Annual review

As of December 31st, 2015

PASTEL & ASSOCIÉS

SOCIÉTÉ DE GESTION DE PORTEFEUILLE

Disclaimer

The analyses presented herein should not be construed as an investment advice or a recommendation to buy or sell any security but reflect only the management company's opinion as of its writing, based on the information in the management company's possession at that time. Such opinion can change at any time and the management company is under no obligation to inform readers of such a change.

Pastel & Associés, on behalf of the funds it manages, may, at any time, add to or dispose partially or totally of positions detailed in the present report. Pastel & Associés will generally not disclose its intent to implement such trades nor will it generally disclose them after they have occurred, except if it chooses to do so in later periodic reports.

Past performance is no guarantee of future results. Prior to making any investment decision regarding the fund, the investor is required to read the Key Investor Information Document (KIID) and the Prospectus which can be accessed at www.pastel.fr.

Dear Investor,

Since the beginning of this new year, the decline in the net asset value per share of our two funds has continued, and even accelerated. Our funds have already been through such phases of accelerating market losses and increasing performance lags with the major indices. That has been the case in 1998 for Margin of Safety Fund, and in 2007-2008 as well as in 2011 for all our funds. As repeatedly mentioned throughout our reports as well as the prospectuses of our funds, such episodes are an inherent part of our investment process and are bound to happen again, in the future. It is our policy not to comment on short term movements in stock market prices and the resulting evolution of our funds' net asset value. Nevertheless, you will find in the Manager's report (part III of the document) some elements that could help you better comprehend the performance of our funds over the past two years.

It is our view that the discount between the intrinsic value of the portfolio and its market value, already significant by the end of 2015, has further increased since then.

We believe in the long term profitability potential of our funds, and we feel that at current levels of net asset value per share, the investor with a long term view should consider investing or re-investing rather than redeeming his shares. However, we know from experience that in the short term, a further decrease in our funds' net asset value, as well as a worsening of the performance gap with the indices, cannot be entirely precluded. Indeed, share prices tend to go to extremes before correcting. Like Warren Buffet often says, when investing in stocks an investor must be ready to suffer paper losses of 50% or more. That is why we always recommend that our potential investors and their advisors make sure, before reaching any subscription decision, that they will be able, both financially and psychologically, to hold on to their position through difficult times (for further discussion of this, please see our "Investor's manual" on our website.

The complete annual reports of our two funds will be made available on our website once they have been certified by their statutory auditors.

Wishing you an excellent year 2016,

Yours sincerely,

David Pastel

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Nota bene: Sections II and III of this report refer to Valeur Intrinsèque Fund's portfolio. As a reminder Margin of Safety Fund is a feeder fund to Valeur Intrinsèque Fund and the investment manager strives to keep a ratio of close to 100% of the fund's assets invested in its master fund.

I – Margin of Safety Fund and Valeur Intrinsèque Fund: investment performance

Margin of Safety Fund

Total annual returns (in percentage)

	Margin of Safety Fund (P class)	Margin of Safety Fund (I class)	MSCI World (USD) dividends reinvested
1998*	2.5	2.5	21.0
1999	42.0	42.0	24.9
2000	15.1	15.1	(13.2)
2001	5.7	5.7	(16.8)
2002	(13.4)	(13.7)	(19.9)
2003	43.8	36.7	33.1
2004	23.9	22.5	14.7
2005	5.3	5.2	9.5
2006	20.9	20.7	20.1
2007	(4.0)	(3.8)	9.0
2008	(40.1)	(39.6)	(40.7)
2009	69.9	71.4	30.0
2010	16.2	17.3	11.8
2011	(19.7)	(19.0)	(5.5)
2012	20.8	21.8	15.8
2013	31.2	32.5	26.7
2014	(8.8)	(7.9)	4.9
2015	(20.8)	(20.0)	(1.8)
CAR**	7.5%	7.5%	5.0%
Cumulative performance	263.4%	266.4%	137.7%

* Fund's inception on February 2nd, 1998

** Compound Annual Returns since inception

Margin of Safety Fund's underlying investment portfolio has been managed according to the same value-oriented investment methodology since the fund's inception on February 2nd, 1998. From March 26th, 2013 onwards, the fund has been a feeder fund to Valeur Intrinsèque, a French UCITS, which has also been managed according to the methodology applied by Pastel & Associés.

I class shares were first offered to investors on August 16th, 2002. As a result, the performance figures provided herein and related to periods prior to this date are those of the P class shares.

Valeur Intrinsèque Fund

Total annual returns (in percentage)

	Valeur Intrinsèque (P class)	Valeur Intrinsèque (I class)	MSCI World (EUR) dividends reinvested
2001*	14.8	14.8	(14.9)
2002	(22.1)	(22.1)	(32.0)
2003	32.9	32.9	10.7
2004	16.3	16.3	6.5
2005	14.5	14.5	26.2
2006	13.2	13.2	7.4
2007	(11.3)	(10.8)	(1.7)
2008	(38.1)	(37.5)	(37.6)
2009	57.2	58.8	25.9
2010	19.7	20.6	19.5
2011	(17.4)	(16.5)	(2.4)
2012	22.6	23.8	14.0
2013	26.8	27.9	21.2
2014	(3.1)	(2.1)	19.5
2015	(16.6)	(15.8)	10.4
CAR**	4.6%	5.2%	2.9%
Cumulative performance	92.3%	108.7%	51.8%

* Fund's inception on June 6th, 2001

** Compound Annual Returns since inception

I class shares were first offered to investors on December 29th, 2006. As a result, the performance figures provided herein and related to periods prior to this date are those of the P class shares.

II – Investment portfolio as of December 31st, 2015

Currency	Company	Average cost per share (in currency)	Price per share (in currency)	Total cost (in currency)	Market value (in currency)	Market value (in euros)	Gains or losses (in euros) (1)	Gains or losses (in %) (2)	% NAV (3)
EUR	ArcelorMittal	6.5	3.897	15 780 213	9 486 070	9 486 070	-6 294 144	-39.9 %	6.3 %
	Salzgitter AG	22.9	22.725	4 515 473	4 471 576	4 471 576	-43 898	-1.0 %	3.0 %
	Thermador Groupe	72.1	87.00	1 979 437	2 387 715	2 387 715	408 278	20.6 %	1.6 %
	Vallourec SA	11.3	8.60	6 376 377	4 871 900	4 871 900	-1 504 477	-23.6 %	3.3 %
					21 217 260	**21 217 260**	**-7 434 240**	**-25.9 %**	**14.2 %**
GBP	Anglo American Plc	3.5	2.9945	3 410 636	2 933 745	3 980 387	-739 838	-15.7 %	2.7 %
	Glencore	0.8	0.9048	2 003 728	2 186 149	2 966 079	192 369	6.9 %	2.0 %
	Lonmin Plc	1.5	0.835	617 349	353 205	479 214	-373 569	-43.8 %	0.3 %
	Rolls-Royce Holdings Plc	5.2	5.75	1 934 811	2 141 300	2 905 230	166 257	6.1 %	1.9 %
	South32 Limited	0.9	0.525	1 924 648	1 160 250	1 574 181	-1 113 108	-41.4 %	1.1 %
					8 774 648	**11 905 092**	**-1 867 888**	**-13.6 %**	**8.0 %**
DKK	D/S Norden	176.2	122.10	136 026 931	94 266 695	12 631 799	-5 623 539	-30.8 %	8.4 %
					94 266 695	**12 631 799**	**-5 623 539**	**-30.8 %**	**8.4 %**
NOK	Subsea 7	70.0	63.05	69 738 295	62 848 681	6 536 354	-1 475 546	-18.4 %	4.4 %
	TGS-NOPEC Geophysical Co.	154.9	141.40	25 097 194	22 913 304	2 383 017	-690 583	-22.5 %	1.6 %
					85 761 986	**8 919 371**	**-2 166 129**	**-19.5 %**	**6.0 %**
USD	American Express	75.0	69.55	3 719 851	3 449 680	3 175 624	-37 932	-1.2 %	2.1 %
	America's Car-Mart	37.4	26.69	5 871 773	4 186 620	3 854 018	-446 299	-10.4 %	2.6 %
	Bed Bath & Beyond Inc	61.3	48.25	3 861 107	3 039 750	2 798 260	-6 809	-0.2 %	1.9 %
	Cummins	118.5	88.01	7 231 118	5 368 610	4 942 106	-666 013	-11.9 %	3.3 %
	Deere & Company	86.1	76.27	14 215 372	12 588 364	11 588 294	623 356	5.7 %	7.7 %
	Diamond Offshore Drilling Inc	27.3	21.10	9 926 437	7 674 492	7 064 800	-1 619 109	-18.6 %	4.7 %
	International Business Machines Corp	154.4	137.62	13 046 301	11 628 890	10 705 045	-682 901	-6.0 %	7.2 %
	Leucadia National Corp.	24.8	17.39	19 233 677	13 492 675	12 420 763	-2 414 684	-16.3 %	8.3 %
	Posco	39.7	35.36	8 360 933	7 453 640	6 861 494	-672 305	-8.9 %	4.6 %
	Rowan Companies plc	19.3	16.95	7 527 796	6 594 906	6 070 980	-412 516	-6.4 %	4.1 %
	Tenaris	27.7	23.80	3 770 765	3 241 560	2 984 038	-537 574	-15.3 %	2.0 %
	Ternium SA	14.4	12.43	7 562 860	6 506 931	5 989 994	-744 995	-11.1 %	4.0 %
	Transocean Ltd	16.7	12.38	8 400 912	6 231 919	5 736 830	-1 810 697	-24.0 %	3.8 %
					91 458 037	**84 192 246**	**-9 428 478**	**-10.1 %**	**56.3 %**
					Total	**138 865 769**	**-26 520 274**	**-16.0 %**	**92.8 %**

(1) Gains or losses in euros. Gains or losses in euros include the impact of currency fluctuations.

(2) Gains or losses in percentage. Gains or losses in percentage include the impact of currency fluctuations.

(3) Percentage of Net Asset Value

III – Manager's report

Stock market valuations in some sectors, such as technology, telecoms, nondurable consumer goods and business services, have significantly risen in the past two years, often unduly so. But valuations in others, such as commodities, heavy industry, transportation and finance, have not kept up and in some cases are even significantly lower than they were just a few years ago.

Starting in late 2013, we set out to exploit this growing valuation gap. Long-held positions, that had over the past several years significantly contributed to our funds' returns but had then become too richly priced versus their fundamentals, were disposed of. This, in turn, enabled us to re-balance the portfolio in favour of excessively undervalued stocks of mostly good-to-excellent companies. One unwanted but to-be-expected consequence of the portfolio overhaul has been a significant uptick in the portfolio's turnover rate, the so-called "churn". We don't like it. Active trading of stocks is costly and quite often counter-productive. We are confident that this time it won't be the case. Only time will tell. We will, however, strive to return to our historically "lazier" investment pace as soon as possible.

The investments made in recent months haven't had time to pay off yet. So, unsurprisingly, our funds have lagged the last two years' global equity rally. In our view, it is only a matter of time before this under-performance gets cured. However, for this to happen, patience might well be required.

Most of the companies added to the portfolio since 2013 have seen, for the last two-to-three years, sharp falls in their annual revenues and profits. We were well aware of these ongoing difficulties when we invested in them. We, too, manage a firm and we know that very few firms see steady growth in business and earnings. We also know that such volatility in numbers does not make them bad companies, or bad investments, to the extent that their long-term profit potential remains unscathed.

For the time being there are no signs of economic improvements, whether in farm equipment or construction, oil & gas services, steel or mining. Farmers in the US and Europe took advantage, in the mid- 2000s to early 2010s, of bountiful harvests and rising prices to renew and increase their equipment. As a result of this buying spree, and the sharp drops in commodity prices that recently occurred, the world's demand for agricultural equipment has first stalled, and then started to decline. No wonder, then, that in 2015, Deere saw its equipment sales drop by more than 20 percent. Over the same timeframe, a very similar story has unfolded in dry bulk shipping, weighing heavily on the earnings, financial position and the stock price of DS Norden, a Danish shipper and one of our fund's main investees. As a result of the oil supply glut caused by the "fracking" revolution compounded by Saudi Arabia's decision to maintain its market share at any cost (we will see how far they can go…), the oil & gas services industry suffered a fate, not very dissimilar to the one meted out to the farm equipment and dry bulk shipping sectors. The slowdown in the Chinese economy and the fact that there are currently no identified short-term growth opportunities elsewhere in the world, have added to the gloom surrounding these industries, and hence further blurring their short-term prospects.

Yet despite this backdrop, most of our investees have, so far, fared relatively well. They have kept on streamlining their operations, steadily reducing, in the process, the capital employed in their business: for instance, D/S Norden has taken advantage of charter contract expiries to downsize its fleet, while ArcelorMittal has shut down several plants to cut capacity. They have also continued investing in their expansion: TGS Nopec and Subsea 7 have been winning several new contracts despite tough market conditions, while IBM has been re-balancing its business portfolio by expanding rapidly into new markets such as cloud computing and big data, and at the same time jettisoning entire product lines.

Most business sectors go through cycles where stability induces euphoria that leads to excesses followed by sharp corrections, then overwhelming pessimism, which will in turn result in excesses, etc. Hence our confidence that in the oil & gas services sector, like in mining, agriculture or shipping, winter will be followed by spring, then summer (for the rare reader who might get confused, seasons are used herein only metaphorically). At such point in time, our companies, most of which we have picked for qualities such as financial strength, strong market positions, tight cost control and rational management and shareholders, will reap the benefits of the major efforts their teams are currently making. Here again, time is of the essence.[1]

Evolution of the portfolio structure in 2015

In 2015, the structure of the portfolio underwent a number of changes.

During the year, new positions were built or reinforced such as American Express, Anglo-American, ArcellorMittal, Cummins, Deere & Company, Diamond Offshore Drilling, Glencore, IBM, Leucadia National Corp., Posco, Rolls-Royce, Rowan Companies, Salzgitter AG, South32 Limited, Subsea 7, Tenaris, Ternium and Transocean.

At the same time, a number of positions were entirely or partially disposed of, such as America's Car-Mart, Bed Bath & Beyond, Fairfax Financial, Lectra, Loews, Electrocomponents, Manitou, Markel Corp., Mayr-Melnhof, Société FFP, TGS Nopec and Vicat.

As a result of these transactions, the equity portion of the portfolio represented, at year-end, 92.8% of the net asset value.

[1] 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.

As of December 31st, 2015, the breakdown by industry sector of the equity portion of the portfolio was as follows (2014 figures are provided for comparison purposes)[2]:

	2015	**2014**
- Heavy Industry:	23.2%	3.0%
- Oil and gas services:	18.6%	7.3%
- Capital goods:	11.0%	9.3%
- Transportation:	8.4%	8.8%
- Holdings:	8.3%	18.7%
- Business to business services:	7.2%	3.0%
- Resources company:	6.0%	0.0%
- Non-food retailing:	4.4%	9.5%
- Other:	5.7%	19.6%
- Cash:	7.2%	20.8%

[2] Following classification changes, 2014 figures provided herein may differ from last year's report.

Appendix: Our investment principles

The investment process used by Pastel & Associés consists in investing in a small number of publicly listed companies, chosen after a detailed analysis of their economic value and long-term prospective return. This process aims at both avoiding permanent loss of invested capital and generating long-term returns in excess of major global indices'. By keeping to the following principles, we believe that over long enough holding periods we should succeed in achieving such a dual goal. Although history is no guide to future results, our two funds, Margin of Safety Fund and Valeur Intrinsèque have done so for the holding periods starting at their respective inception date to today (December 31st, 2015).

Independence

• It is only by investing outside of the consensus that one can reasonably expect long-term out-performance. In order to do so, one can either go systematically against the consensus, or follow an investment process independent from the consensus without always trying to swim against the tide. Pastel & Associés has opted for the latter approach. As a result, we have developed, over the years, our own tools for detection, investment analysis and decision-making. This allows us to manage our funds with neither interference nor influence from brokers, bankers and external advisers.

Price, intrinsic value and risk

• The market price of an asset is not a reliable source of information about its long-term value, but just the "clearing" level at which sell and buy orders balance out. Ultimately, how far, up or down, the price is from the asset's value-in-use (or intrinsic value) is what matters. In some cases, the best estimate of such value will be a multiple of "normalized" free cash flows, at other times a multiple of net reported earnings will be used, and in other instance we will prefer to rely on adjusted net book value.

• An asset does not generally have a single, precisely defined intrinsic value but a series of possible intrinsic values. At Pastel & Associés we try to identify the outer bounds - if any - of this range of values as accurately as possible and then work out the subjective probabilities that such values be realized.

• When investing in stocks, volatility is both an unavoidable phenomenon and a formidable ally. Instead of fearing it, at Pastel & Associés, we turn it to our funds' advantage in order to prey on the opportunities it offers. Rather than worrying about volatility, or other variables such as Sharpe's ratios or maximum drawdowns, we focus instead on the only relevant notion of investment risk - that is, the possibility of permanently losing a substantial portion of the invested capital.

• Common sense tells us not to put all our eggs in one basket. But robust and sustainable baskets are thin on the ground, so Pastel & Associés' funds tend to be quite concentrated, with generally fewer than 30 so-called "risky" assets in portfolio.

Time and patience

• Our aim is not to call market price bottoms or tops. And we are usually not good at it, as for us “pricing” trumps “timing”. As a result, all too often, our investments will, initially, trade in the red for on occasion long time intervals, while our sales will cause us to miss additional profit opportunities. But as our decisions go generally against the market consensus which usually takes time to reverse, how could it be otherwise? In investing, as in many other aspects of life, patience is of the essence.

• Time can be an investment manager’s friend or foe. For an investment to pay off at some point in the future, it must be able to withstand the multiple crises it will inevitably run into along the way. For that reason, it is important to avoid investing in companies that are too fragile, over-indebted or vulnerable to obsolescence for technological, regulatory or other reasons.

Margins of safety

• There will be only one actual future, but there are multiple possible ones. Instead of trying to forecast the unpredictable, at Pastel & Associés we concentrate on trying to assess what would happen to the value of an asset under worst-case scenarii; we then invest only if the possible losses under such scenarii are either non-existent or relatively small. In most cases, this consists in buying an asset when its price is less than or equal to the lower bound of the range of possible intrinsic values.

• Market undervaluation of a stock is not a reason in and of itself for investing in it. First, one must “kick the tires” by looking for drivers of value such as:

- Top executives who excel at allocating capital rationally among organic re-investment, external growth, dividend payouts and share buybacks
- A business culture and a management team with a proven ability to optimize the firms’ operations in terms of cost control, revenue growth, market share capture and retention …
- Sustainable and clearly identified competitive advantages, including pricing power, controlled distribution, reputation, near-captive clients, product or service “criticality”, or annuity-type revenues, …
- …

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