

14692



Dunedin Smaller Companies Investment Trust PLC

ANNUAL REPORT AND ACCOUNTS

FOR THE YEAR ENDING 31 OCTOBER 1997



3



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Objective

The achievement of long term capital growth from a portfolio of smaller companies in the United Kingdom, at a higher rate than the FTSE Small Cap Index (excluding Investment Trusts).

Financial Highlights

- Net asset value increased by 3.8% to 417.57p
- Increased final dividend of 7.0p making total of 10.0p for the year
- Smaller companies should continue to prosper with a background of UK economic growth



Chairman's Statement

The UK smaller company sector has absorbed a number of changes over the last year. The government has changed, interest rates have trended upwards and the strength of sterling has challenged UK industrial competitiveness. Against this background the trust has underperformed its benchmark index, the FTSE Small Cap Index (excluding investment trusts). The net asset value per share increased by 3.8% during the year to 31 October 1997, compared to an increase of 7.0% in

the benchmark index and the share price has increased to 347p.

Four reasons account for the underperformance. The restructuring of the portfolio was largely completed following the appointment of the new manager. This led to a higher than normal turnover in the trust. The trust also has an historic overweight position in very small companies which was detrimental as they underperformed. The index was also distorted by an exceptional level of takeover activity directed principally at underperforming, badly managed businesses. The trust actively avoids these types of investment and does not speculate on prospective takeover candidates. Finally the trust wrote off £227,000 of expenses associated with the debenture issue. The

reasons behind the underperformance are largely exceptional factors. Underlying performance progressively improved throughout the year and this offers encouragement for 1997/8.

The board is recommending an increased final dividend of 7.0p making a total of 10.0p for the year. The revenue return per share has increased to 11.78p.

In May, the trust successfully issued a 25 year 8³/₈% debenture issue, raising £15 million. This fixes the cost of borrowing and gives the trust the ability to capitalise on rising markets.

Small companies should continue to prosper with a background of UK economic growth. Valuations are not stretched and the company is well placed to take advantage.

I M Clubb, Chairman
11 December 1997



Manager's Review

The UK equity market produced markedly divergent returns for the year. The FTSE All Share Index rose by 17.2% while the FTSE Small Cap Index (excluding investment trusts) rose by 7.0%. The FTSE All Share Index performed well due to the high exposure to banks and pharmaceuticals sectors which were re-rated. The industrial bias prevalent in the FTSE Small Cap Index saw its returns undermined by the strength of sterling. The company underperformed its benchmark index with a return of 3.8%.

Review of the year

The sharp and sustained appreciation in the value of sterling has tested the competitiveness of UK manufacturing industry. The FTSE Small Cap Index has a high exposure to general industrial companies and this held back returns. Companies adversely exposed to currency fell out of favour.

In a number of instances, the bearish sentiment was overdone and last year saw an exceptionally high level of takeover activity. This was most frequently targeted at badly managed businesses without a plausible defence. The high level of activity suggests there is undervaluation of the whole small companies sector.

Areas that have performed well over the last year are those where earnings forecasts were perceived as secure. These included the support services, property and financial sectors. The defensive qualities of food producers were in demand as were construction companies on the back of rising property values.

Portfolio

There were a number of changes made to the portfolio over the year. Having taken over the management of the portfolio in March 1996, it was important to establish a spine of blue-chip investments running through the portfolio. These are augmented by a combination of undervalued and overlooked companies and emerging growth companies. The strategy avoids speculative ventures and places a strong emphasis on the quality of earnings and cash.

The company benefited from three takeovers during the year. HTV was acquired by the Scottish Media Group, EFT was acquired by the Bank of Scotland and Protean was subject to a bid from a US buyer. Relative to the benchmark index this represents a low level of takeovers.

There were a number of strong stock performances. Many were long standing investments such as Headlam, Capita, Compel and Hemingway Properties. It was encouraging to see new investments delivering and there were good rises in the share prices of Expro, Galen, PSD, Freeport Leisure and Westminster Healthcare.

The disappointments were generally as a result of stock specific reasons. Oasis and Denby were upset by indifferent trading after a period of strong growth. Skillsgroup warned after problems in its Scandinavian operations. In general terms, the very small companies were overlooked and certain share prices fell without reason. These will undoubtedly recover in time and this will help performance.



Andrew Bamford is the fund manager



Manager's Review

Smaller companies frequently display the dynamism and flexibility to produce good returns and real growth.

Gearing

In May the company raised £15 million through a 25 year 8 $\frac{3}{8}$ % debenture issue. The facility gives the manager the opportunity to enhance returns for shareholders and take advantage of the excellent long term returns which UK small companies have historically generated.

Outlook

The new government has made low inflation a priority and is applying monetary policy in a rigorous fashion.

This has inflated the value of sterling and is likely to lead to a slower rate of UK economic growth in 1998. This is a challenging environment for smaller companies and there will undoubtedly be casualties in the months ahead.

Share prices reflect this difficult environment. However the high level of takeover activity suggests that the bearish sentiment is overdone. Interest rates are likely to peak in 1998. This should lead to an easing in the currency and pave the way for a re-rating of smaller companies. In a low inflation environment, the challenge will be to identify companies demonstrating real growth. Smaller companies frequently display the dynamism and flexibility to produce good returns and real growth.



Distribution of Investments

AT 31 OCTOBER

	1997		1996	
	£000	%	£000	%
MINERAL EXTRACTION				
Oil exploration and production	1,213	1.5	638	0.9
	1,213	1.5	638	0.9
GENERAL INDUSTRIALS				
Building and construction	4,844	6.1	3,228	4.4
Building materials and merchants	3,909	5.0	519	0.7
Chemicals	2,346	3.0	2,402	3.3
Diversified industrials	1,718	2.2	2,903	3.9
Electronic and electrical equipment	3,614	4.6	4,355	5.9
Engineering	7,666	9.8	6,629	9.0
Engineering, vehicles	1,154	1.5	2,871	3.9
Paper, packaging and printing	2,726	3.5	2,997	4.1
Textiles and apparel	1,166	1.5	1,932	2.6
	29,143	37.2	27,836	37.8
CONSUMER GOODS				
Alcoholic beverages	701	0.9	—	—
Food producers	413	0.5	491	0.7
Household goods	1,220	1.6	4,522	6.2
Health care	2,808	3.6	1,327	1.8
	5,142	6.6	6,340	8.7
SERVICES				
Distributors	8,338	10.5	9,204	12.6
Leisure and hotels	3,496	4.5	2,891	4.0
Media	3,481	4.4	3,727	5.1
Retailers, food	1,765	2.3	1,663	2.3
Retailers, general	3,519	4.5	4,396	6.0
Brewers, pubs and restaurants	1,853	2.4	3,336	4.6
Support services	7,548	9.6	4,624	6.3
Transport	2,566	3.3	2,402	3.3
	32,566	41.5	32,243	44.2
FINANCIALS				
Insurance	702	0.9	416	0.6
Other financial	3,285	4.2	2,300	3.1
Property	6,351	8.1	2,854	3.9
Investment trusts	—	—	567	0.8
	10,338	13.2	6,137	8.4
Total investments	78,402	100.0	73,194	100.0

Convertibles amount to nil (1996—£486,000).

Overseas investments amount to £128,000 (1996—£179,000).



List of Largest Investments

AT 31 OCTOBER 1997

Company	Market Value £000	Description
Headlam	1,665	Distributors
Partco	1,604	Distributors
Triad	1,295	Support services
Wescol	1,276	Engineering
Hemingway Properties	1,238	Property
Tibbet & Britten	1,168	Transport
Hicking Pentecost	1,166	Textiles & apparel
Avon Rubber	1,153	Engineering, vehicles
Pillar Property	1,125	Property
Wyko	1,106	Distributors
Ten largest investments	12,796	16.3% of total value of investments
Westminster Health Care	1,105	Healthcare
Southnews	1,089	Media
Watson & Philip	1,083	Retailers, food
Hampson Industries	1,064	Engineering
Inspec	1,042	Building & construction
PSD	1,031	Support services
Brandon Hire	1,024	Building & construction
First Choice Holiday	971	Leisure & hotels
MacDonald Hotels	927	Leisure & hotels
Perry	917	Distributors
Twenty largest investments	23,049	29.4% of total value of investments
Compel	904	Support services
Expro International	900	Oil services
Scholl	894	Healthcare
Bank of Scotland	884	Retail bank
Renold	879	Engineering
Pressac	878	Electronic & electrical equipment
Scottish Highland Hotels	876	Leisure & hotels
Grampian	868	General retailers
McLeod & Russel	860	Diversified industrials
Ascot	858	Diversified industrials
Thirty largest investments	31,850	40.6% of total value of investments



Ten Year Record

Year ended 31 October	Assets at valuation £000	Preference stock and other borrowings £000	Equity shareholders' funds £000	Revenue available for ordinary dividends £000	Net asset value p	Per ordinary share		Share price p
1987	58,317	425	57,892	1,176	344.6	Earnings p	Dividend p	313.0
1988	59,261	425	58,836	1,516	350.2	9.02	8.80	291.0
1989	54,150	425	53,725	1,797	319.8	10.70	10.50	265.0
1990	42,413	425	41,988	2,030	249.9	12.08	12.00	227.0
1991	46,916	425	46,491	1,902	276.7	11.32	12.00	273.0
1992	37,518	425	37,093	1,821	220.8	10.84	12.00	219.0
1993	51,388	425	50,963	1,465	303.4	8.72	9.00	290.0
1994	57,933	5,000	52,933	1,506	315.1	8.96	9.00	306.0
1995	63,851	5,000	58,851	1,553	350.3	9.24	9.00	326.0
1996	72,614	5,000	67,714	1,602	402.5	9.54	9.00	346.0
1997	85,379	15,000	70,379	1,979	417.6	11.78	10.00	346.5

Figures for 1989 and subsequent years reflect the change in accounting policy from including investment income on a receivable basis to an ex-dividend basis. Figures for 1995 and subsequent years reflect the change in accounting policy in the Statement of Recommended Practice.

Analysis of Shareholders

AT 31 OCTOBER 1997

Class of Shareholder	% of shares
Individuals	26.0
Insurance and assurance companies	14.2
Fund management companies	25.1
Pension funds	27.8
Other institutions	6.9
	<u>100.0</u>



Investment Changes

	Valuation at 31.10.96 £000	Net purchases (sales) £000	Appreciation (depreciation) £000	Valuation at 31.10.97 £000
United Kingdom	73,015	13,230	(7,971)	78,274
Other Areas	179	(41)	(10)	128
	73,194	13,189	(7,981)	78,402

Comparison of Market Capitalisation

AT 31 OCTOBER 1997

Equity market capitalisation £m	Dunedin Smaller Companies weighting %	FTSE Small Cap Index (ex Investment Trusts) weighting %
0 – 25	5.4	0.1
25 – 50	17.6	2.2
50 – 75	14.3	6.6
75 – 100	8.9	9.0
100 – 125	8.7	9.8
125 – 150	6.0	11.2
150 – 175	4.6	7.8
175 – 200	8.5	8.4
200 – 225	7.2	9.4
225 – 250	5.8	7.6
250 – 275	4.0	8.9
275 – 300	0.0	5.2
300+	9.0	13.8
	<u>100.0</u>	<u>100.0</u>



Corporate Information

Registered Office

Belsize House
West Ferry
Dundee DD5 1NF
Telephone: 01382-778244

Manager and Secretary

Edinburgh Fund Managers plc
Donaldson House
97 Haymarket Terrace
Edinburgh EH12 5HD
Telephone: 0131-313 1000
Regulated by IMRO and the
Personal Investment Authority

Registrar

Bank of Scotland
Registrar Department
Apex House
9 Haddington Place
Edinburgh EH7 4AL
Telephone: 0131-243 5181

Banker

Bank of Scotland
38 Threadneedle Street
London EC2P 2EH

Auditors

KPMG Audit Plc
Chartered Accountants

Company Broker

NatWest Securities
135 Bishopsgate
London EC2M 3XT

Company Registration Number

SC 14692



Board of Directors

I M Clubb
Chairman

I M Clubb (56), joined the board in March 1995 and was appointed chairman in December 1995. He is chairman of First Choice Holidays and B Elliot and a director of TLG, Expro International Group and Shanks & McEwan.

G S Lowden
Director

G S Lowden MA, LLB, CA (70), a director since 1981, was formerly chairman of the Dundee Port Authority and Managing Partner, KPMG, Dundee.

Lord Ramsay
Director

Lord Ramsay (49), a director since 1993, is a founder of Enskilda Securities and was a former director of Capel-Cure Myers Capital Management. He is chairman of Jamestown Investments and a director of Edinburgh Japan Trust.

M G N Walker
Director

M G N Walker CBE (64), a director since 1982, is chairman of Sidlaw Group and Ivory & Sime UK Smaller Companies Trust and a director of Scottish Hydro-Electric.

All directors are members of the audit committee.



Directors' Report

Business and status

The company carries on business as an investment trust and, for the purpose of the Income and Corporation Taxes Act 1988, has been treated by the Inland Revenue as approved as such for the year ended 31 October 1996, the latest year for which accounts have been submitted. The company has subsequently conducted its affairs so as to enable it to continue to seek such approval.

The company is an investment company within the terms of Section 266 of the Companies Act 1985.

Review of activities

During the year the company followed the normal activities of an investment trust. Details of these are given in the Chairman's Statement on page 2 and the Manager's Review on pages 3 and 4.

Dividends

The directors recommend that a final dividend of 7.0p is paid to shareholders on the register on 30 December 1997 (1996-6.0p) and propose that the company's revenue surplus for the year of £299,000 (1996-£90,000) be transferred to the revenue reserve.

Directors

The names of the directors and their holdings in the company's shares are shown in Table 1 opposite. The company has not been notified of any changes in directors' holdings between 31 October 1997 and 11 December 1997.

In accordance with the Articles of Association, Lord Ramsay retires from the board by rotation and will be proposed for re-election at the Annual General Meeting.

Mr G S Lowden, who has attained the age of 70, retires under section 293(3) of the Companies Act 1985 and offers himself for re-election. Special notice under section 293(5) of the Companies Act 1985 to propose the re-election of Mr G S Lowden has been received by the company.

No contract or arrangement existed during the year in which any of the directors had a material interest.

No director had a service contract with the company.

Going concern

The directors believe that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

	Ordinary 25p shares		Nature of interest
	1997	1996	
I M Clubb	5,000	5,000	Beneficial
G S Lowden	4,345	4,345	Beneficial
Lord Ramsay	4,000	4,000	Beneficial
M G N Walker	2,000	2,000	Beneficial

Table 1 Directors and their holdings in the company as at 31 October



Directors' Report

Corporate Governance

Compliance

The board complies with The Code of Best Practice published by the Cadbury Committee on the Financial Aspects of Corporate Governance ('the Code') and that it has done so throughout the year.

Internal control

The directors acknowledge their responsibility for the company's system of internal financial controls.

The responsibility to ensure compliance with regulations, company law, to provide effective and efficient operations and investment management has been delegated to the manager and secretary, Edinburgh Fund Managers plc, under the terms of the Investment Management Agreement.

Edinburgh Fund Managers plc is responsible for the design, implementation and maintenance of control policies and procedures to safeguard the assets of the company and to manage its affairs properly. The company's investments are segregated from those of Edinburgh Fund Managers plc and those of its other clients through the appointment of Bank of Scotland as independent custodian of those investments.

The board meets regularly and has a number of matters reserved specifically for its approval including investment, treasury and dividend policy. The board also reviews quarterly financial statements, performance and revenue budgets.

The systems are designed to provide reasonable but not absolute assurance against material misstatement or loss. The directors confirm that, during the year, they reviewed the effectiveness of the system of internal financial controls in operation.

Reporting

The auditors, KPMG Audit Plc, have confirmed that in their opinion: with respect to the directors' statements on internal financial control and going concern, the directors have provided the disclosures required by the Listing Rules of the London Stock Exchange and such statements are consistent with the information of which they are aware from their audit work on the accounts; and that the directors' other statements above appropriately reflect the company's compliance with the other paragraphs of the Cadbury Code specified for their review by the Listing Rule 12.43(j). They were not required to perform the additional work necessary to express, and did not express, any opinion on the effectiveness of either the company's system of internal financial control or corporate governance procedures, nor on the ability of the company to continue in operational existence.

Substantial share interests

At 11 December 1997 the substantial interests in the ordinary share capital which had been notified to the company are shown in Table 2.

Holder	No. of ordinary shares	%
The Edinburgh Investment Trust plc	1,630,000	9.70
Prudential Corporation plc	1,037,800	6.18
Dunedin Income Growth Investment Trust PLC	835,000	4.97
DC Thomson & Company Ltd	831,600	4.95
Derbyshire County Council	700,000	4.17
National Westminster Bank Plc	548,720	3.27

Table 2 Substantial share interests

**Directors' Report****Payments policy**

The company's payment policy is to ensure settlement of suppliers' invoices in accordance with the stated terms. In certain circumstances, settlement terms are agreed prior to business taking place and it is the company's policy to abide by those terms.

Annual General Meeting – Special Business

At the Annual General Meeting of the company to be held on 9 February 1998, a special resolution will be proposed under 'Special Business' to give the directors limited power to allot shares in disapplication of statutory pre-emption rights.

Section 89 of the Companies Act 1985 requires the directors, whenever they propose to allot ordinary shares for cash, to offer such shares first to shareholders in proportion to their existing holdings (shareholders' pre-emption rights). Section 95 of the Act enables the disapplication of these pre-emption rights in certain circumstances.

Resolution 6 contains a renewal of the disapplication of shareholders' pre-emption rights granted to the directors on 21 January 1997 for a period of up to 15 months from this year's Annual General Meeting. If approved, this resolution will empower the directors to issue shares for cash without applying pre-emption rights if the issue either is made in connection with a rights issue or does not exceed 5% of the issued ordinary share capital.

Auditor

The company's auditors, KPMG Audit Plc, are willing to continue in office and resolutions will be proposed at the Annual General Meeting to reappoint them and to authorise the directors to fix their remuneration.

By order of the board,

Edinburgh Fund Managers plc, Secretary

Edinburgh, 11 December 1997



Statement of Directors' Responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the revenue of the company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors confirm that they comply with all the above requirements. The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and to detect fraud and other irregularities.



Auditors' Report

To the members of Dunedin Smaller Companies Investment Trust PLC

We have audited the financial statements on pages 17 to 27 which have been prepared under the historical cost convention, as modified by the revaluation of fixed assets and on the basis of the accounting policies set out on page 20.

Respective responsibilities of directors and auditor

As described above, the company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 October 1997 and of its return for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

Chartered Accountants

Registered Auditor

Edinburgh,

11 December 1997



Financial Statements



Statement of Total Return

FOR THE YEAR ENDED 31 OCTOBER

	Notes	Revenue £000	1997 Capital £000	Total £000	Revenue £000	1996 Capital £000	Total £000
Realised gains on investments	15	—	11,322	11,322	—	2,859	2,859
Unrealised (losses)/gains on investments	16	—	(7,981)	(7,981)	—	6,211	6,211
Income from investments	2	2,477	—	2,477	2,334	—	2,334
Interest receivable on short term deposits		419	—	419	56	—	56
Other income		59	—	59	48	42	90
Investment management fee	3	(89)	(267)	(356)	(81)	(250)	(331)
Administrative expenses	4	(201)	—	(201)	(217)	—	(217)
NET RETURN BEFORE FINANCE COSTS AND TAXATION		2,665	3,074	5,739	2,140	8,862	11,002
Interest payable and similar charges	5	(203)	(608)	(811)	(104)	(237)	(341)
NET RETURN ON ORDINARY ACTIVITIES BEFORE TAXATION		2,462	2,466	4,928	2,036	8,625	10,661
Taxation	6	(483)	—	(483)	(434)	48	(386)
RETURN ON ORDINARY ACTIVITIES AFTER TAXATION		1,979	2,466	4,445	1,602	8,673	10,275
Equity dividends	7	(1,680)	—	(1,680)	(1,512)	—	(1,512)
RETURN ATTRIBUTABLE TO EQUITY SHAREHOLDERS		299	2,466	2,765	90	8,673	8,763
RETURN PER ORDINARY SHARE	8	11.78p	14.68p	26.46p	9.54p	51.63p	61.17p

The revenue column of this statement represents the revenue account of the company.

All revenue and capital items in the above statement derive from continuing operations.



Balance Sheet

AT 31 OCTOBER

	Notes	1997 £000	1996 £000
FIXED ASSETS			
Investments	9	78,402	73,194
CURRENT ASSETS			
Debtors	11	905	829
Cash and short term deposits	21	8,398	140
		<u>9,303</u>	<u>969</u>
CREDITORS – Amounts falling due within one year	12	<u>2,553</u>	<u>6,549</u>
NET CURRENT ASSETS		<u>6,750</u>	<u>(5,580)</u>
TOTAL ASSETS			
LESS CURRENT LIABILITIES		85,152	67,614
CREDITORS – Amounts falling due after one year	13	<u>14,773</u>	<u>—</u>
		<u>70,379</u>	<u>67,614</u>
CAPITAL AND RESERVES			
Called up share capital	14		
Ordinary shares		4,200	4,200
Capital reserve – realised	15	52,592	42,145
Capital reserve – unrealised	16	12,102	20,083
Capital redemption reserve	17	425	425
Revenue reserve	18	1,060	761
ORDINARY SHAREHOLDERS' FUNDS		<u>70,379</u>	<u>67,614</u>
NET ASSET VALUE PER SHARE	23	417.57p	402.46p

The financial statements on pages 17 to 27 were approved by the board on 11 December 1997 and were signed on its behalf by:

I M CLUBB, Director



Cash Flow Statement

FOR THE YEAR ENDED 31 OCTOBER

	Notes	1997		1996	
		£000	£000	£000	£000
NET CASH INFLOW					
FROM OPERATING ACTIVITIES	19		1,714		1,319
SERVICING OF FINANCE					
Interest paid		(250)		(318)	
NET CASH OUTFLOW					
FROM SERVICING OF FINANCE			(250)		(318)
TAXATION					
UK income tax paid		—		8	
Corporation tax paid		(15)		115	
TOTAL TAX PAID			(15)		123
FINANCIAL INVESTMENT					
Purchase of investments		(34,445)		(26,718)	
Sale of investments		32,766		26,485	
NET CASH OUTFLOW FROM					
FINANCIAL INVESTMENT			(1,679)		(233)
EQUITY DIVIDENDS PAID			(1,512)		(1,512)
NET CASH OUTFLOW BEFORE FINANCING			(1,742)		(621)
FINANCING					
Repayment of loan	22	(5,000)		—	
Issue of debenture stock	22	15,000		—	
NET CASH INFLOW FROM FINANCING			10,000		—
INCREASE IN CASH	21		8,258		(621)



Notes to the Accounts

1. Accounting policies

The accounts have been prepared under the historical cost convention, modified to include the revaluation of investments and in accordance with applicable Accounting Standards and with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies'. They have also been prepared on the assumption that approval as an investment trust will continue to be granted.

(a) Revenue, expenses and interest payable.

Income from investments, including taxes deducted at source and imputed tax credits, is included in revenue by reference to the date on which the investment is quoted ex-dividend. Foreign income is converted at the exchange rate applicable at the time of receipt. Interest receivable on fixed interest securities, short term deposits, expenses and interest payable are treated on an accruals basis.

Expenses are charged to capital where they are incurred in connection with the maintenance or enhancement of the value of the investments. In this respect the investment management fee and relevant finance costs are allocated 25% to revenue and 75% to capital, in line with the board's expectation of returns from the company's investments over the long term in the form of income and capital respectively.

(b) Investments. Listed investments are valued at market prices, foreign currencies being converted at the rates of exchange ruling at the relevant balance sheet date. Unlisted investments, which include investments traded on the Unlisted Securities Market or Alternative Investment Market or under Rule 4.2(a) of The Stock Exchange, are valued by the directors taking account of latest dealing prices, brokers' valuations and other available accounting information as appropriate.

(c) Realised capital reserves. Gains and losses on realisation of investments and differences on exchange are dealt with in the realised capital reserves. 75% of the investment management fee along with the associated irrecoverable VAT are charged to this reserve. The associated tax relief is credited to this reserve.

(d) Unrealised capital reserves. Increases and decreases in the valuation of investments held are dealt with in the unrealised appreciation reserve.

(e) Taxation. Deferred taxation is provided for on short term timing differences.

2. Investment income

Dividends

	1997		1996	
	Franked £000	Unfranked £000	Franked £000	Unfranked £000
Listed: United Kingdom	2,415	60	2,309	23
Unlisted: Overseas	—	2	—	2
	<u>2,415</u>	<u>62</u>	<u>2,309</u>	<u>25</u>



	1997	1996
	£000	£000
3. Investment management fee		
Investment management fee	303	282
Irrecoverable VAT thereon	53	49
	<u>356</u>	<u>331</u>
Charged against capital reserve – realised	(267)	(250)
	<u>89</u>	<u>81</u>

The management fee paid to Edinburgh Fund Managers ('Edinburgh') is 0.4% per annum of the total assets of the company after deducting current liabilities and excluding commonly managed funds. For the 12 months to June 1998, the fee is also subject to a rebate of 0.2% on net new borrowings. The fee is subject to VAT at the appropriate rate.

The management agreement between the company and Edinburgh is terminable by either party on 2 years' notice.

The management fee is chargeable 25% to revenue and 75% to capital.

4. Administrative expenses

Secretarial fee	50	50
Directors' fees	33	34
Auditors' remuneration – audit	8	8
Registrar's fees	6	6
Other expenses	104	119
	<u>201</u>	<u>217</u>

The secretarial fee of £50,000 per annum is paid to Edinburgh.

A contribution of £11,000 (1996–nil) was paid to Edinburgh in respect of marketing and promotion of the company through their Investment Trust Initiative.

The chairman who was the highest paid director received £10,000 (1996–£10,000).

The emoluments of the other directors were £7,500 each (1996–£7,000).

Remuneration paid to the auditors for non-audit services amounted to £4,250 which related to the £15 million debenture stock issue in May and has been allocated to capital reserve – realised.

**Notes to the Accounts**

	1997	1996
	£000	£000
5. Interest payable and similar charges		
Bank overdraft	—	3
Sterling loan interest	196	338
8 ³ / ₈ % debenture loan stock interest	611	—
Amortised debenture stock premium and issue expenses	4	—
	<u>811</u>	<u>341</u>
Charged against capital reserve – realised	(608)	(237)
	<u>203</u>	<u>104</u>

6. Taxation

Tax attributable to franked investment income	483	451
Relief for surplus franked investment income	—	(28)
	<u>483</u>	<u>423</u>
Deferred tax	—	10
Overseas tax	—	1
	<u>483</u>	<u>434</u>

No provision has been made for advance corporation tax on the final dividend as, in the opinion of the directors, such tax will be fully relieved by tax credits.

7. Dividends

Interim dividend of 3.0p (1996–3.0p) paid 30 June 1997	504	504
Final dividend of 7.0p (1996–6.0p) payable 10 February 1998	1,176	1,008
	<u>1,680</u>	<u>1,512</u>

8. Return per ordinary share

The return per ordinary share is based on the following figures.

	1997	1996
Revenue return	£1,979,000	£1,602,000
Capital return	£2,466,000	£8,673,000
Number of ordinary shares in issue	16,800,000	16,800,000



Notes to the Accounts

9. Investments

	Listed in UK £000	Unlisted £000	Total £000
Valuation at 31 October 1996	71,023	2,171	73,194
Unrealised appreciation at 31 October 1996	(19,062)	(1,021)	(20,083)
Book cost at 31 October 1996	51,961	1,150	53,111
Additions at cost	34,926	—	34,926
Disposals at cost	(21,517)	(220)	(21,737)
Transfers at cost	653	(653)	—
Book cost at 31 October 1997	66,023	277	66,300
Unrealised appreciation at 31 October 1997	12,182	(80)	12,102
Valuation at 31 October 1997	78,205	197	78,402
		1997 £000	1996 £000

10. Unlisted investments

Unlisted Securities Market	—	809
Unquoted	197	1,362
	197	2,171

11. Debtors

Dividends and interest receivable	262	305
Withholding taxes deductible therefrom	(47)	(61)
Net dividends and interest receivable	215	244
Amounts due from brokers	592	504
Taxation recoverable	89	73
Other debtors	9	8
	905	829

12. Creditors: amounts falling due within one year

Amounts due to brokers	714	438
Short term sterling loan	—	5,000
Debenture interest	611	—
Other creditors	52	103
Final dividend	1,176	1,008
	2,553	6,549

The short term unsecured loan outstanding at 31 October 1996 was repaid on 30 May 1997.

**Notes to the Accounts**

1997	1996
£000	£000

13. Creditors: amounts falling due after one year

Repayable after more than 5 years:

8.375% debenture stock 2022	15,000	—
Unamortised premium and expenses of issue	(227)	—
	<u>14,773</u>	<u>—</u>

A £15 million debenture stock was issued on 6 May 1997 and the whole stock is redeemable at par on 6 May 2022. Interest on the debenture stock is payable in half-yearly instalments in May and November each year. The debenture stock is secured by a floating charge over the whole assets of the company.

14. Called up share capital

Authorised:

20,800,000 (1996–20,800,000) ordinary shares of 25p	<u>5,200</u>	<u>5,200</u>
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Allotted, issued and fully paid:

16,800,000 (1996–16,800,000) ordinary shares of 25p	<u>4,200</u>	<u>4,200</u>
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15. Capital reserve – realised

At 31 October 1996	42,145	39,683
Realised net gain on sales of investments	11,322	2,859
Sterling loan interest	(147)	(237)
Debenture loan interest	(458)	—
Amortised debenture stock premium and issue expenses	(3)	—
Management fee	(267)	(250)
Other capital items	—	48
Capital income	—	42
At 31 October 1997	<u>52,592</u>	<u>42,145</u>

75% of the management fees, loan interest, debenture loan interest, debenture stock premium and issue expenses have been allocated to this capital reserve. The proportion reflects an assessment of the activities undertaken by the manager in pursuit of the investment objective of the company.

16. Capital reserve – unrealised

At 31 October 1996	20,083	13,872
Movement in unrealised appreciation on investments	<u>(7,981)</u>	<u>6,211</u>
At 31 October 1997	<u>12,102</u>	<u>20,083</u>



Notes to the Accounts

	1997	1996
	£000	£000
17. Capital redemption reserve		
At 31 October 1997 and 31 October 1996	<u>425</u>	<u>425</u>

18. Revenue reserve

At 31 October 1996	761	671
Transferred from revenue account	<u>299</u>	<u>90</u>
At 31 October 1997	<u>1,060</u>	<u>761</u>

19. Reconciliation of net revenue before finance costs and taxation to net cash inflow from operating activities

Revenue before interest and taxation	2,665	2,140
Decrease in accrued income	43	(40)
Increase on other debtors	(1)	11
Increase in creditors	1	(131)
Tax on franked investment income	(496)	(461)
Other income within investment account	—	50
Management fee charged to capital	(267)	(250)
Debenture premium and issue expenses	<u>(231)</u>	<u>—</u>
	<u>1,714</u>	<u>1,319</u>

20. Analysis of changes in financing during the year

	1997		1996	
	Share Capital	Debentures & Loans	Share Capital	Debentures & Loans
	£000	£000	£000	£000
Balance at 31 October 1996	4,200	5,000	4,200	5,000
Issue of debenture stock	—	15,000	—	—
Repayment of sterling loans	—	(5,000)	—	—
Balance at 31 October 1997	<u>4,200</u>	<u>15,000</u>	<u>4,200</u>	<u>5,000</u>

	1997	1996
	£000	£000

21. Analysis of changes in cash during the year

Balance at 31 October 1996	140	761
Net cash inflow	<u>8,258</u>	<u>(621)</u>
Balance at 31 October 1997	<u>8,398</u>	<u>140</u>

**Notes to the Accounts****22. Analysis of changes in net debt**

	Balance at 31 October 1996 £000	Cash Flows £000	Unamortised issue expenses and premium £000	Balance at 31 October 1997 £000
Cash and short term deposits	140	8,258	—	8,398
Debt due within one year	(5,000)	5,000	—	—
Debt due after more than one year	—	(15,000)	227	(14,773)
	<u>(4,860)</u>	<u>(1,742)</u>	<u>227</u>	<u>(6,375)</u>
			1997 £000	1996 £000

23. Total shareholders' funds

Total shareholders' funds attributed to equity shares	70,379	67,614
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Total shareholders' funds have been calculated in accordance with the provisions of Financial Reporting Standard 4 'Capital Instruments'.

However, the net asset value per share figures in note 24 have been calculated on the basis of shareholders' rights to reserves adjusted to reflect the deduction of the debentures at par. A reconciliation of the two figures is as follows:

Shareholders funds attributable as above	70,379	67,614
Number of equity shares in issue at the year end	16,800,000	16,800,000
	1997	1996
Funds per share	418.92p	402.46p
Deduct: Premium and expenses of debenture issue	(1.35p)	—
At 31 October 1997	<u>417.57p</u>	<u>402.46p</u>



Notes to the Accounts

24. Net asset value per share

The net asset value per share and the net asset value attributable to the ordinary shareholders at the year end, adjusted to reflect the deduction of the debentures at par, were as follows:

	1997	1996	1997 £000	1996 £000
Ordinary shares	417.57p	402.46p	70,152	67,614

The movements during the year of the assets attributable to the ordinary shares were as follows:

	1997 £000	1996 £000
Total assets at 31 October 1996	67,614	58,851
Total recognised capital gains for the year	2,466	8,673
Revenue return for the year	1,979	1,602
Dividends appropriated in the year	(1,680)	(1,512)
Unamortised loan note expenses	(227)	—
Total net assets at 31 October 1997	<u>70,152</u>	<u>67,614</u>

Basic net asset value per ordinary share is based on net assets (adjusted to reflect the deduction of the debentures at par) and on 16,800,000 (1996–16,800,000) ordinary shares, being the number of ordinary shares in issue at the year end. The analysis of shareholders' funds on the face of the balance sheet has been computed in accordance with the provisions of Financial reporting Standard 4 'Capital Instruments', and does not reflect the rights under the Articles of Association of the respective classes of shares on a return on assets. A reconciliation of the two sets of figures is given in note 23.

25. Reconciliation of movement in shareholders' funds

Shareholders' funds at 31 October 1996	67,614	58,851
Total recognised capital gains for the year	2,466	8,673
Net revenue for the year	299	90
Shareholders' funds at 31 October 1997	<u>70,379</u>	<u>67,614</u>

26. Commitments and contingencies

There are contingent liabilities in respect of underwriting agreements amounting to £679,000 (1996–£455,000).

Uncalled liabilities in respect of nil paid and partly paid shares amount to nil (1996–nil).



Financial Calendar

Announcements and the issue of the annual and interim reports may normally be expected in the following months:

December – Preliminary results for year and recommended final dividend for year announced. Annual report and accounts published

February – Annual General Meeting and final dividend paid

June – Interim results announced and interim report for half-year to 30 April published and interim dividend paid

This year's Annual General Meeting will be held in Donaldson House, 97 Haymarket Terrace, Edinburgh on Monday 9 February 1998 at 12 noon. Shareholders are asked to reply on the enclosed card if they will be attending the meeting.



The Company is a member of The Association of Investment Trust Companies.



Notice of Meeting

Notice is hereby given that the seventieth Annual General Meeting of Dunedin Smaller Companies Investment Trust PLC will be held in Donaldson House, 97 Haymarket Terrace, Edinburgh on **Monday 9 February 1998 at 12 noon**, for the following purposes:

1. To receive the Report of the Directors and the Accounts for the year to 31 October 1997 and to declare a final dividend on the ordinary shares.
2. To re-elect Lord Ramsay as a director of the company.
3. To re-appoint KPMG Audit Plc as auditor of the company.
4. To authorise the directors to fix the remuneration of the auditor for the year to 31 October 1998.

SPECIAL BUSINESS

To consider and, if thought fit, to pass the following resolutions, with Resolution 5 being proposed as an ordinary resolution and Resolution 6 being proposed as a special resolution.

Ordinary resolution

5. To re-elect Mr G S Lowden as a director of the company having received special notice pursuant to Sections 293 and 379 of the Companies Act of the intention to propose the following resolution: that Mr G S Lowden, who attained the age of 70 years on 22 May 1997, be re-elected a director of the company.

Special resolution

6. (i) That the directors be and are hereby empowered pursuant to Section 95 of the Companies Act 1985 ('the Act') to allot equity securities (within the meaning of Section 94(2) of the Act) for cash at a price not below the net asset value per share, pursuant to any general authority conferred upon them for the purposes of Section 80 of the Act as if Section 89(1) of the Act did not apply to any such allotment, provided that this power shall be limited:
 - (a) to the allotment of equity securities in connection with any rights issue in favour of the holders of ordinary shares on the register on a date fixed by the directors where the equity securities respectively attributable to the interests of all the holders of ordinary shares are proportionate (as nearly as practicable) to the respective numbers of ordinary shares held by them on that date, provided that the directors may make such exclusions or other arrangements as they may deem necessary or expedient in relation to fractional entitlements or legal or practical problems under the laws in any territory or the requirements of any relevant regulatory body or stock exchange; and



Notice of Meeting

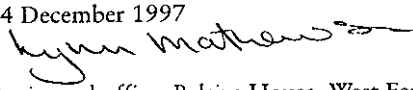
(b) to the allotment (otherwise than pursuant to paragraph (a) of this Resolution) of equity securities up to an aggregate nominal amount of £210,000 being 5% of the nominal value of the existing issued share capital of the company;

and shall expire at the conclusion of the next Annual General Meeting of the company after the passing of this Resolution or fifteen months from the passing of this Resolution, whichever is earlier, save that the company may, before such expiry, make an offer or agreement which would or might require equity securities to be allotted after such expiry and the directors may allot equity securities pursuant to any such offer or agreement as if the power conferred hereby had not expired.

By order of the board

Edinburgh Fund Managers plc, Secretary,

24 December 1997


Registered office: Belsize House, West Ferry,
Dundee DD5 1NF

Notes:

1. Holders of ordinary shares are entitled to attend and vote at the meeting.

Members must be entered on the company's register of members 48 hours before the time appointed for the meeting. If the meeting is adjourned for more than 48 hours then, for members to be entitled to vote, they must be entered on the company's register of members 48 hours prior to the time fixed for the adjourned meeting. Any such holder may appoint another person (whether a member of the company or not) as his proxy to attend and vote on a poll in his stead. Proxies must be lodged at the company's registrars, Bank of Scotland, Registrar Department, Apex House, 9 Haddington Place, Edinburgh EH7 4AL not less than 48 hours before the time appointed for the meeting. Completion of a form of proxy will not prevent a holder of ordinary shares from attending or voting in person should he so wish.

2. There are special arrangements for holders of shares through InvestIT – The Edinburgh Fund Managers Investment Trust Savings Plan and The Edinburgh Fund Managers Investment Trust Personal Equity Plan and pension arrangements. These are explained in the 'Letter of Directions' which such holders will have received with this report.



Information for Investors

EDINBURGH FUND MANAGERS PLC

Edinburgh Fund Managers has many years of experience in the investment trust market and can trace its roots back to the formation of Edinburgh US Tracker Trust in 1902. This trust was launched to enable investors to invest in the then emerging markets of North America. In 1969 the staff of Edinburgh US Tracker Trust founded Edinburgh Fund Managers.

In March 1996 the merger with Dunedin Fund Managers was completed with the result that Edinburgh Fund Managers is now one of the largest managers of investment trusts in the UK. In addition, the company also manages a wide range of unit trusts and pension fund portfolios. Total assets managed by the group are currently around £6.8 billion.

Edinburgh Fund Managers is based in the city of Edinburgh, with offices in Dundee and Atlanta, Georgia. Edinburgh Fund Managers is a value investor and has a well established investment philosophy designed to provide consistent above average investment performance, within an acceptable measured risk environment.

This value based approach builds portfolios which typically have the characteristics of lower price earnings and price to book ratios than the relevant benchmark.

The long association with the management of investment trust companies has been developed over the years and, in summary, Edinburgh Fund Managers is an innovative investment management company which creates and delivers investment solutions to its clients throughout the world.

INVESTMENT TRUSTS

It is the business of investment trusts, advised by their managers, to invest in the shares of other companies. The investment objectives vary from trust to trust ranging from investment for capital growth and/or income, to trusts which invest internationally, in a specific area of the world or in a single country market.

Investing in investment trusts can provide a spread of investments, managed by experts, at low cost.

HOW TO INVEST

Ordinary shares

Investors can buy and sell shares in an investment trust directly through a stockbroker or indirectly through a lawyer, accountant or other professional adviser. Alternatively shares can be bought directly through InvestIT – The Edinburgh Fund Managers Investment Trust Savings Plan and The Edinburgh Fund Managers Investment Trust PEP.

PRODUCT DETAILS

InvestIT – The Edinburgh Fund Managers Investment Trust Savings Plan

Edinburgh Fund Managers has combined the best of SaveIT (The Investment Trust Savings Scheme from Edinburgh Fund Managers) and the Dunedin Share Plan, with additional features, to create InvestIT. The product provides a straightforward way to invest in the investment trusts offered by Edinburgh Fund Managers. Investors can make regular monthly payments (minimum £30 per month) or invest occasional lump sums (minimum £250 initially and £30 thereafter). Existing shareholders can also invest in the Plan and have their dividends reinvested. There is no charge for buying, selling or holding shares through InvestIT other than 0.5% Government Stamp Duty which is currently payable on all share purchases.

*Edinburgh Fund
Managers is a value
investor and has a
well established
investment
philosophy*



Information for Investors

The Edinburgh Fund Managers Investment Trust PEP

Investors can invest up to £6,000 through a PEP in any one financial tax year. A feature of the Edinburgh Fund Managers Investment Trust PEP is its low charges. The initial charge is £30 (plus VAT) and the annual management charge is 0.5% and is capped at £40 (plus VAT). No charges are made for buying or selling shares other than Government Stamp Duty on share purchases.

The Edinburgh Fund Managers Investment Trust Pension

The Investment Trust Pension enables investors to save for retirement by investing in investment trusts managed both by Edinburgh Fund Managers and other leading fund management groups. The Investment Trust Pension offers the choice of a Personal Pension Plan or a Free Standing Additional Voluntary Contributions Plan. Contributions can be made monthly, yearly or by lump sums, and there are low minimum investment amounts. It is also completely penalty free.

Note

Please remember that past performance is not necessarily a guide to the future. Stock market and currency movements may cause the value of shares and the income from them to fall as well as rise and investors may not get back the amount they originally invested.

Investors should further bear in mind that the value of any tax relief will depend on the individual circumstances of the investor and that tax rates and reliefs, as well as the tax treatment of PEPs, may be changed by future legislation.

Keeping you informed

The company's share price appears under the heading 'Investment Trusts' in the Financial Times, The Times, The Daily Telegraph, The Guardian, The Independent, The Scotsman and The Herald. Investors can also obtain the latest share price by phoning FT Cityline on 0336-432 385. All calls cost 50p per minute.

For internet users, detailed data on Dunedin Smaller Companies Investment Trust, including price and performance information, is available on the TrustNet website (<http://www.trustnet.co.uk>).

For information and application forms on the InvestIT, PEP, Pension and Share Exchange Schemes please contact:

The Client HelpDesk

Edinburgh Fund Managers plc
Donaldson House
97 Haymarket Terrace
Edinburgh EH12 5HD
Telephone: 0131-313 1000
or **FREE** on 0800-838 993 (24 hours)

InvestIT Administrator

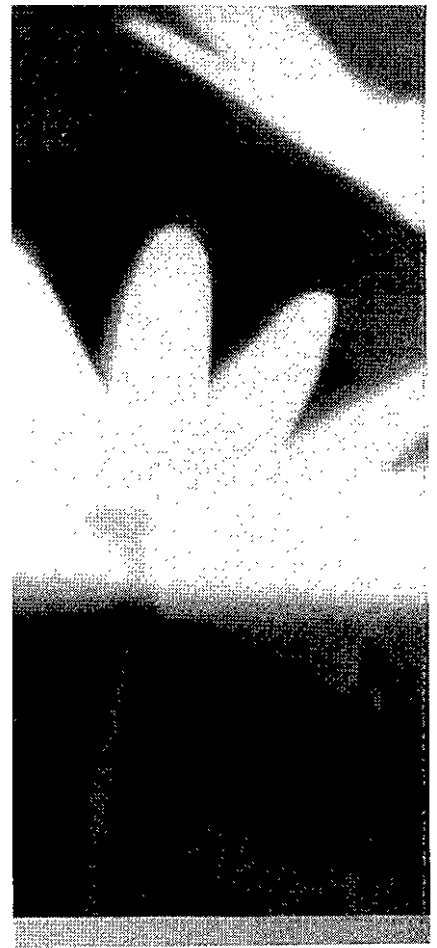
Bank of Scotland
Registrar Department (SP)
Apex House
9 Haddington Place
Edinburgh EH7 4AL
Telephone: 0131-243 5070

Personal Equity Plan Administrator

Henderson Ltd
PEP Administrator
3 Finsbury Avenue
London EC2M 2PA
Telephone: 0171-410 4018

Pension Administrator

Edinburgh Pension Centre
Personal Pension Management Limited
24-27 Barnack Business Centre
Blakey Road
Salisbury
Wiltshire SP1 2LP
Telephone: 0800-137 079



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