Annual letter to investors 2013

January 20th, 2014

"Diligence is the mother of good luck" Benjamin Franklin

Dear Investor / Dear Partner,

In 2013, our main funds delivered performances in excess of 25%. Since their inception, our two oldest funds, Margin of Safety (USD) (P class) and Valeur Intrinsèque (P class) have generated respective annualised returns of 10.7% (since February 2nd 1998) and 7.1% (since June 6th 2001). For information, their benchmark indices, the MSCI World (USD with dividends reinvested) and the MSCI World (EUR with dividends reinvested) posted annualised returns of 5.3% and 1.1% respectively over the same period.

For more detailed information about the absolute and relative performances of our funds since their inception, please visit our website at www.pastel.fr.

A 2013 overview

During 2013, were either sold or downsized a number of positions, that had generated healthy IRRs (annualised internal rates of return) since their acquisition. Many of these were acquired during the 2007-2009 financial crisis: Cintas Corp., Legrand and Procter & Gamble Company… Having outperformed over several years, these stocks were trading at what we considered to be too-demanding multiples. Hence our decision to dispose of them either totally or partially.
This was the case for Cintas Corp., the North-American leader in work apparel rental & laundry and business support services. We had set up the position in 2008-2009, paying well below intrinsic value, and we sold our last remaining shares during the summer, generating an IRR of more than 12% over our holding period.

Our selling of existing positions combined with net investor subscriptions provided us with cash that we partially put to use during the year.

We added to existing positions such as Hays (UK), Leucadia National Corp. (US), Loews (US), Markel (US) and Vicat (France) at compelling price levels, we also bought into some attractively valued new companies. For example, we invested in Fairfax Financial (Canada), a company founded in the early 1980s in Canada by Prem Watsa, a faithful disciple of Benjamin Graham, the father of "value" investment. Prem Watsa, who is still at the helm, built the group up into an international conglomerate with its primary focus on insurance and reinsurance. The financial returns generated by Fairfax Financial, over more than 30 years, have earned Prem Watsa the epithet of the "Warren Buffett of the North". Fairfax Financial has, over the years, clinched a number of intriguing deals (for example, the recent refinancing of Blackberry), which turned out to be, for most of them, highly profitable. We shall, very likely, be given the opportunity to comment further about Fairfax in future annual letters.

A few thoughts about our Funds' portfolios

The actions undertaken thoughout 2013 allow us to face **the future with peace of mind and optimism**. Why?

- We have **available cash,** which can be used to **seize investment opportunities** that "Mr Market" will probably offer us over the next few months, or years. With cash representing between 14% and 20% of AUM (depending on the fund under consideration), our selective and "focused" investment approach will enable us to set up new positions, or increase existing investments, at the "right" price. With almost EUR 300 million of AUM and just under EUR 60 million to reinvest, a few good ideas should enable us to put to good use most of our current available cash. Thus, our size is an asset, as it is easier to find opportunities with AUM of a few hundred million euros, as opposed to several billions!

- **For most portfolio holdings, valuation levels are reasonable** and even, in some cases, cheap. For example, Leucadia National Corp. (9% of the Valeur Intrinsèque portfolio) was trading slightly above net book value at year-end. Some holdings were even trading at more discounted levels, such as Lectra (2% of the Valeur Intrinsèque portfolio) or AIG (3% of the Valeur Intrinsèque portfolio). Other longstanding portfolio positions, such as Randstad, Vicat and Hays, were more fairly valued, but nonetheless generally trading at very acceptable levels.

- **More resilient portfolios***. Four companies, Fairfax Financial, Leucadia National Corp., Loews and Markel Corp., representing almost 20% of AUM, have contributed to enhance the long term economic resilience of our portfolios.

While these four companies have been run according to distinct "value" approaches for decades, they share a common commitment to the notions of intrinsic value, margin of safety, on-and off-balance sheet robustness, and a long-term focus.
Not only have their management teams "talked the talk", but they have also "walked the walk" as illustrated by their long-term track record. During 2008-2009, as a result, these companies were able to "shop around", with, for instance, one of them acquiring a bankrupt North American leader in commercial mortgage servicing (Capmark bought by Leucadia National Corp. and Berkshire Hathaway in 2009).

Average net annual returns on assets per share			
As of 12/31/2012	**20 years**	**10 years**	**5 years**
Loews	**11.3%**	**10.2%**	**9.6%**
Leucadia National Corp.	**15.4%**	**13.5%**	**2.6%**
Markel Corp.	**16.1%**	**13.1%**	**8.8%**
Fairfax Financial	**17.4%**	**13.7%**	**13.4%**
S&P 500 dividends reinvested	***8.2%***	***7.1%***	***1.7%***

The market capitalisation of the S&P 500, expressed as a multiple of ten-year average inflation-adjusted earnings is now not only well above its 50-year historical average level of 20, but is closing in on its all-time high of around 30 (excluding the "dot-com bubble" of 1998-2000).
Were this ratio applied to European indices, it would probably send similar signals. However, Europe's institutional instability (nationalisations, privatisations, changes in benchmark currency, etc.) would make this ratio less reliable and less easily computable.

Whatever these numbers point to, we remain convinced that an investment strategy based on market-timing is generally lossmaking for the end-investor, be it an individual or an institutional one, whereas selecting a time–tested asset manager, with a rational and consistent approach, and sticking to one's choice over the long-term, is much more profitable and far less risky.

*concerns only Valeur Intrinsèque and the Margin of Safety Fund

To paraphrase Warren Buffett, greater caution is required when euphoria begins to set in. Hence our trust that our selective, focused and prudent approach, combined with the current structure of our portfolios, are particularly well adapted to current circumstances.

Our confidence is based upon our 16-year track record of investing according to the same methodology built around three key ideas:

- Valuing a stock as a long-term share in a business. Price is what you pay. **Value** is what you get in the long term.

- Focusing on companies with **sustainable competitive advantages and quality management.** In the world of finance as in the real economy, over time, the best end up out-performing.

- Staying away from the stock-market information and recommendation system (investment banks, brokers, sell-side research, etc.) with regard to idea origination, analysis and investment decisions. Our self-sufficiency in terms of information sourcing and processing will vouch for our **independence of mind**.

During 2014, we shall stick to our, so far, successful knitting, with an objective of continuing to make our investors wealthier and outperform the major indices over a 5-to-10-year period.

Wishing you an excellent New Year for 2014,

Yours sincerely,

David Pastel