MARGIN OF SAFETY FUND

Audited annual report

at 31/12/06

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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.

Management and Administration

REGISTERED OFFICE
5, Allée Scheffer
L-2520 Luxembourg

INVESTMENT MANAGER
Pastel & Associés S.A.
27, rue de Marignan
F-75008 Paris

PROMOTOR
CACEIS Bank Luxembourg
5, Allée Scheffer
L-2520 Luxembourg
(until May 10, 2006)

Pastel & Associés S.A.
27, rue de Marignan
F-75008 Paris
(since May 10, 2006)

CO-PROMOTOR
Pastel & Associés S.A.
27, rue de Marignan
F-75008 Paris
(until May 10, 2006)

AUDITOR
KPMG Audit S.à r.l.
31, 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
(since April 28, 2006)

Board of Directors

Chairman of the Board

M. Jean-Marie RINIE, Business Development Director, Vice-Président de CACEIS Bank Luxembourg (until May 10, 2006)

M. John MILLS, Managing Director, Maitland J. & Co. S.A. (Chairman since May 10, 2006)

Members of the Board

M. Hervé SCHUNKE , Business Development Director, CACEIS Bank Luxembourg (until April 28, 2006)

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

M. Yves-Pascal PELCENER, Managing Director, Pastel & Associés (since May 10, 2006)

M. Antoine GILSON DE ROUVREUX, Managing Director, Luxcellence Management Company S.A. (since May 10, 2006)

M. Philip BOYLAN, Director, BDO Fund Administration Services (since May 10, 2006)

M. John MILLS, Managing Director, Maitland J. Co. S.A. (until May 10, 2006)

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 4.60% of its assets invested in debt-claims.

This update has been effective from May 1, 2006 and will remain in force until April 30, 2007 date at which the status will be updated again.

Class B shares

In 2006, the Fund's NAV class B shares increased by 20.9%, resulting in a cumulative performance since inception on February 2nd**,** 1998, of 248.0%. As a result, while $1,000 invested at inception in the Margin of Safety Fund Class B (USD) would now be worth $3,480, the same $1,000 invested in the MSCI World index would now equal $1,821.

Class A shares

The fund had only one class of shares until August 16th , 2002, on which date the first Class A shares were issued.
In 2006, the Fund's NAV class A shares increased by 20.7% in USD and 8.1% in EURO, resulting in a cumulative performance since inception on August 16th, 2002**,** of 105.5% in USD and 53.3% in EURO

The top ten portfolio holdings in 2006

Amazon.com (United States)

Portfolio weight: 6.5% - Market capitalization: $16,254M - Revenues: $9,702M - Net income: $291M - Stock performance, excluding dividends, since inception of the position in 2006: +45.1%.

Launched in 1994, as the "world's largest bookstore", the e-commerce leader has gradually matured into a profitable and fast-growing global online marketplace where one can buy or sell all sorts of merchandise, from books, to electronic appliances, or even gourmet food. Early on, Amazon.com made the decision to open its websites to third-party merchants, who would benefit from its existing visitor traffic, but also, if needed, from its web-hosting and transaction processing services and its distribution infrastructure. By doing so, it quickly reached a critical mass that today makes its business model very difficult to copy. To further enhance its dominant position, Amazon.com keeps reinvesting significant amounts of money in both its physical infrastructure and its IT system. The company's founder, the maverick Jeff Bezos, is still leading from the front, both as CEO and main shareholder. Against such a positive backdrop, we would be remiss if we did not mention what we consider to be the main competitive threat facing Amazon.com's business, that is the increasingly dominant part played by search engines, especially Google, in visitor acquisition, a part that could, at some point in time, undermine Amazon.com's profitability and growth. Nevertheless, we remain very confident that Amazon.com's will succeed in overcoming this challenge and provide our investors with a good-to excellent long-term return.

Carpetright (United Kingdom)

Portfolio weight: 4.7% - Market capitalization: £890M - Revenues: £464M - Net income: £46M - 2006 stock performance excluding dividends: +18.6% - Position in portfolio since 2002.

The leading floor covering retailer's competitive position keeps getting stronger, year after year. Its purchasing power has increased along with both its market share in Great Britain (n°1 carpet retailer in Great Britain with a 22% market share and 494 stores) and its expansion plans in Continental Europe. At the same time, the optimization of its store network has been relentlessly pursued (relocation of 50% of its Great Britain stores to "bulky goods parks") resulting in lower rental expenses and higher customer traffic. The management team has also worked on strengthening the Carpetright brand identity based upon the notions of low prices, wide choice and availability and service. The group has over the past three years built a strong foothold in Continental Europe with first, in 2003, the acquisition of Carpetland in the Benelux, swiftly converted to the Carpetright fascia, and, since last year, a store opening program in Poland. We believe that this venture could eventually result in substantial additional value creation. Meanwhile, in the United Kingdom, the group has taken advantage of the consumer spending slowdown and increased market share, thanks to its strong financial position and cash flow generation.

The co-founder of the group, Lord Harris of Peckham, while also its main shareholder, is still at the helm and has recently stated his intention to stay on for another five years.

The configuration we have just described, combining strong competitive advantages, growth potential and quality leadership, makes us feel very comfortable about holding Carpetright's stock for the long-term.

<u>Charles Schwab (United States)</u>

Portfolio weight: 4.4% - Market capitalization: $24,421M - Revenues: $5,060M - Net income: $947M - 2006 stock performance excluding dividends: +31.8% - Position in portfolio since 2004.

In 2006, the North American financial services group has confirmed, through its excellent financial results, that its restructuring is now completed and that it is back on a profitable growth trajectory. Its three core divisions (discount brokerage and asset management, independent financial advisers' platform and corporate employee benefit plan servicing) have all recorded gains in market shares and profits. The refocusing of the group, that started in 2005 after the return of Charles Schwab to the position of CEO of his eponymous company, has continued in 2006, punctuated at year-end by the disposal, at a very satisfactory price, of US Trust, its high-networth asset management arm. His previously botched succession plan probably still in mind (see our 2005 letter), Charles Schwab announced at year end that his leaving for retirement was indefinitely postponed and that it won't be back on the agenda until a potential successor has clearly emerged from within the current leadership of the group. To sum it up, we are quite satisfied with the way the company is going and confident about the future long-term profitability of our investment in its common stock.

<u>Coca-Cola Company (United States)</u>

Portfolio weight: 7.2% - Market capitalization: $113,084M - Revenues: $23,707M - Net income: $5,266M - 2006 stock performance excluding dividends: +19.7% - Position in portfolio since 2004.

The soft drink world behemoth has been through some inclement weather since his charismatic leader, Roberto Goizueta, died suddenly in 1997. His insistence on keeping the group focused on the carbonated soft drink segment at the expense of other types of non-alcoholic beverages, proved to be the Coca-Cola's nemesis as ways of living and demographics gradually altered beverage consuming habits. It took a number of years and three succeeding CEOs for the board, and the group's staff itself, to come to terms with the new market conditions and shift course. Coca-Cola's predicament was made worse by its corporate culture that during the last years of Roberto Goizueta's reign and, even more so after his death under the stewardship of Doug Ivester, had turned inward-looking, arrogant and complacent. This whole attitude angered and alienated Coca-Cola's traditional partners, especially its bottlers upon whom the whole Coca-Cola money machine has been built.

Manager's Report

Fortunately, albeit belatedly, the board realized how serious the situation was and named, in 2004, as CEO, Neville Isdell a veteran of the Coca-Cola system. He has, since put in charge, worked on four fronts: opening up to the new realities of the market (still water, health trends, etc.), reconnecting with the group’s tradition of product and marketing innovations, mending the relationship with the bottlers, and strengthening the management team. His strategy seems to be already bearing fruit. Moreover despite several missed opportunities (cancelled acquisitions of Orangina and Quaker Oats, botched launch of Dasani in the United Kingdom, etc.), The Coca-Cola Company has remained very profitable and financially strong. Meanwhile its competitive advantages, namely its powerful brand, its distribution network of exclusive bottlers, and its dominant market shares, have not gone away. These positive factors, when combined with the strategy implemented by The Coca-Cola Company’s current CEO, make us confident that our investment should prove quite profitable over the long-term.

<u>Dell (United States)</u>

Portfolio weight: 4.7% - Market capitalization: $56,995M - Revenues: $56,738M - Net income: $3,400M - 2006 stock performance excluding dividends: -16.2% - Position in portfolio since 2005.

In 2006, the Dell model, based on direct distribution of customized computing devices (PCs, servers, printers, etc.) assembled in its facilities from parts supplied by third party manufacturers, met several challenges that, for most of them, have yet to be overcome. First, its focus on corporate customers and direct distribution made him lose market share in the United States against reinvigorated competitors such as Hewlett-Packard or Lenovo as growth this year was mostly confined to the retail store channel. Its plight was not eased by the aggressive price actions taken by Asian manufacturers such as Acer, Asus,etc. It was also faced with customer service issues (overwhelmed hotlines etc.) and a major product recall. One must mention, in this regard, that the management team is now aware of the extent of these customer issues and has already implemented a remediation plan that seems to be, so far, quite effective.

To make matters worse, it announced in September that due to an ongoing S.E.C. investigation, it could not complete the preparation of its financial statements, and as a result would be unable to file its regulatory accounts on time. This situation is still ongoing.

Against such a rather dark backdrop, one must not overlook the strengths of the Dell model that had us invest in its shares, albeit before the company’s accounting woes became public. Thanks to its direct distribution, Dell gets to learn about and fulfill its customers’ needs better and faster than its competitors. At the same time, its industrial set-up based on the extensive use of subcontractors and its no-middleman-involved sales policy allow it to remain price-competitive. As a result of this operating structure, Dell has been able to generate very high rates of return on capital. Moreover, over the last few years, it has successfully developed new growth areas such as servers, printers or IT services.

To wrap up our review, let us also mention that Michael Dell, its eponymous founder, is still very involved with the company, both as its Chairman, and as its main shareholder. Nevertheless, since we started investing in Dell’s stock, the risk profile of this position has, undoubtedly, worsened, especially after the S.E.C. investigation and its extent were made public. As a result, we will very carefully monitor the ongoing situation and will decide accordingly whether we keep, size down or entirely dispose of the existing position.

Manager's Report

Electrocomponents (United Kingdom)

Portfolio weight: 9.6% - Market capitalization: £1,277M - Revenues: £854M - Net income: £45M - 2006 stock performance excluding dividends: +4.4% - Position in portfolio since 2002.

This worldwide leader in odd-lot distribution of electronic components has had a better year in 2006 than in 2005, with growth fuelled by its fast-growing international operations while its domestic market stayed flat. As announced in 2005, it has started implementing a market segmentation plan designed to better serve its two main constituencies: the electronics design engineers, on one hand, and the MRO staff, on the other. Management expects this plan to offset some, if not all, of the revenue loss caused by the ongoing manufacturing offshoring trend. In 2006, the group has, also, continued its geography-by-geography installation of its new E.R.P. system (S.A.P.), without meeting any of the problems initially encountered in France, in 2004-2005.
One must also mention the replacement of Bob Lawson, the longstanding group's Chairman by Helmut Mamsch. This change at the top should make it easier to implement, if needed, strategic or operational shifts.
The main factors behind our decision to invest in Electrocomponents have remained valid: its presence in Asia should, in time, more than offset the manufacturing decline of the West while its strong balance sheet and profitability allow for a sustainable dividend yield of close to 6.3% at year end closing prices.

Harley-Davidson (United States)

Portfolio weight: 4.3% - Market capitalization: $18,261M - Revenues: $5,640M - Net income: $1,021M - 2006 stock performance excluding dividends: +36.9%. - Position in portfolio since 2005.

In 2006, the renowned bike manufacturer had a very profitable year, firing on the two cylinders of its manufacturing and financial services divisions. The group's fundamentals have not changed and remain strong: an efficient manufacturing organization combining outsourcing and in-house assembly, a network of motivated, and quite often exclusive, dealers, and a loyal, if not fanatical, customer base that has been growing at a healthy rate over a number of years.
Moreover the financial services division which now amounts to close to 13% of its pre-tax income keeps growing in what seems to be a very profitable and controlled way. This successful diversification helps Harley-Davidson know and monitor its customers better while at the same time generating streams of recurring income. As a result of such a strong competitive position, Harley-Davidson's United States market share in the 650 cc - segment was at last count greater than 48%. However, we are very aware of the risk created by the combination of these two activities (manufacturing and distribution on one side and financial services on the other) whose dynamics are very different and of the potentially negative consequences that could result, should the financial services division become less independent from the salesforce. We must, in this regard, mention the departure of the head of the division with no permanent replacement named so far. Despite these reservations, and while we will closely monitor he evolution of the credit business, we remain confident about this investment's long-term return potential.

McDonald's (United States)

Portfolio weight: 4.8% - Market capitalization: $54,825M - Revenues: $21,790M - Net income: $2,911M - 2006 stock performance excluding dividends: +31.5% - Position in portfolio since 2005.

The leading fast food restaurant chain is now back on track as its like-for-like sales have been growing for close to two years at mid-single digit rates. This improvement in the Company's fortune is the result of its back-to-basics re-focusing started in 2003. This strategic shift has translated in a more motivated franchisee population as well as more loyal and satisfied consumers. But more importantly, it has returned the company to a path where it is able to combine growth in revenue with increasing profits. Despite these early successes, the management team is well aware that it has to keep updating and adapting the company’s offering through constant menu innovations aimed at new and growing market segments, such as women and minorities, as well as through ongoing remodeling of its standard restaurant formats. While going through this exercise, the company has, at the same time, started disposing of its past diversification attempts such as the Chipotle chain. As a result of the strong competitive moat surrounding McDonald's and thanks to its strategy implemented since 2003 and aimed at "widening the moat", we remain very positive about this investment.

TJX (United States)

Portfolio weight: 4.8% - Market capitalization: $12,977M - Revenues: $17,102M - Net income: $821M - 2006 stock performance excluding dividends: +22.8% - Position in portfolio since 2003.

This leading North American off-price retailer had been suffering since the beginning of the new century from what one might aptly call a mid-life crisis as exemplified by the slowdown in the growth rate of both its top- and bottom-lines.
From its 2006 preliminary results, it seems that it is in the process of quickly recovering and refocusing on its core competencies under the leadership of Ben Cammarata, one of its historical leaders who agreed to come back as temporary CEO in late 2005 (see our 2005 annual letter) until retail veteran Carol Meyrowitz, newly appointed as group president, be ready to take over. Its core Marmaxx division, albeit a slow-grower, is highly profitable and cash-generative thanks to its higher-income female customer base and its business model built around the liquidation of unsold apparel inventory. The "new" management team has made clear what its position was regarding TJX’s past attempts at diversifying its revenue base, namely, its two other domestic divisions (Homegoods for furniture and A.J.Wright targeted toward a less affluent shopper) and its foreign ventures (Canada and the United Kingdom). Either these operations succeed in quickly turning around or they will be either closed or disposed of. To sum it up, our opinion about this investment remains sanguine, as its long term fundamentals have kept improving since last year.

Wm Morrison (United Kingdom)

Portfolio weight: 9.1% - Market capitalization: £6,809M - Revenues: £12,118M - Net income: NR - 2006 stock performance excluding dividends: +31.5% - Position in portfolio since 2004.

The fourth supermarket player in the United Kingdom started, in 2006, to benefit from its 2004 merger with Safeway and the ensuing tripling of its store network size. After completing, in 2005, the integration of the newly acquired stores and their conversion to the Morrison fascia, the management has turned its attention, in 2006, to streamlining its offering, re-motivating its staff, and optimizing its logistics. As a result of acquiring Safeway, Morrison has now gained strong positions in the Midlands and the South of England. And thanks to an unchanged planning "regime" making opening new stores a process fraught with uncertainty, delays, and cost overruns, these new locations have now turned into a major asset. In its "new territories", the introduction of the Morrison retail concept turned out to be quite successful as attested by the continuing like for like sales growth of converted stores. As a reminder, the typical Morrison store tends to give priority to "food and drinks" over "non-food" items, and to create and maintain a feeling of excitement and authenticity thanks to, among other things, its almost quaint "market Street", while at the same time keeping its pricing very competitive through its recurring use of national promotional campaigns. This

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

Report of the Réviseur d'Entreprises

Following our appointment by the Annual General Meeting of the shareholders of the SICAV of May 10, 2006, 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, 2006 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.

Responsibility of the Board of Directors of the SICAV 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 as of December 31, 2006, 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, xx April 2007

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

Nathalie Dogniez	Patrice Perichon
Partner	Director

MARGIN OF SAFETY FUND - Fund 1

Financial Statements at 31/12/06

Statement of net assets at 31/12/06

Expressed in USD

Assets		**45,078,270.02**
Securities portfolio at market value	Note 2	43,687,841.20
Cost price		*35,156,559.73*
Unrealised profit on the securities portfolio		*8,531,281.47*
Cash at banks and liquidities		1,944.07
Time deposits		1,140,000.00
Interest receivable		320.47
Brokers receivable		131,040.59
Other assets		117,123.69
Liabilities		**1,108,810.54**
Bank overdrafts		3,940.26
Subscribers payable		172,402.62
Unrealised loss on forward foreign exchange contracts	Note 6	587,765.54
Accrued management fees		104,491.65
Other liabilities		240,210.47
Net asset value		**43,969,459.48**

Changes in number of shares outstanding from 01/01/06 to 31/12/06

	Shares outstanding at 01/01/06	**Shares issued**	**Shares redeemed**	**Shares outstanding at 31/12/06**
Class A				
Capitalisation shares	16,231.33	7,159.56	11,984.44	11,406.45
Class B				
Capitalisation shares	2,943.66	17.00	974.75	1,985.91

Key figures relating to the last 3 years

	Year ending at:	**31/12/06**	**31/12/05**	**31/12/04**
Total Net Assets	USD	43,969,459.48	52,153,700.50	44,000,747.49
Class A		USD	USD	USD
Capitalisation shares				
Number of shares		11,406.45	16,231.33	20.00
Net asset value per share		3,248.86	2,691.01	2,558.40
Class B		USD	USD	USD
Capitalisation shares				
Number of shares		1,985.91	2,943.66	16,080.67
Net asset value per share		3,480.26	2,879.09	2,733.07

The accompanying notes form an integral part of these financial statements

MARGIN OF SAFETY FUND - Fund 1

Securities portfolio at 31/12/06

Expressed in USD

Quantity	Denomination	Quotation currency	Market value	% of net assets
	Transferable securities admitted to an official stock exchange listing		43,687,841.20	99.36%
	Shares		**43,687,841.20**	**99.36%**
	Bermuda		*883,975.00*	*2.01%*
47,500	MONTPELIER RE HOLDINGS LTD	USD	883,975.00	2.01%
	France		*893,321.10*	*2.03%*
8,400	CHRISTIAN DIOR SA	EUR	893,321.10	2.03%
	Greece		*1,312,203.09*	*2.98%*
33,323	FOLLI FOLLIE SA REG.SHS	EUR	1,312,203.09	2.98%
	Ireland		*1,181,102.88*	*2.69%*
85,984	RYANAIR HOLDINGS PLC	EUR	1,181,102.88	2.69%
	United Kingdom		*14,377,009.14*	*32.70%*
81,400	CARPETRIGHT PLC	GBP	2,092,988.56	4.76%
48,000	DIAGEO PLC	GBP	943,768.28	2.15%
737,291	ELECTROCOMPONENTS PLC	GBP	4,240,496.53	9.64%
37,100	NEXT PLC	GBP	1,309,743.26	2.98%
454,600	PREMIER FARNELL PLC	GBP	1,760,906.47	4.00%
807,200	WM MORRISON SUPERMARKETS PLC	GBP	4,029,106.04	9.16%
	United States of America		*25,040,229.99*	*56.95%*
72,478	AMAZON COM INC	USD	2,859,981.88	6.50%
18,000	ANHEUSER BUSCH COS INC	USD	885,600.00	2.01%
22,300	APPLEBEES INTERNATIONAL INC	USD	550,141.00	1.25%
101,000	CHARLES SCHWAB CORP	USD	1,953,340.00	4.44%
66,300	COCA-COLA CO	USD	3,198,975.00	7.28%
82,950	DELL INC	USD	2,081,215.50	4.73%
31,490	ETHAN ALLEN INTERIORS INC	USD	1,137,103.90	2.59%
26,960	HARLEY DAVIDSON INC	USD	1,899,871.20	4.32%
22,800	LEUCADIA NATIONAL CORP	USD	642,960.00	1.46%
37,000	LOWE'S COMPANIES INC	USD	1,152,550.00	2.62%
48,287	MC DONALDS CORP	USD	2,140,562.71	4.87%
108,900	SOUTHWEST AIRLINES CO	USD	1,668,348.00	3.79%
38,000	TIFFANY CO	USD	1,491,120.00	3.39%
74,240	TJX COS INC	USD	2,117,324.80	4.82%
36,800	WALT DISNEY CO (HOLDING CO)	USD	1,261,136.00	2.87%
	Total securities portfolio		**43,687,841.20**	**99.36%**

The accompanying notes form an integral part of these financial statements

MARGIN OF SAFETY FUND - Fund 1

Statement of Operations and Changes in Net Assets from 01/01/06 to 31/12/06

Expressed in USD

Income		**921,344.00**
Net dividends		866,599.50
Bank interest on cash account		169.81
Bank interest on time deposits		54,574.69
Expenses		**928,784.61**
Management & management company fees	Note 4	476,365.67
Custodian & sub-custodian fees		35,933.33
Taxe d'abonnement	Note 3	21,501.72
Administrative expenses		41,545.33
Performance fees	Note 5	196,437.43
Domiciliation fees		8,861.75
Professional fees		21,816.78
Bank interest on overdrafts		6.69
Legal fees		6,196.90
Brokers fees		88,193.90
Other expenses		31,925.11
Net loss from investments		**-7,440.61**
Net realised profit on sales of investment securities		3,085,154.22
Net realised profit on foreign exchange		284,407.68
Net realised loss on forward foreign exchange contracts		-379,392.65
Net realised profit		**2,982,728.64**
Movement in net unrealised appreciation / depreciation on forward foreign exchange contracts		-880,867.71
Movement in net unrealised appreciation / depreciation on investments		6,522,307.03
Increase in net assets as a result of operations		**8,624,167.96**
Subscription capitalisation shares		23,131,464.94
Class A		*23,080,252.61*
Class B		*51,212.33*
Redemption capitalisation shares		-39,939,873.92
Class A		*-36,956,697.04*
Class B		*-2,983,176.88*
Decrease in net assets		**-8,184,241.02**
Net assets at the beginning of the year		**52,153,700.50**
Net assets at the end of the year		**43,969,459.48**

MARGIN OF SAFETY FUND

Notes to the financial statements

Notes to the financial statements at December 31, 2006

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, 2006 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.

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.

2. Realised profit and loss on investments

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

Notes to the financial statements at December 31, 2006

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 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.

4. Income from investments

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.

2. Summary of significant accounting principles (continued)

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.

As at December 31, 2006, the following significant exchange rates were used:

1 EUR	=	1.317 USD
1 GBP	=	1.9613 USD

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 A: maximum 0.90%
Class B: maximum 1.15%

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 wich 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 A shares and Class B shares over a 12% annual benchmark as defined in the prospectus. For the year ended December 31, 2006 an incentive fee amounting to **196 437,43** USD was charged for the Class A and Class B shares, including crystallisation of performance subsequent to redemptions.

Notes to the financial statements at December 31, 2006

6. Open positions on forward exchange rate contracts

At December 31, 2006, MARGIN OF SAFETY FUND - Fund 1 had the following open positions:

Purchase	Sale	Maturity date	Unrealised Appreciation/ Depreciation in USD
210,000.00 EUR	272,307.00 USD	05/01/07	4,643.99
412,512.00 USD	320,000.00 EUR	05/01/07	-9,505.15
500,000.00 GBP	956,200.00 USD	05/01/07	22,456.42
100,000.00 GBP	190,600.00 USD	05/01/07	5,132,61
882,757.59 USD	694.000,00 EUR	05/01/07	-32,521.18
7,856,960.00 USD	4,300,000.00 GBP	05/01/07	-559,085.38
163,241.00 USD	130,000.00 EUR	05/01/07	-8,208.91
150,960.00 USD	80,000.00 GBP	05/01/07	-5,617.59
127,120.00 USD	100,000.00 EUR	05/01/07	-4,764.55
130,920.00 USD	100,000.00 EUR	05/01/07	-964.55
355,671.00 USD	270,000.00 EUR	05/01/07	-417.28
392,530.00 USD	200,000.00 GBP	05/01/07	1,086.03
		TOTAL	**-587,765.54**

7. Co-management

In order to reduce operational and administrative charges while allowing a wider diversification of investments, the Fund 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 holds a proportion of the Co-Managed Assets corresponding to the proportion of its net assets to the total value of the Co-Managed Assets.

In 2006, the Fund did not use the co-management’s facility and has no plans in the near future to do so.

8. Statement of changes in Portfolio

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