Annual review

As of December 30th, 2016

Pastel & Associés

Société de Gestion de Portefeuille

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Ad augusta per angusta,

Dear investor,

After two difficult years in 2014 and 2015, each of our two mutual funds, Valeur Intrinsèque and Margin of Safety Fund, delivered one of its best performance ever in 2016 (see section I).

This rebound completely erased the paper losses accumulated in 2014-2015 and significantly narrowed the performance lag against the MSCI World index that occurred during the same period.

While we are pleased by this reversal of fortune, we know that we are only half-way through, the annualized return of our funds since year end 2013 still trailing our long-term expectations. In 2017 and beyond, we shall remain committed to our "value" investment approach, which we have been developing and executing for several decades. By sticking to our knitting, we believe that we will be able to achieve, in the years to come, 5 and 10-year rolling performances in line with the ones achieved during the past 15 years for Valeur Intrinsèque and the past 18 years for Margin of Safety Fund. But, all the while, avoiding the permanent loss of the capital entrusted to us by our investors will remain at the top of our mind.

Although we feel pretty confident about reaching our destination, we don't expect the journey to be without turbulence and unwelcome surprises. Often, the path taken by our funds will diverge from the one followed by the indices. However, if our past experience in managing funds is any guide, the investor willing to be patient and stay the course shall be amply rewarded. Others might object that the past is not a good indicator of the future. And there is truth in this statement. Nevertheless it is often said that if History doesn't repeat itself, it does rhyme…Time will tell…

Before you continue on this long-haul cruise with us, we invite you to take some time to read the following annual review. You will find new sections, including one - entitled "Post mortems" - which will be part of our report every year from now on. To those of you who may wonder how the political surprises of 2016, and others that might arise in 2017, could impact our funds, the thesis we developed in our half-year report (see extract in Annex V.1) may be an interesting read or re-read.

We hope this annual review will be up to your expectations and provide you with the answers to the questions, that as long-term investors in our funds you may have had. This is, at any rate, with this goal in mind, that the present report has been designed.

We wish you all the best for 2017,

David Pastel

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<u>Nota Bene</u> :

- Margin of Safety Fund being a feeder fund to Valeur Intrinsèque Fund, the data presented in section III and IV relate solely to Valeur Intrinsèque, except if otherwise indicated.

- The information provided herein is still subject to the upcoming certification by the statutory auditors of our funds.

I. Margin of Safety Fund and Valeur Intrinsèque: perfomance since inception

Total annual returns (in percentage)

	Margin of Safety Fund (P class)	MSCI World (USD) dividends reinvested	Difference
1998	2.5	21.0	(18.5)
1999	42.0	24.9	17.1
2000	15.1	(13.2)	28.3
2001	5.7	(16.8)	22.5
2002	(13.4)	(19.9)	6.5
2003	43.8	33.1	10.7
2004	23.9	14.7	9.2
2005	5.3	9.5	(4.2)
2006	20.9	20.1	0.8
2007	(4.0)	9.0	(13.0)
2008	(40.1)	(40.7)	0.6
2009	69.9	30.0	39.9
2010	16.2	11.8	4.4
2011	(19.7)	(5.5)	(14.2)
2012	20.8	15.8	5.0
2013	31.2	26.7	4.5
2014	(8.8)	4.9	(13.7)
2015	(20.8)	(1.8)	(19.0)
2016	29.8	7.5	22.3
Cumulative performance	371.6%	155.5%	
Annualized performance	8.5%	5.1%	

Fund's inception on February 2nd, 1998

Total annual returns (in percentage)

	Valeur Intrinsèque (P class)	MSCI World (EUR) dividends reinvested	Difference
2001	14.8	(14.9)	29.7
2002	(22.1)	(32.0)	9.9
2003	32.9	10.7	22.2
2004	16.3	6.5	9.8
2005	14.5	26.2	(11.7)
2006	13.2	7.4	5.8
2007	(11.3)	(1.7)	(9.6)
2008	(38.1)	(37.6)	(0.5)
2009	57.2	25.9	31.3
2010	19.7	19.5	0.2
2011	(17.4)	(2.4)	(15.0)
2012	22.6	14.0	8.6
2013	26.8	21.2	5.6
2014	(3.1)	19.5	(22.6)
2015	(16.6)	10.4	(27.0)
2016	31.8	10.7	21.1
Cumulative performance	153.5%	68.1%	
Annualized performance	6.2%	3.4%	

Fund's inception on June 6th, 2001

The performance of the other classes of shares is available on our website www.pastel.fr.

II. Balance sheet and income statement of Valeur Intrinsèque in 2016 – Key facts

Table 1: Breakdown of the change in net asset value (numbers in million euros)

Net asset value 31.12.15	Realized gains or losses	Net dividends	Mgmt. fees	Other fees	Cash (income/cost)	Change in unrealized gains or losses	Subscriptions / redemptions	Net asset value 30.12.16
149,7	6,3	1,7	-2,3	-0,1	NS	37,6	-25,4	167,3

No performance fees have been either provisioned or charged during the period under review.

The net cost of carrying cash and equivalents was not significant in 2016 (€47K - "NS" in the table).

At the end of 2016, the number of shares outstanding was 62,220 shares, compared to 73,708 a year ago (all classes of shares combined).

Table 2: Income statement of the fund – respective impact of securities and currencies (numbers in million euros)

Securities		Currency impact before hedging	Net impact of currency hedging
Realized gains or losses	Change in unrealized gains or losses		
4,8	41,6	0,4	-2,8

The "currency impact before hedging" assumes the whole portfolio is valued using the Euro as the functional currency. The "net impact of currency hedging" provided above aggregates the respective impacts of the specific currency hedging policies applied to each class of shares.

III. Investment portfolio as of December 30th, 2016

III.1. Inventory and breakdown by industry sector

Table 3: Inventory

Currency	Company	Shares	Average cost per share (in currency)	Market price per share (in currency)	Gains or losses (in currency)	Gains or losses (in euros)	Market value (in euros)	% Net asset value
EUR	Randstad	60 000	37.13	51.53	38.8%	38.8%	3 091 800	1.8%
	Thermador Groupe	21 732	72.31	83.50	15.5%	15.5%	1 814 622	1.1%
						29.1%	**4 906 422**	**2.9%**
GBP	Next Group Plc	56 393	47.37	49.83	5.2%	3.3%	3 292 014	2.0%
	Sports Direct International plc	450 000	2.84	2.79	-2.0%	-1.7%	1 468 721	0.9%
						1.7%	**4 760 735**	**2.8%**
DKK	D/S Norden	865 437	161.57	110.50	-31.6%	-31.5%	12 861 293	7.7%
						-31.5%	**12 861 293**	**7.7%**
NOK	Subsea 7	1 006 807	68.23	109.30	60.2%	55.2%	12 120 719	7.2%
	TGS-NOPEC Geophysical Co.	202 394	140.49	191.70	36.5%	27.5%	4 273 481	2.6%
						46.9%	**16 394 199**	**9.8%**
USD	American Express	67 200	69.16	74.08	7.1%	15.6%	4 719 769	2.8%
	Bed Bath & Beyond Inc	57 700	61.29	40.64	-33.7%	-13.5%	2 223 207	1.3%
	Cummins	53 300	118.54	136.67	15.3%	40.9%	6 906 386	4.1%
	Deere & Company	141 850	86.13	103.04	19.6%	47.1%	13 857 525	8.3%
	Diamond Offshore Drilling Inc	374 120	24.57	17.70	-28.0%	-22.2%	6 278 193	3.8%
	International Business Machines	40 300	154.39	165.99	7.5%	16.8%	6 342 164	3.8%
	Leucadia National Corp.	666 387	24.79	23.25	-6.2%	15.3%	14 689 261	8.8%
	Rowan Companies plc	424 210	17.90	18.89	5.5%	15.2%	7 597 371	4.5%
	Tenaris	113 500	27.69	35.71	29.0%	30.9%	3 842 697	2.3%
	Ternium SA	384 037	14.45	24.15	67.2%	78.0%	8 793 073	5.3%
	Transocean Ltd	563 486	15.36	14.74	-4.0%	1.2%	7 874 647	4.7%
						19.7%	**83 124 292**	**49.7%**
						Equities	**122 046 941**	**72.9%**
						Cash	**45 269 673**	**27.1%**
						Net asset value	**167 316 614**	**100.0%**

The average cost per share displayed in this table is the average historical cost for each investment, and as such does not reflect the impact of subscriptions and redemptions on the “economic cost” for the investor who had subscribed prior to and was still invested after these transactions.

This impact was far from immaterial in 2016 as our funds experienced significant cash outflows while we chose not to unwind some of the fund’s positions we deemed most undervalued. This no-action course allowed those longer-term investors to virtually increase their indirect holdings of undervalued companies at very attractive prices. However, this “relutive” phenomenon was not reflected in the average cost per share as provided herein which is a mere accounting figure.

Table 4: Breakdown by industry sector

As a reminder, this breakdown is not based on a sector allocation that was decided ex-ante. It is merely the result of our "bottom-bottom" approach.

Sectors	Weight
Oil and gas services	**22.8%**
Diamond Offshore Drilling Inc	
Rowan Companies Plc	
Subsea 7	
TGS-NOPEC Geophysical	
Transocean Ltd	
Capital goods	**12.4%**
Cummins	
Deere & Company	
Holdings	**8.8%**
Leucadia National Corp.	
Transportation	**7.7%**
D/S Norden	
Heavy industry	**7.5%**
Tenaris	
Ternium SA	
Business to business services	**5.6%**
International Business Machines	
Randstad	
Non-food retailing	**4.2%**
Bed Bath & Beyond Inc	
Next Group plc	
Sports Direct International	
Financial services	**2.8%**
American Express	
Other(s)	**1.1%**
Thermador Groupe	
Cash (€)	**27.1%**

III.2. Forex exposure

As a reminder, regarding Valeur Intrinsèque, the H class of shares is systematically hedged against nominal non-euro risk whereas the other classes (I and P) are subject to a partial hedging strategy (resulting in a hedge ratio usually comprised between 25% and 75%). Regarding Margin of Safety Fund, the exchange rate risk is subject to partial hedging against nominal non-dollar risk (resulting in a hedge ratio usually comprised between 25% and 75%).
For both funds, the hedging policies - be they systematic or partial - are generally only implemented for currency exposures greater than 10% of the portfolio.

Table 5: Currency hedging

	Valeur Intrinsèque		Margin of Safety Fund
	I Class P Class	**H Class**	**I Class P Class**
Reference currency	Euro	Euro	USD
USD	98.4%	95.5%	0.0%
GBP	0.0%	0.0%	0.0%
DKK	0.0%	95.8%	0.0%
NOK	0.0%	96.1%	0.0%
EUR	0.0%	0.0%	18.5%

Apparent hedging ratios (I and P classes), of almost 100% for the US dollar and zero for the DKK and NOK are mainly due to the fact that the Scandinavian companies the funds have invested in, make most of their business in US dollars. As a result we have made the decision to hedge these investments as if they were denominated in US dollars. Adjusting for this, the US dollar versus Euro hedging ratio would get closer to 75%.

In the case of the H class, the hedging policy being by definition systematic, such consideration were not taken into account.

IV. Evolution of the portfolio of Valeur Intrinsèque in 2016

IV.1. Main transactions over the period under review

- Partial or complete disposal of positions which had reached market valuation levels that we deemed to be excessive compared to their long-term economic value: America's Car-Mart (USA), Anglo American (UK) , ArcelorMittal (Luxembourg), Glencore (UK), IMB (USA), Lonmin (UK), Posco (South Korea), Rolls-Royce (UK), Salzgitter (Germany), South32 (Australia) and Vallourec (France).

- New positions were built or reinforced in quality companies when their stock prices were found to be cheap enough. Let us mention: American Express (USA), Diamond Offshore (USA), Next Group (UK), Randstad (Netherlands), Rowan Companies (USA), Sports Direct (UK), Subsea 7 (Norway), TGS Nopec (Norway) and Transocean (USA).

- The "cash" position was up at 27.1% of the portfolio as of December 30th, 2016, versus 7.2% at the end of 2015.

The high level of cash is not the sign of a defensive stance on our part, but merely an outcome of our investment process. We divested several holdings after they became overvalued in 2016, following a sharp increase in their stock prices. And we haven't yet identified cheap enough opportunities to reinvest the proceeds of these sales. As of today we have no view on how the cash position will be used during the year. This will depend on how "Mister Market" will behave or misbehave during the year and at what level he will decide to price the stocks of companies we are already invested in, and those of companies we would like to add to our portfolio. However, no matter how high the level of cash held by our funds, our requirements in terms of margin of safety won't be lowered. In other words, and to paraphrase Warren Buffett, we won't let cash burn a hole in our investors' pockets.

Table 6: Year-to-year portfolio comparison

As of December 31st, 2015

Currency	Company	% NAV
EUR	ArcelorMittal	6.3%
	Salzgitter AG	3.0%
	Thermador Groupe	1.6%
	Vallourec SA	3.3%
		14.2%
GBP	Anglo American Plc	2.7%
	Glencore	2.0%
	Lonmin Plc	0.3%
	Rolls-Royce Holdings Plc	1.9%
	South32 Limited	1.1%
		8.0%
DKK	D/S Norden	8.4%
		8.4%
NOK	Subsea 7	4.4%
	TGS-NOPEC Geophysical Co.	1.6%
		6.0%
USD	American Express	2.1%
	America's Car-Mart	2.6%
	Bed Bath & Beyond Inc	1.9%
	Cummins	3.3%
	Deere & Company	7.7%
	Diamond Offshore Drilling Inc	4.7%
	International Business Machines	7.2%
	Leucadia National Corp.	8.3%
	Posco	4.6%
	Rowan Companies plc	4.1%
	Tenaris	2.0%
	Ternium SA	4.0%
	Transocean Ltd	3.8%
		56.3%
Equities		**92.8%**
Cash		**7.2%**

As of December 30th, 2016

Currency	Company	% NAV
EUR	Randstad	1.8%
	Thermador Groupe	1.1%
		2.9%
GBP	Next Group Plc	2.0%
	Sports Direct International plc	0.9%
		2.8%
DKK	D/S Norden	7.7%
		7.7%
NOK	Subsea 7	7.2%
	TGS-NOPEC Geophysical Co.	2.6%
		9.8%
USD	American Express	2.8%
	Bed Bath & Beyond Inc	1.3%
	Cummins	4.1%
	Deere & Company	8.3%
	Diamond Offshore Drilling Inc	3.8%
	International Business Machines	3.8%
	Leucadia National Corp.	8.8%
	Rowan Companies plc	4.5%
	Tenaris	2.3%
	Ternium SA	5.3%
	Transocean Ltd	4.7%
		49.7%
Equities		**72.9%**
Cash		**27.1%**

IV.2. Portfolio turnover in 2016

Warren Buffett often says that the stock market is a wealth redistribution mechanism through which money is transferred from the active to the patient investor.

The following table will help the reader assess to which category we, as investors, belong.

For all purposes, we have also calculated the portfolio turnover according to the AMF-AFG method, which amounts to 21.1% for the year.

Table 7: Key portfolio turnover variables (numbers in million euros)

Daily average net asset value	Securities' purchases	Securities' sales	Subscriptions	Redemptions
148,5	21,4	85,0	24,8	50,2

IV.3. Performance attribution

Table 8: Main contributors / detractors

Main contributors	
ArcelorMittal	7.1%
Subsea 7	3.8%
Ternium SA	3.6%
Deere & Co	2.4%
Leucadia National corp	2.2%
Total	**19.1%**

Main detractors	
D/S Norden	-0.5%
Diamon Offshore Drilling Inc	-0.5%
Bed Bath & Beyond Inc	-0.2%
Thermador Groupe	-0.1%
Sports Direct	0.0%
Total	**-1.3%**

The quantitative data are adjusted and restated according to our methods and may consequently differ from data available from other sources.

IV.4. Post-mortems

Last summer, in our half-year report, we provided a two-year review of our investments in the mining sector. Since then, we have kept on divesting the portfolio out of hard-commodity related stocks. As a result, at year-end, the portfolio exposure to steel production, albeit still material, was much lower than at the beginning of the year.

As a reminder, short-term macro-economic views played no role in our decisions to divest out of these sectors. When selling, like when we first bought these stocks, we only took into consideration their market prices as compared to the underlying businesses' quantitative and qualitative fundamentals.

While most of these companies' stock prices were showing steep discounts to their net asset value when we invested, qualitative factors likely to preserve the long-term value of these investments were also present. Margins of safety present included for instance, owner-CEOs (Arcelor, Glencore, Subsea7, Tenaris, Ternium...) or leading market shares in some sustainable customer segments (Anglo-American on the diamond market, Tenaris and Vallourec with the specialty tubes for the oil and gas industry…).

Table 9: "Post-mortems" of our investments in the mining and steel sectors

Company	Date of entry	Exit date	ACS (in currency)	ACS / First acquisition price	Average selling price (in currency)	Total amount invested EUR	Realized gains or losses EUR	Cumulative perf.	Discount / restated net asset value at entry	Discount / restated net asset value at exit
Anglo American	11/2015	04/2016	3.50	90.9%	4.89	4 616 407	1 828 097	39.6%	-52%	0%
Glencore	12/2015	04/2016	0.80	96.4%	1.51	3 012 973	2 666 481	88.5%	-50%	-2%
South32	06/2015	05/2016	0.87	92.6%	0.68	6 392 901	-1 380 867	-21.6%	-27%	-24%
Lonmin	07/2015	04/2016	NS	NS	NS	4 418 247	-857 140	-19.4%	-72%	-80%
ArcelorMittal	01/2015	12/2016	5.55	62.9%	5.91	16 313 455	1 048 775	6.4%	-39%	29%
Vallourec	08/2015	12/2016	6.45	49.1%	5.25	7 597 625	-1 413 151	-18.6%	-37%	-13%
Salzgitter	01/2015	11/2016	22.87	99.2%	30.79	5 070 208	1 756 597	34.6%	-51%	-16%
Posco	07/2015	09/2016	39.66	97.6%	47.15	8 653 753	1 635 238	18.9%	-52%	-38%
Ternium	07/2015	-	14.45	94.5%	21.26	8 100 705	3 815 599	47.1%	-14%	48%
					Total	**64 176 275**	**9 099 630**	**14.2%**		

ACS stands for Average Cost per Share.

The performance was computed assuming constant exchange rates.

Since Ternium is still in our funds' portfolio, we used a "theoretical" exit price as of December 30th, 2016 for computation purposes.

What we learned so far from these investments:

- The internal rate of return on these investments, as a whole, was lower than our long-term objective, all the more so as the average holding period was shorter than our 3/5 years "normal".

- In order to avoid a repeat of such a sub-performance, here are the steps we took to enhance our investment process:

  1. In a number of cases we have seen "catastrophic events" take place, events which we have used in our valuation models as worst-case scenarios highly unlikely to occur. Let us mention, for instance, the botched and harried share capital increase of both Arcelor and Vallourec. We were not so much taken by surprise by these companies having to tap financial markets; this we had expected. But we never thought in our worst nightmares that this exercise would be implemented in such an incompetent and chaotic way and so badly timed. Instead of denying the inevitable, the management of both companies should have faced it earlier and taken the appropriate actions on time.
     In the future, when dealing with very cyclical and indebted companies, we will give more weight to the left-hand side of the return distribution, trying to keep in mind that the worst can be worse than expected and more probable than one would have been naturally inclined to consider based on historical data points. In more practical terms, we will, from now on, require even larger discounts before considering making such investments.

  2. Before investing in companies which may face temporary financial difficulties, it is necessary to consider in a detailed manner the different possible scenarios through which the crisis and its aftermath could unfold, both for the companies involved and our funds. In particular, since our funds are UCITS and open to subscriptions and redemptions, investments becoming "illiquid" or even non-negotiable would be problematic. If we cannot exclude, or at least consider as highly improbable, the realization of such a risk ex-ante, we may have to question whether such investments should be part of our funds' portfolio. As a consequence, if we won't refrain from investing again in very cyclical and indebted companies, we will strive to avoid those companies whose stocks may face sudden and lasting illiquidity or even delisting. Also, the weight represented by the former companies in the portfolio should be limited, as it has indeed always been the case. As a matter of fact, the weight of our investments in the mining and steel sectors, measured at the end of each month, has never reached more than 30% of the portfolio over the 2015-2016 period, spread over 9 different issues.

- When the glass is half empty, it is also half full, and we have at least three reasons to be satisfied by our still ongoing incursion into the commodities and related processed products:

  1. Our research has led us to discover high quality companies that we did not have an opportunity to look at before, like Tenaris and Ternium, thus enhancing our investment universe.

2. One of the cornerstones of our investment approach is to require that, for each investment, potential permanent losses be limited and potential gains be significant. This is one of the reasons why, in the long-run, we expect our funds to deliver significant returns, although ones unlikely to be linear. In this instance, although some of our worst case scenarios did in fact occur, the stock positions involved suffered, and only for a few of them, very contained realized losses. Concurrently, the portion of the portfolio invested in mining and steel stocks, considered as a whole, contributed positively to the overall funds' performance. The optionality that our investment approach strives for has, in this case, proved its efficacy, even when faced with major headwinds.

3. The lessons we learned from this investing experience in the mining and steel sectors will help us improve the quality and profitability of our future investments.

V. Outlook

In 2017, we will continue to manage the portfolio in accordance with the same investment methodology that we have developed and implemented since our company's inception in December 1997. This method has proven its mettle and its profitability over a long period of time, and we remain confident that it still offers long-term substantial benefits for our funds and our investors. Concerning the performance we expect in 2017, we will have a clearer view on January 1st, 2018. In the meantime, we will remain focused on the disciplined implementation of our investment process rather than waste time and energy trying to predict how our funds, the financial markets or the global economy will perform over the freshly started year.

VI. Annex

VI.1. Extract from the half-year report - June 2016

"There are two classes of forecasters: those who don't know, and those who don't know they don't know"

- John Kenneth Galbraith -

[…]

As we were compiling this report, the result of the British referendum on exiting the EU was on everybody's mind. Financial markets, in particular, have taken the issue to heart, leading many pundits to declare some asset classes such as British equities and real estate as off limit to prudent investors, the referendum's result making them too "risky".

However, had the "Remain" vote won, would the future have become less risky? Doesn't the future always carry risks, some of which will materialize while others simply won't? Most often it is only in hindsight that we fully understand what dangers the future, after morphing into the past, was holding. And the years to come will surely bring their own share of surprises, as it would have also been the case if the pro-Europeans had won the referendum.

It will probably take a long time for the consequences of the Brexit vote of June 23rd to fully materialize, if indeed the United Kingdom was to actually leave the EU (considering the past referenda on the European construction, one can justifiably wonder). Anyway, its impact on companies' profitability will be significant, especially for British ones. However, it will be hard to single it out from the impact of other phenomena not directly linked to the Brexit issue, may they be of a political, macroeconomic or microeconomic nature. Many British firms might have to rethink their business model - which some might fail to accomplish - whereas others should continue to thrive. In sum, it is too early to assume, despite the dire predictions of the "usual suspects", be they investment banks' strategists or TV shows' business "experts", that the vote of June 23rd will be the start of a deep and enduring crisis for the British economy.

In this environment, we could increase, maybe significantly, the share of the portfolio invested on the London Stock Exchange, depending on the bargains that Mr Market could offer us in the coming weeks or months. At the time we write these lines, the "sales" period that seemed to have started on June 24th has come to a quick stop. Will it be re-instated soon?

[…]

VI.2. Our investment principles

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 inception (respectively 1998 and 2001) to today (Dec 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

- Because, for us, “pricing” trumps “timing”, we are not interested in calling market price bottoms or tops. And we are usually not good at it. 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 generally 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 …
  - …

VI.3. Investor's manual

INVESTOR'S MANUAL

"If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes"

- Warren Buffett -

Before making any decision about investing in our funds, you might be interested in reading our "Investor's manual", and notably the questionnaire you can find in part II of this document. Your answers to the questionnaire should make it easier for you to decide whether the way we manage our funds and report to investors and your own experience and expectations as an investor are consistent with each other. Only then, will you be in a position whether to invest or not to invest in our funds. Because your answers are not supposed to be read by anyone but yourself, please be as candid and honest as you can in expressing them.

This document is the direct result of more than twenty years' experience dealing with investors. In turn, this experience has helped us form some distinct opinions about investing and how to manage a fund and deal with potential and existing investors. Here are some of or our insights:

- Pastel & Associés would rather have a limited but stable base of assets under management than manage a larger but more volatile pot of money. By choosing this path, the company aims to make it easier to stay true to its long-term and value approach (see "Our investments principles" on our website), and to manage its funds serenely. To further its goal, Pastel & Associés strives to build long-term relationships with investors who are already familiar with the value investing universe and who embrace this philosophy. This is also why the company is neither looking to actively enroll new investors through conventional sales techniques based on arguments that can only be biased, nor to incite current holders to maintain or increase their holdings of our funds' shares. It is the investor's sole responsibility, or his adviser's, to decide, with no interference from us, whether or not to subscribe to the funds managed by Pastel & Associés.
- When investing into a fund, some investors tend to trade into and out of their position. Such a behavior could severely disrupt the management of a fund and divert its managers from their task. Other investors tend to put themselves in the managers' shoes and base their decision to subscribe or redeem their shares upon a fund's make-up at a given moment, rather than upon lasting features such as the methodology being applied by the managers and the trust they can have in them. Such a behavior is most often counterproductive and often leads such investors to take wrong turns at inopportune times. Pastel & Associés strives, through all the tools available to it, including through the nature of its communication, to deter those two types of investors to enter its funds.
- By trying to optimize the timing of their investment operations rather than subscribing gradually and staying invested as long as possible, a lot of investors don't benefit fully from the performance of the funds they are invested in. To quote a well-known saying by Warren Buffett, which applies to equities as well as to funds: "the stock market is a wonderfully efficient mechanism for transferring wealth from the impatient to the patient".
- Pastel & Associés favors focusing its resources, including its managers' workload, on managing its funds, doing financial analysis and going on study trips over interacting too often with its investors, be it during meetings or through sending documents. By so doing, the pace at which we communicate with our investors is better aligned with the timeframe of our own investing of the funds 'assets.
- Because many fund managers have the tendency to publicly discuss at length, if not promote, some of their funds' positions, they, then, find it difficult to dispose of them when the time has come. To reduce the negative impact of

this behavioral bias on performance, we try to avoid as much as possible to discuss the specifics behind our decision to invest in a given stock. For the same reason, Pastel & Associés' communication regarding the make-up of our funds' portfolios as well as their evolution is strictly descriptive and is not meant to convince or reassure.

Questions for the investor:

- The following questions and the answers you will give them are meaningful only to the extent that on one hand the managers at Pastel & Associés stay true to their investment philosophy, as described in "Our investments principles", and on the other hand the fund's management company, namely Pastel & Associés, doesn't go through a major change that could threaten its durability or its loyalty to the said philosophy.
- Do I embrace the value investment approach at the heart of Pastel & Associés' philosophy? While I may not have read and processed the writings of Benjamin Graham, Warren Buffett or John Templeton, did I take time to go through Pastel & Associes' investment principles as they appear on their website (see "Our investments principles" on www.pastel.fr)? Did I fully agree with these principles?
- Will I be patient enough to hold onto my investment in the funds managed by Pastel & Associés for at least five years before considering redeeming my holdings partially or fully? Did I make sure that I won't be needing for other purposes, before the end of this five-year minimum holding period the capital I intend to invest in the funds managed by Pastel & Associés?
- Will I be able to withstand potentially long periods of temporary but possibly significant paper losses, regarding my investment in the funds managed by Pastel & Associés, without losing confidence and/or without trading out of my position under the influence of overwhelming stress? Will I be able to watch my stock holding decline potentially by 50% without becoming panic-stricken? Especially if, meanwhile, other funds or other types of assets were to exhibit significant outperformance?
- Do I fully understand that Pastel & Associés reports on its funds on a quarterly basis only, even if their net asset value can be calculated more frequently? Will I be able to stay confident while, between two quarterly reports, my only source of information on the funds will be their net asset values which, just like equity prices, might vary erratically?
- Will the information provided by Pastel & Associés fulfill my expectations knowing that no quantitative data such as Sharpe ratio, maximum drawdown, beta or volatility will figure in the funds' management reports, nor will they be mentioned or discussed by the portfolio managers?
- Will I be able to keep both my holdings and my confidence intact when the funds managed by Pastel & Associés might see their portfolio make-up significantly diverge from what my own expectations or preferences would favor, be it in regard to a stock, a sector or a geographical location?
- Have I properly read the funds' KIIDs and prospectuses before contemplating buying their shares?

Pastel & Associés

Pastel & Associés is an independent asset manager which, since its inception in 1997, has implemented a "value" investing process, based on the concepts of intrinsic value, margin of safety and independent investment research. The objective of our investment process is twofold: to reduce the risk that our funds suffer a permanent loss of value, and to generate for each of our funds a satisfactory long term rate of return per share*.

The two investment funds (UCITS) managed by the company, Valeur Intrinsèque (established in France and started in 2001) and Margin of Safety Fund (established in Luxembourg and started in 1998) are invested primarily in shares of companies listed on the stock exchanges of OECD countries. But if the manager considers that reasonably priced investment opportunities have become too scarce, the investment portfolio may be allocated, to a significant extent, to fixed income and monetary assets.

The investment process implemented by Pastel & Associés is detailed in "Our investment principles" which is available on the company's website www.pastel.fr under the heading "Philosophy".

Any decision to subscribe to any of these funds should be based on a thorough analysis of the funds' prospectus and KIID, which are available on the company's website under the heading "Funds".

* The investment time horizon of the funds Valeur Intrinsèque and Magin of Safety Fund is 5 years or longer and the risk of permanent loss of capital is significant.

Investor Relations

The investment partnership that Pastel & Associés is looking to build with its investors is described in the document "Investor's Manual", which is available on the company's website.

Pastel & Associés is not in the investment advisory business. Therefore, it is up to each investor, or his own representative and/or advisor, to decide whether and to what extent he is ready to invest in the funds managed by Pastel & Associés. However, Pastel & Associés will be pleased to provide any explanation or assistance with regard to the documents published on the company's website.

In order to follow up with their investment, unitholders can use three types of documents that are published and made available on the company's website: a quarterly report, a biannual report and an annual review, the latter being designed in the spirit of the annual report of a public company. In order to preserve the equal treatment of all its funds' investors, the company does not provide any other additional information.

PASTEL & ASSOCIÉS

SOCIÉTÉ DE GESTION DE PORTEFEUILLE

17, rue de Miromesnil 75008 Paris - France
33 (0)1 58 36 24 00 - www.pastel.fr
Agrément AMF GP 97-108