



# MARGIN OF SAFETY FUND

Audited annual report

at 31/12/03

## 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

39, Allée Scheffer  
L-2520 Luxembourg

#### INVESTMENT MANAGER

Pastel & Associés S.A.  
10, rue du Colisée  
F-75008 Paris

#### PROMOTOR

Crédit Agricole Indosuez Luxembourg S.A.  
(until 28/02/03)  
Crédit Agricole Investor Services Bank Luxembourg S.A.  
(from 01/03/03)  
39, Allée Scheffer  
L-2520 Luxembourg

#### CO-PROMOTOR

Pastel & Associés S.A.  
10, rue du Colisée  
F-75008 Paris

#### AUDITOR

KPMG Audit  
31, Allée Scheffer  
L-2520 Luxembourg

#### CUSTODIAN AND

#### CENTRAL ADMINISTRATION AGENT

Crédit Agricole Indosuez Luxembourg S.A.  
(until 28/02/03)  
Crédit Agricole Investor Services Bank Luxembourg S.A.  
(from 01/03/03)  
39, Allée Scheffer  
L-2520 Luxembourg

### Board of Directors

#### Chairman of the Board

M. Jean-Marie RINIE, Senior Sales Manager - Financial Services, Vice-President  
Crédit Agricole Investor Services Bank Luxembourg S.A. (from 14/05/2003)

#### Members of the Board

M. José-Benjamin LONGREE, Head of Sales CRM & Head of Fund Structuring - Europe,  
First Vice-President, Crédit Agricole Investor Services Bank Luxembourg S.A.

M. John MILLS, Managing Director,  
Maitland J. Co. Sàrl (from 28/07/03)

M. David PASTEL, CEO Investment Manager,  
Pastel & Associés S.A.

# MARGIN OF SAFETY FUND

## Manager's Report

### Investment performance Margin of Safety Fund – Fund 1

(cumulative figures after all fees and expenses)

#### Class B shares

	1998	1999	2000	2001	2002	2003	Cumulative performance since inception	6 years annualized rate of return
USD	2.5%	42.0%	15.1%	5.7%	-12.0%	44.6%	125.4%	14.7%
EUR	-5.2%	66.4%	22.9%	11.4%	-25.3%	20.1%	93.8%	11.8%
15% Benchmark	13.7%	15.0%	15.0%	15.0%	15.0%	15.0%	128.6%	15.0%
MSCI World in USD	21.4%	25.3%	-12.9%	-16.5%	-19.5%	33.8%	19.0%	3.0%
MSCI World in EUR	12.5%	46.8%	-7.0%	-12.0%	-31.7%	11.3%	2.7%	0.5%

All performance figures have been computed on the basis of a December 31<sup>st</sup> year-end which may differ from the last valuation day of the year.

For 1998, the period used for computation covers only 11 months from the fund's inception date, on February 2<sup>nd</sup>, 1998, to the year-end.

#### Class A shares

The Fund had only one class of investor shares until August 16, 2002, on which date the first Class A shares were issued. From August 16<sup>th</sup>, 2002, to December 31<sup>st</sup>, 2003 the performance of the Class A shares was 34.6% in USD and 4.7% in €. The performance of the Class A shares for the year ended December 31, 2003 was 37.5% in USD.

### Review of operations

In 2003, the Fund recouped a large chunk of its 2002 negative performance. Although it is still trailing its long term 15% benchmark, it has significantly reduced the gap as shown in the table above. Moreover it again outperformed the MSCI world index by a wide margin (see table).

So much for our track record. But 2003 was also a meaningful year with regard to the Fund's portfolio as it underwent a number of important changes. In fact, the ongoing market volatility provided us with numerous opportunities to improve the risk-return profile of the portfolio.

New investments were made in companies such as Kone (Finland), Ryanair (Ireland) in the euro-zone, Dixons and Sage in the UK, and Ethan Allen, Home Depot, Target and TJX for the US. At the same time, we increased the size of existing positions (Accor and Electrocomponents) while entirely disposing of the Fund's investments in companies such as Boots, DFS Furniture, Pizza Express and Six Continents in the UK and McDonald's and Timberland in the US. We also, as the year went by, decreased the Fund's exposure to the British banking sector (Abbey National, HBOS, and Lloyds TSB).

As already mentioned in our half year report, Sterling-denominated portfolio assets were partially hedged back into the US Dollar through forward currency sales.

# MARGIN OF SAFETY FUND

## Manager's Report

### Portfolio structure

The portfolio structure by asset class was on December 31<sup>st</sup>, 2003, as follows:

	Portfolio
- Euro Zone:	35%
- United Kingdom:	33%
- United States:	23%
- Fixed income:	<u>9%</u>
	100%

At year end, the main equity holdings of the Fund were (expressed as a percentage of total assets):

- Accor (France):	4.7%
- Electrocomponents (UK):	6.1%
- Hunter Douglas (Netherlands Antilles):	8.2%
- Premier Farnell (UK):	8.6%
- Randstad (Netherlands):	9.6%

### Outlook

Although we have no opinion about the rate of return the Fund will achieve in 2004, we trust that, barring any adverse development, it will, over the next three to five years, obtain a level of performance comparable to what it has achieved in the past.

This outcome should primarily result from the implementation of our investment methodology whose core principles we shall now reiterate:

- We focus on a few, carefully screened and researched companies that tend to share some common features such as a good and historically profitable business and a competent and honest management.
- We demand that a significant margin of safety be present, at the time of purchase, in every one of our investments.
- We do not shift course and dispose of or increase some of our holdings because of changes in macro-economic or financial market expectations. In fact, we do not harbor any kind of expectations as to where the economy or the markets are supposed to go.

As the Fund is about to enter its seventh year in existence, please let me thank you for your continuing trust and support.

No dividend will be declared for the year under review.

David Pastel,  
Pastel&Associés S.A.

# MARGIN OF SAFETY FUND

## **Independent Auditor's Report**

To the Shareholders of  
MARGIN OF SAFETY FUND  
39, Allée Scheffer  
L – 2520 LUXEMBOURG

We have audited the financial statements, which consist of the statement of net assets, the securities portfolio, the statement of operations and changes in net assets and the notes to the financial statements of MARGIN OF SAFETY FUND (the "SICAV") at December 31, 2003. These financial statements are the responsibility of the Board of Directors of the SICAV. 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 Board of Directors of the SICAV in preparing the financial statements, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the attached financial statements give, in conformity with Luxembourg legal and regulatory requirements, a true and fair view of the financial position of MARGIN OF SAFETY FUND at December 31, 2003 and the results of its operations and changes in its net assets for the year then ended.

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. We have no observation to make concerning such information in the context of the financial statements taken as a whole.

Luxembourg, April 12, 2004

KPMG Audit  
Réviseurs d'Entreprises

Nathalie Dogniez  
Partner

Patrice Perichon  
Director

**MARGIN OF SAFETY FUND - Fund 1**  
**Financial Statements at 31/12/03**

Statement of net assets at 31/12/03

*Expressed in USD*

Assets			<b>28,127,960.17</b>
Securities portfolio at market value	Note 2		25,604,238.58
<i>Cost price</i>			<i>18,880,178.50</i>
<i>Unrealised profit on the securities portfolio</i>			<i>6,724,060.08</i>
Cash at banks and liquidities			5,993.11
Time deposits			2,424,000.00
Interest receivable			94.27
Brokers receivable			40,487.31
Other assets			53,146.90
Liabilities			<b>913,754.24</b>
Accrued advisory fees	Note 6		73,899.90
Unrealised loss on forward foreign exchange contracts	Note 7		787,012.55
Other liabilities			52,841.79
Net asset value			<b>27,214,205.93</b>

Changes in number of shares outstanding from 01/01/03 to 31/12/03

	Shares outstanding at 01/01/03	Shares issued	Shares redeemed	Shares outstanding at 31/12/03
Class A				
Capitalisation shares	107.94	118.26	1.40	224.80
Class B				
Capitalisation shares	11,115.71	7,850.31	7,107.07	11,858.95

Key figures relating to the last 3 years

	<i>Year ending at:</i>	<b>31/12/03</b>	<b>31/12/02</b>	<b>31/12/01</b>
Total Net Assets	USD	27,214,205.93	17,495,797.86	19,834,836.00
<b>Class A</b>		USD	USD	USD
<b>Capitalisation shares</b>				
Number of shares		224.80	107.94	-
Net asset value per share		2,128.38	1,548.45	-
<b>Class B</b>		USD	USD	USD
<b>Capitalisation shares</b>				
Number of shares		11,858.95	11,115.71	11,200.37
Net asset value per share		2,254.48	1,558.93	1,770.91

# MARGIN OF SAFETY FUND - Fund 1

## Securities portfolio at 31/12/03

Expressed in USD

Quantity	Denomination	Quotation currency	Market value	% of net assets
Transferable securities admitted to an official stock exchange listing			25,604,238.58	94.08%
<b>Shares</b>			<b>25,604,238.58</b>	<b>94.08%</b>
	<i>Belgium</i>		<i>1,273,710.24</i>	<i>4.68%</i>
13,200	ETABLISSEMENTS FR COLRUYT SA	EUR	1,273,710.24	4.68%
	<i>Finland</i>		<i>697,643.31</i>	<i>2.56%</i>
12,140	KONE OY -B-	EUR	697,643.31	2.56%
	<i>France</i>		<i>2,049,545.88</i>	<i>7.53%</i>
28,400	ACCOR SA	EUR	1,287,704.28	4.73%
16,000	MANUTAN INTERNATIONAL	EUR	761,841.60	2.80%
	<i>Ireland</i>		<i>817,518.40</i>	<i>3.00%</i>
98,222	RYANAIR HOLDINGS PLC	EUR	817,518.40	3.00%
	<i>The Netherlands</i>		<i>2,617,657.10</i>	<i>9.62%</i>
107,778	RANDSTAD HOLDING	EUR	2,617,657.10	9.62%
	<i>The Netherlands Antilles</i>		<i>2,244,413.47</i>	<i>8.25%</i>
47,886	HUNTER DOUGLAS	EUR	2,244,413.47	8.25%
	<i>United Kingdom</i>		<i>9,371,561.46</i>	<i>34.44%</i>
90,000	ABBAY NATIONAL PLC	GBP	856,395.70	3.15%
55,500	CARPETRIGHT	GBP	823,991.90	3.03%
447,000	DIXONS GROUP	GBP	1,113,421.93	4.09%
289,790	ELECTROCOMPONENTS	GBP	1,687,734.79	6.20%
56,886	HBOS	GBP	737,532.87	2.71%
98,500	LLOYDS TSB GROUP PLC	GBP	790,772.75	2.91%
560,000	PREMIER FARNELL PLC	GBP	2,350,742.58	8.64%
321,000	SAGE GROUP	GBP	1,010,968.94	3.71%
	<i>United States of America</i>		<i>6,532,188.72</i>	<i>24.00%</i>
23,764	AMERICAN EXPRESS CO COM.	USD	1,146,137.72	4.21%
6,000	AUTOMATIC DATA PROCESSING INC	USD	237,660.00	0.87%
14,000	ETHAN ALLEN INTERIORS INC	USD	586,320.00	2.15%
14,900	HOME DEPOT INC	USD	528,801.00	1.94%
21,900	LEUCADIA NATIONAL CORP	USD	1,009,590.00	3.71%
26,500	MANPOWER INC	USD	1,247,620.00	4.58%
18,000	TARGET	USD	691,200.00	2.54%
49,200	TJX COS INC	USD	1,084,860.00	3.99%
<b>Total securities portfolio</b>			<b>25,604,238.58</b>	<b>94.08%</b>



**MARGIN OF SAFETY FUND - Fund 1**  
**Statement of Operations and Changes in Net Assets from 01/01/03 to 31/12/03**

*Expressed in USD*

Income			<b>621,070.10</b>
Net dividends			609,028.12
Bank interest on cash account			0.68
Bank interest on time deposits			12,041.30
Expenses			<b>400,857.51</b>
Management & advisory fees	Note 4		263,114.78
Custodian & sub-custodian fees	Note 5		16,804.21
Taxe d'abonnement	Note 3		10,639.35
Administrative expenses	Note 5		21,908.85
Incentive and performance fees	Note 4		22,714.17
Professional fees			16,434.87
Bank interest on overdrafts			2.08
Legal fees			13,958.45
Other expenses			35,280.75
Net income from investments			<b>220,212.59</b>
Net realised profit on sales of investment securities			1,506,284.10
Net realised loss on foreign exchange			-21,875.17
Net realised loss on forward foreign exchange contracts			-87,556.70
Net realised profit			<b>1,617,064.82</b>
Movement in net unrealised appreciation / depreciation on forward foreign exchange contracts			-787,012.55
Movement in net unrealised appreciation / depreciation on investments			7,177,940.88
Increase in net assets as a result of operations			<b>8,007,993.15</b>
Subscription capitalisation shares			17,349,400.68
Class A			179,067.10
Class B			17,170,333.58
Redemption capitalisation shares			-15,638,985.76
Class A			-2,357.39
Class B			-15,636,628.37
Increase in net assets			<b>9,718,408.07</b>
Net assets at the beginning of the year			<b>17,495,797.86</b>
Net assets at the end of the year			<b>27,214,205.93</b>

# *MARGIN OF SAFETY FUND*

## **Notes to the financial statements**

# MARGIN OF SAFETY FUND

## Notes to the financial statements at December 31, 2003

### 1. General

**MARGIN OF SAFETY FUND** is a “Société d’Investissement à Capital Variable” (SICAV) with multiple Sub-Funds under the laws of the Luxembourg law of March 30, 1988 (part I) on Collective Investment Undertakings (the Law) and under the law of August 10, 1915 on Commercial Companies. The Fund complies with the requirements of the UCITS Directive EC 85/611. From February 13, 2004 the Fund falls under the scope of the UCITS Directive EC 2001/108.

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 15 May, 2002, and the Fund was transformed into a Luxembourg SICAV by way of an extraordinary General Meeting held on 14 August, 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, 39, Allée Scheffer, L-2520 Luxembourg.

As at December 31, 2003, only the sub-fund MARGIN OF SAFETY FUND - Fund 1 is open. This sub-fund has issued two Classes of Shares: Class A and Class B. Both Classes A and B may be issued as accumulation shares or distribution shares at the investor’s discretion.

### 2. Summary of significant accounting principles

The financial statement have been prepared using accounting principles generally accepted for such 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.

#### **2. Realised profit and loss on investments**

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

#### **3. Foreign exchange**

The combined financial statements of the Company are established in USD. The combined financial statements are the sum of the sub-fund’s financial statements converted into USD at the rates 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.

## MARGIN OF SAFETY FUND

### Notes to the financial statements at December 31, 2003

#### 2. Summary of significant accounting principles (continued)

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, 2003, the following significant exchange rates were used:

1 EUR	=	1.2630000 USD
1 GBP	=	1.7919977 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, Advisory and Performance fees

For its services the Investment Manager receives from the Sub-Funds a management fee payable quarterly, at an annual rate calculated on the Class's quarterly average Net Asset Value.

The maximum rate for Class A is 1.70% and for Class B is 1.15% since September 2, 2003 and 1.50% and 1.15% before this date.

The Sub-Fund shall pay to the Investment Manager an annual performance fee of up to 20% of the annual increase in the annual increase in the aggregate net assets of the Class A shares and Class B shares over a 15% annual benchmark as defined in the prospectus.

For the year ended December 31, 2003 an incentive fee amounted to 22,714.17 USD was calculated from the Class A shares.

#### 5. Custodian and administration fees

The Custodian may receive from the Company a custodian fee accrued monthly and payable monthly in arrears based on the monthly Net Asset Value of the Company.

The Administrator receives from the Company an administration fee accrued monthly and payable monthly in arrears based on the monthly Net Asset Value of the Company.

#### 6. Accrued advisory fees

Each Class will have to pay:

Class A	1,862.59	USD
Class B	72,037.31	USD
<b>Total</b>	<u>73,899.90</u>	USD

## MARGIN OF SAFETY FUND

### Notes to the financial statements at December 31, 2003

#### 7. Open positions on forward exchange rate contracts

At 31/12/03, MARGIN OF SAFETY FUND - Fund 1 had the following open positions:

Purchase	Sale	Agreement date	Maturity date	Unrealised Appreciation/ Depreciation in USD
USD 5,528,600.00	GBP 3,500,000.00	22/07/2003	23/01/2004	-734,819.40
USD 205,687.50	GBP 125,000.00	30/09/2003	23/01/2004	-18,006.05
USD 413,200.00	GBP 250,000.00	13/10/2003	23/01/2004	<u>-34,187.10</u>
			TOTAL	-787,012.55

#### 8. Co-management

In order to reduce operational and administrative charges while allowing a wider diversification of investments, the Company may decide that part or all of its assets will be co-managed with the assets belonging to other collective investment schemes.

Each Co-Managed Entity hold a proportion of the Co-Managed Assets corresponding to the proportion of its net assets to the total value of the Co-Managed Assets.

The fractions appearing at the end of the securities portfolios are generated by the technique of co-management. The value of the fractions are based on the market value of the corresponding equity at period end.

In 2003, the SICAV did not use the co-management's facility and has no plans in the near future to do so.

#### 9. Depositary Bank

From 1<sup>st</sup> March 2003, any references to Crédit Agricole Indosuez Luxembourg S.A. (CAIL) in the prospectus will be understood as Crédit Agricole Investor Services Bank Luxembourg S.A. (CAISBL), the Luxembourg Company resulting from the division of Crédit Agricole Indosuez Luxembourg on 28<sup>th</sup> February 2003. CAISBL will keep the same contact details as CAIL.

#### 10. Statement of change in Portfolio

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