



# MARGIN OF SAFETY FUND

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

Audited annual report

as at 31/12/11

# 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 Luxembourg 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.  
(until April 14, 2011)

## 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 of the scope of the Law for the realised and distribution income:

MARGIN OF SAFETY FUND - Fund 1 with 7.79% of its assets invested in debt-claims.

This update has been effective from May 2, 2011 and will remain in force until April 30, 2012 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 I shares

In 2011, the Fund's NAV decreased by 19.0%, resulting in a cumulative performance since inception on February 2, 1998, of 207.7%. As a result, while \$1,000 invested at inception in Margin of Safety Fund I Class (USD) would now be worth \$3,077 the same \$1,000 invested in the MSCI World index in USD (with dividends reinvested) would now equal \$1,662.

#### Class P shares

In 2011, the Fund's NAV decreased by 19.7%, resulting in a cumulative performance since inception on February 2, 1998, of +217.2%. As a result, while \$1,000 invested at inception in Margin of Safety Fund P Class (USD) would now be worth \$3,172, the same \$1,000 invested in the MSCI World index in USD (with dividends reinvested) would now equal \$1,662.

### **Management report**

We have rarely seen a year so full of upheavals, from geo-politics (the Arab spring) and finance (crisis in the euro zone, downgrading of the US government's credit rating) to nature (earthquake in Japan, floods in Thailand). Rarely also has the future seemed so uncertain, with presidential elections due to take place in a number of countries in 2012, including Russia, the United States and France, as well as the heightened risk of a new recession in Europe, spurred by a weakened single currency.

Against that backdrop, several major financial markets (notably Frankfurt and Paris) ended 2011 in the red. But there was a silver lining to this predicament, as the stocks of many great companies were, once again, made available at very attractive prices.

The performance of your fund was negative over the year and below that of its benchmark. However disappointing, 2011 is simply one episode in the history of your fund. It is managed for the long run, and its results should be assessed as such.

Our methodology, implemented by our team of managers for more than 15 years, results in highly concentrated portfolios of great companies, with geographical and sector weightings very different from their benchmarks, together with a very low turnover rate for the main positions.

Under such circumstances, it is hardly surprising that our funds' performance might diverge from their benchmarks' over time periods as short as a year.

## MARGIN OF SAFETY FUND

### Manager's Report (Continued)

Furthermore, since Pastel & Associés' inception in late 1997, such short-term underperformance has befallen our funds on more than one occasion. This occurred in 1998, over the last six months of 2002, and in 2007-2008 (refer to our past annual letters, which may be accessed on our Web site).

Each time, our funds bounced back strongly, not only outperforming the stock markets but also providing significant appreciation of capital, even over long periods of market stagnation (1998-2011). Of course, it is true that, to reiterate the customary warning, "past performance is no guarantee of future results." However, our strong performance in the past did not come about by accident and cannot be attributed to a temporary fit between an investment style and specific economic and financial conditions. On the contrary, it is the result of a rational and replicable approach, implemented by our team with discipline and consistency. Just as our confidence in this methodology remains unshaken, we are also confident in potential of your fund to outperform markets and benchmarks over the long term\*.

#### Evolution of the portfolio structure in 2011

In 2011, the structure of the portfolio underwent a certain number of changes.

During the year, new positions were built or reinforced such as Debenhams Plc, Hays and Legrand.

At the same time, a number of positions were entirely or partially disposed of, such as Best Buy, Persimmon and Cintas Corp.

As a result of these transactions, the Fund's equity portion represented 96.34% 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, 2011, the geographic breakdown of the Fund's portfolio, before currency hedging, was as follows (2010 figures are provided for comparison purposes):

	2011	2010
- United States:	38.3%	47.9%
- United Kingdom:	37.8%	33.1%
- Euro Zone:	23.9%	19.0%

MARGIN OF SAFETY FUND  
**Manager's Report (Continued)**

As of December 31, 2011, the breakdown by industry sector of the equity portion of the Fund's portfolio was as follows (2010 figures are provided for comparison purposes)\*\*:

	2011	2010
- Business to business services:	43.2%	39.6%
- Durable goods:	5.2%	5.4%
- Consumer staples:	5.2%	0.0%
- Financial services:	4.6%	9.0%
- Food Retailing:	2.5%	0.0%
- Industrials:	12.6%	16.0%
- Holdings:	11.5%	9.3%
- Non-food retailing:	15.2%	20.7%

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.

\*\*Following classification changes, 2010 figures provided herein may differ from last year's report.

# MARGIN OF SAFETY FUND

## Report of the Réviseur d'Entreprises agréé

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

We have audited the accompanying financial statements of **MARGIN OF SAFETY FUND**, which comprise the Statement of net assets and the Securities portfolio as at December 31, 2011 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 information.

### *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, and for such internal control as the Board of Directors of the SICAV determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Responsibility of the Réviseur d'Entreprises agréé*

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 for Luxembourg by the Commission de Surveillance du Secteur Financier. 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 agréé, 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 agréé 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.

## MARGIN OF SAFETY FUND

### Report of the reviseur d'entreprises agréée (Continued)

#### *Opinion*

In our opinion, the financial statements give a true and fair view of the financial position of **MARGIN OF SAFETY FUND** as of December 31, 2011, 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.

#### *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, April 25, 2012

KPMG Luxembourg S.à r.l.  
Cabinet de révision agréé

Nathalie Dogniez  
Partner

# *MARGIN OF SAFETY FUND*

**- Fund 1**

**MARGIN OF SAFETY FUND - Fund 1**  
**Financial Statements as at 31/12/11**

Statement of net assets as at 31/12/11

*Expressed in USD*

<b>Assets</b>			<b>12,120,234.45</b>
	Securities portfolio at market value	Note 2	11,610,400.01
	<i>Cost price</i>		<i>13,571,025.46</i>
	<i>Unrealised loss on the securities portfolio</i>		<i>-1,960,625.45</i>
	Cash at banks and liquidities		252,562.65
	Brokers receivable		26,949.84
	Unrealised profit on forward foreign exchange contracts	Note 6	195,602.79
	Other assets		34,719.16
<b>Liabilities</b>			<b>68,367.73</b>
	Accrued management fees and management company fees	Note 4	36,367.99
	Other liabilities		31,999.74
<b>Net asset value</b>			<b>12,051,866.72</b>

Changes in number of shares outstanding from 01/01/11 to 31/12/11

	Shares outstanding as at 01/01/11	Shares issued	Shares redeemed	Shares outstanding as at 31/12/11
Class I				
Capitalisation shares	4,296.77	44.25	850.00	3,491.02
Class P				
Capitalisation shares	348.94	208.00	143.40	413.54

Key figures relating to the last 3 years

	<i>Year ending as at:</i>	<b>31/12/11</b>	<b>31/12/10</b>	<b>31/12/09</b>
Total Net Assets	USD	12,051,866.72	17,700,023.83	19,688,818.48
<b>Class I</b>		USD	USD	USD
<b>Capitalisation shares</b>				
Number of shares		3,491.02	4,296.77	5,763.77
Net asset value per share		3,076.54	3,798.49	3,239.19
<b>Class P</b>		USD	USD	USD
<b>Capitalisation shares</b>				
Number of shares		413.54	348.94	299.67
Net asset value per share		3,171.60	3,951.42	3,399.99

# MARGIN OF SAFETY FUND - Fund 1

## Securities portfolio as at 31/12/11

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			11,610,400.01	96.34%
<b>Shares</b>			<b>11,610,400.01</b>	<b>96.34%</b>
	<i>Austria</i>			
2,623.00	MAYR-MELNHOF KARTON AG	EUR	223,064.66	1.85%
	<i>Canada</i>			
18,200.00	LEON'S FURNITURE LT	CAD	221,633.69	1.84%
	<i>Finland</i>			
52,866.00	UPONOR OYJ	EUR	470,788.07	3.91%
	<i>France</i>			
7,115.00	CIMENT VICAT SA	EUR	935,924.40	7.77%
4,102.00	FONCIERE FINANCIERE PART. ACT NOM.	EUR	408,292.29	3.40%
11,300.00	LEGRAND SA	EUR	163,105.10	1.35%
	<i>The Netherlands</i>			
38,564.00	RANDSTAD HOLDING	EUR	364,527.01	3.02%
	<i>United Kingdom</i>			
75,272.00	CARPETRIGHT PLC	GBP	1,144,414.04	9.50%
519,000.00	DEBENHAMS PLC	GBP	1,144,414.04	9.50%
171,069.00	ELECTROCOMPONENTS PLC	GBP	4,391,013.32	36.43%
1,151,242.00	HAYS	GBP	561,509.48	4.66%
33,300.00	PERSIMMON PLC	GBP	472,255.10	3.92%
419,566.00	PREMIER FARNELL PLC	GBP	500,349.34	4.15%
46,749.00	TESCO PLC	GBP	1,146,851.14	9.52%
	<i>United States of America</i>			
47,100.00	CHARLES SCHWAB CORP/THE	USD	243,234.12	2.02%
16,355.00	CINTAS CORP	USD	1,173,694.82	9.73%
3,150.00	COLGATE-PALMOLIVE CO	USD	293,119.32	2.43%
51,370.00	LEUCADIA NATIONAL CORP	USD	4,223,561.83	35.04%
20,126.00	LOWE'S COMPANIES INC	USD	530,346.00	4.40%
6,031.00	MOHAWK INDUSTRIES INC	USD	569,317.55	4.72%
16,365.00	PATTERSON COS INC	USD	291,028.50	2.41%
4,645.00	PROCTER AND GAMBLE CO	USD	1,168,153.80	9.69%
			510,797.88	4.24%
			360,955.35	3.00%
			483,094.80	4.01%
			309,867.95	2.57%
<b>Total securities portfolio</b>			<b>11,610,400.01</b>	<b>96.34%</b>

# MARGIN OF SAFETY FUND - Fund 1

Statement of operations and changes in net assets from 01/01/11 to 31/12/11

*Expressed in USD*

Income		<b>402,793.10</b>
Net dividends		401,779.36
Bank interest on time deposits		1,013.74
Expenses		<b>394,689.13</b>
Management & management company fees	Note 4	215,901.89
Custodian & sub-custodian fees		13,061.10
Taxe d'abonnement	Note 3	7,506.92
Administrative expenses		18,240.00
Domiciliation fees		8,600.00
Professional fees		23,361.31
Legal fees		21,573.01
Transaction fees	Note 2	74,509.01
Other expenses		11,935.89
Net income from investments		<b>8,103.97</b>
Net realised profit / loss on:		
- sales of investment securities		290,293.99
- forward foreign exchange contracts		117,239.57
- foreign exchange		-180,790.56
Net realised profit		<b>234,846.97</b>
Movement in net unrealised appreciation / depreciation on:		
- investments		-3,661,094.23
- forward foreign exchange contracts		-69,786.57
Decrease in net assets as a result of operations		<b>-3,496,033.83</b>
Subscription capitalisation shares		954,362.40
Class I		173,479.47
Class P		780,882.93
Redemption capitalisation shares		-3,106,485.68
Class I		-2,633,791.40
Class P		-472,694.28
Decrease in net assets		<b>-5,648,157.11</b>
Net assets at the beginning of the year		<b>17,700,023.83</b>
Net assets at the end of the year		<b>12,051,866.72</b>

# *MARGIN OF SAFETY FUND*

## **Notes to the financial statements**

## MARGIN OF SAFETY FUND

### Notes to the financial statements as at December 31, 2011

#### 1. General

**MARGIN OF SAFETY FUND** is a “société anonyme” with the status of a “Société d’Investissement à Capital Variable” under the law of August 10, 1915 on Commercial Companies. It is also submitted to the Part I of the Luxembourg law of December 20, 2002 on Collective Investment Undertakings until June 30, 2011 and the Part I of the law of December 17, 2010 on Collective Investment Undertakings since July 1, 2011. The Fund is incorporated with limited liability for an unlimited duration.

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.

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 15 of the Luxembourg law dated December 17, 2010.

As at December 31, 2011 only the sub-fund MARGIN OF SAFETY FUND - Fund 1 is open. This sub-fund has issued two Classes of Shares: Class I (in USD) and Class P (in USD). 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.

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 as at December 31, 2011 (Continued)

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

##### 3. Foreign exchange

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, 2011, the following significant exchange rates were used:

1 EUR	=	1.29815 USD	1 CAD	=	0.98207 USD
1 GBP	=	1.55411 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.

##### 5. Transaction fees

The transactions fees for the period from January 1, 2011 to december 31, 2011, i.e. fees charged by the brokers for securities transactions and similar transactions are recorded separately in the Statement of operations and changes in nets assets in the account "Transactions fees"

#### 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:

<b>Class I:</b>	maximum and effective 0.90%
<b>Class P:</b>	maximum 2%
	effective 1.80%

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 a annum which shall be calculated on the Fund's average Net Asset Value.

#### 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 and Class P shares over a 12% annual benchmark as defined in the prospectus. For the year ended December 31, 2011, no performance fee was paid by the Fund.

## MARGIN OF SAFETY FUND

### Notes to the financial statements as at December 31, 2011 (Continued)

#### 6. Open positions on forward foreign exchange contracts

As at December 31, 2011, MARGIN OF SAFETY FUND - Fund 1 had the following open positions:

<b>Sale</b>	<b>Purchase</b>	<b>Maturity date</b>	<b>Unrealised appreciation in USD</b>
-1,800,000.00 GBP	2,875,860.00 USD	10/02/12	79,445.37
-1,150,000.00 EUR	1,609,425.00 USD	10/02/12	116,157.42
		<b>TOTAL</b>	<b>195,602.79</b>

#### 7. Statement of changes in Portfolio

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

## MARGIN OF SAFETY FUND

### **Global exposure calculation method (unaudited information)**

#### **The commitment approach**

The sub-fund MARGIN OF SAFETY FUND - FUND 1 uses the commitment approach in order to monitor and measure the global exposure.