

Annual letter to investors 2014

February 2nd, 2015

Dear Investor, dear Partner,

“Hegel remarks somewhere that all great world-historic facts and personages appear, so to speak, twice. He forgot to add: the first time as tragedy, the second time as farce.” Karl Marx, The Eighteenth Brumaire of Louis Bonaparte.

We embarked upon our entrepreneurial venture a little over 17 years ago, setting up Pastel & Associés in December 1997, then, on February 2nd 1998, launching our first fund, the Margin of Safety Fund. Bursting with enthusiasm, we hoped to steal a quick march on “traditional” portfolio managers. Needless to say, nothing went according to plan. The dot-com bubble continued to grow, driving “new economy” stock prices through the roof, while in many cases mature, profitable, companies saw their share prices underperform, or even decline. We stuck to our values however, as we still do today, refusing to jump on the speculative bandwagon. Our steadfastness in abiding by our investment philosophy earned our then one-year-old fund, Margin of Safety, a near-bottom ranking in its category, with an underperformance versus its most representative benchmark, the MSCI World index (USD with dividends reinvested) of almost 20% on the year. During 1999 however, the fund clawed its way back, eventually delivering a cumulative three-year outperformance of 36% compared to the same index by December 31st, 2000.

Valeur Intrinsèque posted an annual performance of -3.1%* in 2014, compared to +19.5% for the MSCI World index (EUR with dividends reinvested).

The heaviest negative contributor, D/S Norden, weighed the fund’s NAV down by -4.9% (see page 3 for details).

* Margin of Safety Fund P class performance, see page 2.

The shift of the portfolio* towards new positions was also a major factor in the fund's 2014 negative performance. These changes, that took place over the last two years, have helped "rejuvenate" the portfolio (see "overview" on page 3). A significant proportion of it is now composed of companies harbouring significant upside, but whose stock prices have yet to start climbing back up. Our contrarian approach implies that we often seize upon investment opportunities which are on a short term basis what traders call "falling knives". Their share prices continue to plummet while we keep building up the positions. And quite often, they even keep going down for a while after our buying has ended.

Therefore, our idiosyncratic way of investing (contrarian, independent, concentrated, "non-benchmarked" and "long-termist") may result in temporary periods of underperformance, as we have witnessed in 2014 and as we have also weathered on a number of previous occasions, in 1998, 2007-2008 and 2011.

The major headwind experienced over the past twelve months does not imply, in any way, that we have changed our methods, nor does it undermine the relevance of our approach. A year is simply not long enough to reach any conclusion in this regard, given our investment horizon.

Rather than trying to win every playoff game, we aim to remain near the top of the league table in terms of medium to long-term profitability for investors. Since inception, Valeur Intrinsèque has generated annualised returns of 6.3% compared to 2.4% for the MSCI World index (EUR with dividends reinvested).

	2014 Performance	Cumulative performance since inception	Inception date
Valeur Intrinsèque (P class)	-3,1%	+130.6%	June 6th 2001
MSCI World (EUR with dividends reinvested)	+19.5%	+37.5%	
Margin of Safety Fund (USD) (P class)	-8.8%	+358.6%	February 2nd 1998
MSCI World (USD with dividends reinvested)	+4.9%	+139.8%	

Performance from 12/31/2013 to 12/31/2014, except for the Margin of Safety Fund (P class) calculated from 12/27/2013 to 12/24/2014. The performance of the Pastel & Associés funds may vary considerably and over long periods of time from that of benchmark indices, provided herein for informational purposes only. In addition, the reader is cautioned that past performance is no guarantee of future results.

Once again, our swimming against the tide initially resulted in quite a poor outcome, albeit one we believe to be temporary. We are now, as on such previous occasions, waiting for the rebound to happen. As already explained above, we remain entirely confident of our funds' capacity to do so, while the timing of such bouncing back remains totally unknown, at least to us.

*Refers to the Valeur Intrinsèque portfolio. NB: the Margin of Safety Fund became a feeder fund for Valeur Intrinsèque in March 2013.

A 2014 overview

“Those who sow in tears shall reap with songs of joy” (Psalm 126: 5-6)

In 2014, like in 2013, we kept on selling, either totally or partially, several portfolio holdings and reinvesting some of the resulting cash proceeds in new ideas which will bear their fruits over the next few years.

Most of our sales in 2014 related to stocks whose prices had appreciated too much ahead of their intrinsic values. Thus several long-standing positions such as Charles Schwab, Hays and Randstad, completely exited the portfolio.

In other cases such as Carpetright, Electrocomponents, Leucadia National and Premier Farnell, aside from their share price behaviour versus their intrinsic value, our decision to sell all or part of our investment was triggered primarily by a narrowing of their margins of safety, involving a significant change in either the make-up of the management team or the business strategy, or else the emergence of new substitute products, services or distribution channels.

All of these sales resulted from the strict application of our investment process, with no consideration given to macroeconomic or market trends' forecasts. Needless to say, on a number of occasions, we were saddened to have to part with companies and management teams that we had learnt to get to know over the years.

Meanwhile, we were able to put to good use some of the cash proceeds resulting from these disposals, seizing upon several investment opportunities that emerged during the course of year, some of which we outline below.

Bursts of volatility in the financial markets, during the summer and fall of 2014, enabled the fund to build up positions in several high-quality French industrial companies, such as Manitou and Bénéteau, which had been on our radar screen for quite a long time. Both are leaders in their respective markets and manage their capital resources judiciously, while equally benefitting from a shareholding structure in which the founding family is still on board and owing a significant percentage of the outstanding shares. Having followed the fortunes of these companies over several years, we were ready and able to react very swiftly when their share prices were suddenly marked-down.

In the US, the opportunity arose to invest in two out-and-out “Buffett franchises”. Let us mention Bed Bath & Beyond which, with a 25% market share is one of the leading household product retailers in North America (bedding, home decor, small appliances, etc.), and Deere & Company, which is the global leading manufacturer of agricultural equipment, with dominant market shares.

Both companies enjoy a strong competitive edge, drawing primarily on major economies of scale: in the case of Bed Bath & Beyond, purchasing power, low-cost brand awareness, and nationwide coverage while with regard to Deere & Company, broad distribution and after-sales service networks and a dealer-and- customer financing capability. We could also mention innovation and a reputation for reliability as additional strengths benefitting Deere & Company. Both companies have, on top of all that, carried out generous and rational capital allocation policies, returning cash to shareholders in the form of dividends and share buybacks.

Now to our D/S Norden stake. For the record, we picked this Danish shipping company on account of its rational capital management, its highly-profitable long-term strategy and sound balance sheet. Furthermore, when building up the position, the stock was already trading below tangible book value. We initiated a position in 2012 at around DKK 165, after which the price surged to almost DKK 285 in early 2014, at which point we lowered the portfolio exposure to it. The share price then slumped by more than 50% during the year, perhaps as a result of difficulties in the maritime transport sector during 2014. We averaged-down as the price fell, as far down as DKK 120, resulting in D/S Norden becoming our largest portfolio holding. Gradually buying “down” into a stock, after carefully reviewing and confirming the fundamentals of our investment case, epitomizes a major facet of our investment approach. We have in the past, successfully used the same tactic, for Randstad, Vicat, Accor and several other investments.

A few thoughts about the current portfolio

Like early last year, but even more so today, the two following features of the portfolio contribute to its margin of safety:

- The level of cash available after reinvestment during 2014 remains high (almost 20% of NAV). Resurgent volatility over recent months has enabled us to seize upon a number of opportunities (see above). However, most of the companies we have earmarked for possible investments still remain too expensive. Although some of their stock prices have recently declined and thus gotten closer to “buy” levels. Like every year, "Mr Market" should continue to offer us value during his recurrent bouts of depression. With almost EUR 300 million of assets under management (AUM), just over EUR 60 million of cash to reinvest and a highly concentrated portfolio (a maximum of thirty-five stocks), a few good ideas should enable us to put to good use most of our current available cash over the coming months. Thus, as our size is an asset, it should be easier to find opportunities with AUM of a few hundred million euros, as opposed to several billion!

- For most of our portfolio holdings, valuation levels are reasonable and even, in some cases, cheap, which implies significant long-term upside potential. Examples among our current investments include the French stocks mentioned above, Bénéteau and Manitou, and our latest US additions Bed Bath & Beyond and Deere & Company.

Looking further ahead

“Be fearful when others are greedy. Be greedy when others are fearful” Warren Buffett.

We remain convinced that in the current monetary climate and after 6 years of a long-lasting stock market rally, investors have become temporarily impervious to financial risk. As a result, many investors have probably built up positions which might prove excessive with regard to their capacity to absorb heavy losses. In such circumstances, we consider our selective, concentrated and cautious approach, combined with the current structure of our portfolio, particularly well-adapted.

Our confidence is based upon our successful 17-year track record, itself the result of our consistently applying 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 generally financially sound companies, with sustainable competitive advantages and quality management teams. **In the world of finance as in the real economy, over time, the best and the most resilient 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 2015, we shall stick to our, so far, successful knitting, with an unchanged long-term objective of preserving and growing the capital entrusted to us by our investors.

For further information regarding our funds, please consult the following December 2014 "monthly review".

Wishing you an excellent New Year for 2015,

Yours faithfully,
David Pastel

P.S. This letter includes comments that may be found in earlier publications of ours. As we aim to inform rather than entertain or surprise, we have not shied away from reusing entire phrases or paragraphs already published by us when we have thought it appropriate.

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