial instruments are carried at market value or at amounts which, because of their short-term nature, approximate current fair value.

Fair value estimates are made at a specific point in time, based on market conditions and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Credit risk is the risk that one party to a financial instrument will fail to discharge on obligation and cause the other party to incur financial loss. The company invests mainly in blue chip equities. Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The company invests in denominations of US dollars, Sterling pounds and French francs. However, whilst using its best endeavours to attain the investment objective as stated in note 1, the Board of directors cannot guarantee the extent to which this objective can be achieved. The investments of the fund are subject to normal market fluctuations and other inherent risks and there can be no assurance than any appreciation in value will occur.

7 Related party transactions

One of the directors of the company is a partner in an international law firm who were retained in the formation of the company. Legal fees of US\$25,000 incurred in the formation of the company were paid to the law firm.

The accounting administrator has a director in common with the Company. Details of fees paid are disclosed in note 3.

The investment adviser, Pastel et Associes S. A., holds 192 shares in the Company.

No further material contracts or contracts for provisions of services existed during the period under review to which the Company is a party and in which any director was materially interested.

8 Redemption reserve

The redemption reserve arises on the redemption of class 'A' preference shares by the shareholders. This reserve relates to the difference between the amount of share premium a shareholder pays on subscription and the amount that is repaid when that same subscription is redeemed.

9 Approval of financial statements

The board of directors approved these financial statements on 14 March 2000.