SC14692

2002

Dunedin Smaller Companies Investment Trust plc

Annual Report and Accounts 31 October 2002

Contents:

Company Summary

The trust aims to attract long term retail investors and institutional holders wanting to benefit from the growth prospects of smaller companies by investment in a relatively risk averse trust.

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 SmallCap Index (excluding Investment Companies).
Benchmark	FTSE SmallCap Index (excluding Investment Companies)
Investment manager	Edinburgh Fund Managers plc
Equity shareholders' funds	£57.2 million at 31 October 2002
Market capitalisation	£43.7 million at 31 October 2002
Capital structure	16,550,000 ordinary shares of 25p each
Management fee	The basic management fee is 0.4% per annum of adjusted gross assets. There is also a performance-related management fee calculated at a rate of 0.1% per annum (up to a maximum of 0.5% per annum) of the adjusted gross assets for every 1.0% by which the company's net asset value performance outperforms the capital performance of the benchmark index over the previous 12 month period.
PEP/ISA status	The company's shares are eligible for existing general PEPs, PEP transfers and Individual Savings Accounts (ISAs).
AITC	The company is a member of The Association of Investment Trust Companies.

Financial Summary

	At 31 October 2002	2001	% change
Performance			
Total assets less current liabilities (£'000)	72,043	95,040	(24.2)
Equity shareholders' funds (£'000)	57,224	80,231	(28.7)
Capital return			
Net asset value per share	344.67p	479.28p	(28.1)
FTSE SmallCap Index (ex investment companies)	1,777.75	2,298.00	(22.6)
Share price	264.00p	391.00p	(32.5)
Total return (capital return plus income re-invested)			
Net asset value	—	—	(26.3)
FTSE SmallCap Index (ex investment companies)	—	—	(20.6)
Share price	—	—	(30.2)
Total dividend for year	12.90p	12.90p	—
Revenue return per share	9.92p	13.43p	(26.1)
Net asset value per share adjusted for borrowings valued at market value	323.15p	456.83p	(29.3)

Discount (difference between share price and net asset value)		
– where borrowings are deducted at par value	(23.40%)	(18.42%)
– where borrowings are deducted at market value	(18.30%)	(14.41%)

Gearing (ratio of borrowings to shareholders' funds)		
Actual gearing ratio	(1.25%)	3.71%
Maximum potential gearing ratio	26.30%	18.74%

Expense ratio		
– as % of average shareholders' funds	1.00%	1.24%

Year's Highs/Lows	**High**	**Low**
Net asset value	537.61p	340.72p
Share price	433.00p	244.00p
Discount	(16.90%)	(28.84%)

Chairman's Statement

I am disappointed to report a significant fall in the net asset value of your trust. Share prices of many smaller companies have been badly affected by the difficult stockmarket environment with technology and other economy sensitive sectors suffering sharp falls. The equity portfolio fell 24.2% but due to the effects of gearing the net asset value fell 28.1% compared to a fall of 22.6% in the FTSE SmallCap Index (excluding investment companies)

The share price fell from 391.0p to 264.0p, a decrease of 32.5%. The discount to net asset value widened reflecting the current uncertainty in equity markets and smaller company shares in particular.

Background

Investors in smaller company shares, once again, endured a difficult period as the UK economy experienced below average levels of growth. Apart from the housing market, which enjoyed high activity levels and rising prices, most sectors of the economy faced problems in terms of the demand for and prices achieved by their products. Technology companies in particular, faced an environment of low demand and high supply resulting in pressure on profitability. With activity remaining subdued the Bank of England kept interest rates at low levels which gave homeowners the opportunity to remortgage property thus boosting disposable income. This supported consumption resulting in the service sector holding up quite well. Overall the situation is very similar to previous years with manufacturing output falling and consumer expenditure remaining buoyant. Price rises and hence profits growth has been hard to achieve and cost cutting has been the key to company profitability and survival.

In this difficult environment the trust intends to reinforce its investment emphasis on a combination of core quality companies with consistent earnings allied to selective value situations and emerging growth companies. Many companies have continued to operate profitably over the last twelve months, but share prices have not reflected the underlying business strength. The manager neutralised the gearing in the autumn and the trust will remain ungeared until the outlook for corporate profitability becomes clearer and market sentiment improves.

The Earl of Dalhousie

Revenue

The revenue return for the year amounted to 9.92p per share (2001–13.43p). A number of companies have taken the opportunity to reduce or omit dividend payments in order to conserve cash and improve balance sheets in the current environment. The board is recommending a final dividend of 8.9p which will be paid on 14 February 2003 to shareholders on the register on 17 January 2003. When combined with the interim dividend of 4.0p the total dividend paid for the year will amount to 12.9p, unchanged from last year. Although the dividend was not covered by earnings in the current year we have been able to maintain the dividend level by using part of the reserve which has been accumulated over many years.

Share Buy Backs

Shareholders have given the board authority to purchase the company's shares for cancellation. During the year the company bought back 150,000 shares. A special resolution proposing an extension to this facility will be put to shareholders at the annual general meeting.

Corporate Governance

As a Stock Exchange listed company, this trust is required to consider the degree to which it complies with the guidelines emanating from the Combined Code. In line with best practice, your board meets regularly with the manager, auditors and other advisors and is in compliance with its corporate governance responsibilities.

Marketing Initiatives

The board also continues to promote the company through the AITC's and manager's marketing initiatives which provide a range of savings schemes through which investors are able to invest in Dunedin Smaller Companies at a low cost and in a convenient manner.

More information on these savings products is available on the manager's website, www.edfd.com.

Outlook

Recent economic data suggests that the UK economy is unable to shrug off the effects of slowdown elsewhere in the world. The manufacturing sector has to contend with poor conditions in the UK as well as weakness in its main export markets of the United States and Europe as capital investment continues to be cut back. The onus for keeping the economy moving forward will once again fall on the consumer with some help from increased government spending. As long as interest rates remain low and employment high, the economy should be capable of growing, albeit at a lower rate than previously. The resultant modest increase in corporate profits should allow some progress in smaller companies' shares from current levels but, until overall confidence in the economy improves, share price gains are likely to be limited.

The Earl of Dalhousie
Chairman
17 December 2002

Manager's Review

The smaller company sector performed poorly over the period under review reflecting concern over the economic outlook, negative investor reaction to equities following financial fraud in the United States and the prospect of war in the Middle East. These factors presented a very difficult backdrop for equity investment. Over the year the company's net asset value per share fell by 28.1% compared to a fall in the benchmark index of 22.6%. Gross assets fell by 24.2%

Andrew Paisley

Market Background

The period under review proved to one of the most difficult for markets in recent years, forming a continuation of the bear market which started in September 2000 following the bursting of the technology bubble.

The UK markets were dominated by events in the US and the prospects for the US economy. During the tail end of 2001 the small company market rallied as several economic indicators suggested that the US economy might be recovering with a positive impact on the global economy. Following the index changes in October a number of technology companies fell back into the index and rallied strongly during November, subsequently leaving the index at the December index rebalancing. This resulted in a period of particularly poor performance for the company during November of 2001.

During January and February of 2002 the market focussed increasingly on accounting issues following the collapse of Enron and later revelations regarding off balance sheet vehicles. Investor confidence in the quality of financial statements decreased, resulting in a fall in markets. Investors became increasingly wary of companies with complicated accounting and companies which had been acquisitive. The share prices of these companies were marked down aggressively.

During March, April and May the markets again focussed on data from the US which continued to indicate recovery in the US economy. This was taken positively by both the US and UK markets with cyclical sectors such as media and electronics performing strongly. The FTSE SmallCap Index (ex IC) has a high exposure to these sectors, resulting in the index recovering some of the relative losses seen at the start of the year against the larger company indices.

During June and July further accounting revelations and financial fraud emerged, resulting in a sharp correction to markets. The markets were further depressed as investors considered the likely impact of a less buoyant consumer on the recovery of the economy in the US. The markets remained weak towards the end of the period under review reflecting the possibility of a war in the Middle East.

Gearing

The company has available a bank borrowing facility of £15 million. A proportion of this borrowing was utilised during the majority of the year. This had a negative impact on performance as the market fell. We reduced borrowing towards the end of the year and the company is currently ungeared. Borrowings will not be utilised until there are clear signs of market and economic recovery.

Portfolio

The approach to portfolio construction remains consistent with previous years with a balanced portfolio structure built with the aim of achieving consistency of performance. The portfolio is structured with a spine of long term growth companies augmented by a combination of value investments and emerging growth companies.

Quality of stock selection remains paramount. We will maintain a disciplined approach in selecting the companies we will invest in, focussing on the quality of management, the financial characteristics of the business, valuation and perhaps most importantly of all the extent to which the business exhibits a sustainable distinct competitive advantage. This quality will become increasingly important in determining the ability of a business to increase profits in a low inflation environment.

Over the year we moved the portfolio weighting more towards value and long term growth investments with less than 10% of the portfolio in emerging growth companies.

The company benefited from the performance of the value and blue chip segments of the portfolio. The major positive contributions to performance came from the holdings within the Leisure and Transport sectors, with particularly strong performances from Clydeport which is benefiting from the Glasgow harbour property project and has subsequently been bid for by Peel Holdings, Holidaybreak which has a strong position in the camping and short-breaks market and Belhaven which continues to benefit from the popularity of its beer. The holdings within the construction and house building sector also performed well with Bellway in particular performing strongly as a result of a buoyant housing market.

The company benefited from a number of takeovers despite the general low level of corporate activity in the market. Takeovers included Gullane, Sytner, FCX and Brake Brothers.

Despite a reduction in portfolio weighting towards emerging companies, disappointments within the emerging growth segment of the portfolio outweighed positive performances elsewhere within the portfolio. Major negative performances came from the holdings in the Media, Health and Software sectors. Specifically within Media, World Sport Group was suspended following greater than anticipated contract liabilities. Within Support Services BTG was derated on concerns over the development of a product. The holding has been reduced. Within the Software sector, Innovation Group was derated following concerns over accounting. The holding has also been reduced.

Outlook

There remains an increased level of political risk to markets following the events of September 11 2001, the possibility of further major terrorist attacks and the potential for a war in the Middle East. The speed of recovery of the US economy is likely to continue to be a major determinant in the direction of global markets. Economic indicators in the US are mixed with some doubts emerging over the strength of the consumer and the possibility of a "double dip" recession on continued weak corporate spending.

The UK economy remains robust relative to other economies with domestic sectors remaining buoyant. Consumer confidence continues to be the bedrock of the economy supported by a strong housing market.

Inflation and interest rates are likely to remain low by historical standards meaning that company profitability is generally likely to increase at a lower rate than seen in recent decades. Companies with a sustainable distinct competitive advantage and commensurate pricing power will have a greater ability to increase profits and will become increasingly sought after investments in a lower inflation environment.

The decline in markets presents excellent opportunities to buy good quality companies trading on attractive valuations which have the ability to grow even in a difficult economic environment. In particular we will be looking for companies with strong cashflow with strong asset backing and a low level of debt. Our priority over the coming year will be to focus on sound fundamental analysis to identify these quality investment opportunities within the smaller companies market.

Edinburgh Fund Managers plc
17 December 2002

Distribution of Portfolio

at 31 October

	FTSE SmallCap Index (ex ICs) Weighting %	Portfolio Weightings 2002 %	2001 %
Resources			
Mining	1.39	—	—
Oil & Gas	3.12	3.20	3.56
	4.51	**3.20**	**3.56**
Basic industries			
Chemicals	1.53	0.18	0.36
Construction & Building Materials	5.19	11.89	10.27
	6.72	**12.07**	**10.63**
General industrials			
Aerospace & Defence	1.05	3.93	2.81
Electronic & Electrical Equipment	5.92	2.57	2.94
Engineering & Machinery	3.87	3.44	4.29
	10.84	**9.94**	**10.04**
Cyclical consumer goods			
Automobiles	2.52	1.11	0.32
Household Goods & Textiles	0.86	1.64	0.29
	3.38	**2.75**	**0.61**
Non cyclical consumer goods			
Beverages	0.43	—	—
Food Producers & Processors	2.93	1.71	1.96
Health	3.02	2.73	5.17
Packaging	—	—	0.06
Personal Care & Household Products	0.45	—	—
Pharmaceuticals	2.68	—	—
	9.51	**4.44**	**7.19**
Cyclical services			
Distributors	—	—	4.23
General Retailers	9.56	4.25	4.57
Leisure Entertainment & Hotels	5.64	9.20	8.39
Media & Photography	4.86	3.56	5.09
Support Services	11.71	7.63	9.56
Transport	4.26	2.99	5.29
	36.03	**27.63**	**37.13**
Non cyclical services			
Food & Drug Retailers	0.58	—	—
Telecommunications Services	1.37	0.43	—
	1.95	**0.43**	**—**
Utilities			
Electricity	0.28	—	—
Gas Distribution	0.57	—	—
Water	0.26	—	—
	1.11	**—**	**—**
Information technology			
Information Technology Hardware	3.24	0.78	0.42
Software & Computer Services	7.94	1.58	6.01
	11.18	**2.36**	**6.43**
Financials			
Insurance	2.70	2.48	0.93
Real Estate	8.71	7.84	5.86
Speciality & Other Finance	3.36	5.04	4.96
	14.77	**15.36**	**11.75**
Total equities	**100.00**	**78.18**	**87.34**
Net current assets	—	21.82	12.66
Total assets less current liabilities	**100.00**	**100.00**	**100.00**

List of Largest Investments

at 31 October 2002

Company	Market Value £000	Sector Classification
Holidaybreak	1,799	Leisure entertainment and hotels
Intermediate Capital Group	1,694	Speciality and other finance
Bellway	1,593	Construction and building materials
Luminar	1,517	Leisure entertainment and hotels
Alvis	1,514	Aerospace and defence
Clydeport	1,458	Transport
Paladin Resources	1,390	Oil and gas
Mowlem (John)	1,319	Construction and building materials
Cox Insurance Holdings	1,280	Insurance
Dairy Crest	1,230	Food producers and processors
Ten largest investments	14,794	20.53% of total assets less liabilities
McCarthy & Stone	1,230	Construction and building materials
Headlam Group	1,182	Housing goods and textiles
Belhaven Group	1,156	Leisure entertainment and hotels
Compco Holdings	1,155	Real estate
Menzies (John)	1,074	Support services
Wellington Holdings	944	Engineering and machinery
Dobbies Garden Centres	918	General retailers
Ramco Energy	917	Oil and gas
Topps Tiles	916	General retailers
Care UK	903	Health
Twenty largest investments	25,189	34.96% of total assets less liabilities
Macdonald Hotels	902	Leisure entertainment and hotels
Ultra Electronics	900	Aerospace and defence
Rutland Trust	889	Speciality and other finance
Zotefoams	864	Construction and building materials
Helical Bar	854	Real estate
London Merchant Securities	835	Real estate
Fenner	826	Engineering and machinery
Peterhouse Group	785	Construction and building materials
Savills	762	Real estate
Freeport	756	Real estate
Thirty largest investments	33,562	46.59% of total assets less liabilities
Other investments represented by 74 holdings	22,769	31.60% of total assets less liabilities
Total value of investments	56,331	78.19% of total assets less liabilities
Net current assets	15,712	21.81% of total assets less liabilities
Total assets less current liabilities	72,043	100.00% of total assets less liabilities

Long Term Record

Year ended 31 October	Assets at valuation[1] £000	Preference stock and other borrowings £000	Equity shareholders' funds £000	Revenue available for ordinary dividends £000	Net asset value per share p	Earnings per share p	Dividends per share p	Share price p
1991	46,916	425	46,491	1,902	276.7	11.32	12.0	273.0
1992	37,518	425	37,093	1,821	220.8	10.84	12.0	219.0
1993	51,388	425	50,963	1,465	303.4	8.72	9.0	290.0
1994	57,933	5,000	52,933	1,506	315.1	8.96	9.0	306.0
1995	63,851	5,000	58,851	1,553	350.3	9.24	9.0	326.0
1996	72,614	5,000	67,714	1,602	402.5	9.54	9.0	346.0
1997	85,379	15,000	70,379	1,979	417.6	11.78	10.0	346.5
1998	75,136	15,000	60,136	2,463	356.6	14.67	11.9	292.0
1999	100,509	15,000	85,509	2,576	507.7	15.33	12.4	383.5
2000	127,708	15,000	112,708	2,510	673.7	14.97	12.9	520.0
2001	95,231	15,000	80,231	2,243	479.3	13.43	12.9	391.0
2002	72,224	15,000	57,224	1,647	344.7	9.92	12.9	264.0

(1) Total assets less current liabilities plus borrowings

Investment Changes

	Valuation at 31 October 2001 £000	Net purchases (sales) £000	Appreciation (depreciation) £000	Valuation at 31 October 2002 £000
United Kingdom	82,747	(5,799)	(20,652)	56,296
Overseas	259	(205)	(19)	35
Total investments	83,006	(6,004)	(20,671)	56,331

Comparison of Market Capitalisation

at 31 October 2002

Equity market capitalisation £m	Dunedin Smaller Companies Weighting %	FTSE SmallCap Index (ex investment companies) Weighting %
0-100	16.7	38.6
100-200	27.4	51.9
200-300	18.3	9.5
300-400	18.9	—
400-500	7.1	—
500+	11.6	—
Total	100.0	100.0

Analysis of Shareholders

at 31 October

% of ordinary shares held by shareholders

Corporate Information

Manager and Secretary and Registered Office
Edinburgh Fund Managers plc
Donaldson House
97 Haymarket Terrace
Edinburgh EH12 5HD
Telephone: 0131-313 1000
Website: www.edfd.com
Regulated by the FSA

Registrar
Lloyds TSB Registrars Scotland
PO Box 28448
Finance House
Orchard Brae
Edinburgh EH4 1WQ
Website: www.lloydstsb-registrars.co.uk
Telephone: 0870-601 5366

Banker
Bank of New York Limited

Auditors
KPMG Audit Plc
Saltire Court
20 Castle Terrace
Edinburgh EH1 2EG

Company Broker
Cazenove & Co. Ltd

Company Registration Number
SC 14692

Board of Directors

The Earl of Dalhousie
Chairman
The Earl of Dalhousie (54), appointed on 1 November 1993, is a founder of Enskilda Securities and was a director of Capel-Cure Myers Capital Management. He is chairman of Jamestown Investments.

R M Entwistle
Director
R M Entwistle (58), appointed on 18 December 1998, is managing director of Adam & Company and is a fellow of the Chartered Institute of Bankers.

the board

M G N Walker
Director
M G N Walker CBE (69), appointed on 24 March 1982 , is chairman of Ivory & Sime UK Smaller Companies Trust. He was a director of Sidlaw Group and of Scottish Hydro Electric.

N M Yarrow
Director
N M Yarrow CA (42), appointed on 21 May 1998, is a director of Northern Venture Managers which is a subsidiary of Edinburgh Fund Managers.

All directors are members of the Audit and Management Engagement Committee

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 2001. The company has subsequently conducted its affairs so as to receive 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 and the Manager's Review.

Share capital

During the year the company bought back 150,000 ordinary shares of 25p each (representing 0.9% of the issued share capital as at 31 October 2001) on the London Stock Exchange for cancellation. The total cost of these shares was £584,566.

Dividends

The directors recommend that a final dividend of 8.9p (2001–8.9p) is paid on 14 February 2003 to shareholders on the register on 17 January 2003. The ex-dividend date is 15 January 2003.

Status of Directors

In accordance with the articles of association, The Earl of Dalhousie retires from the board by rotation and will be proposed for re-election at the annual general meeting.

The names of the directors and their holdings in the company's shares are shown in Table 1 below. The company has not been notified of any changes in the holdings between 31 October 2002 and 17 December 2002.

No contract or arrangement subsisted during the period in which any of the directors was materially interested. Mr Yarrow is an executive director of Northern Venture Managers which is a wholly-owned subsidiary of Edinburgh Fund Managers plc, the manager and secretary to the company. No director had a service contract with the company.

Director's liability insurance

The company maintains insurance in respect of directors' and officers' liabilities in relation to their acts on behalf of the company.

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.

Corporate governance

Compliance

The company is committed to high standards of corporate governance. The board is accountable to the company's shareholders for good governance and this statement describes how the company applies the principles identified in the Combined Code (appended to the Financial Services Authority Listing Rules).

The board confirms that the company has complied throughout the accounting period with the provisions set out in Section 1 of the Code.

Directors

The Earl of Dalhousie and Messrs Entwistle and Walker are considered by the board to be independent of the company and the manager and free of any material relationship with the manager. Mr Yarrow is a director of Northern Venture Managers which is a wholly-owned subsidiary of Edinburgh Fund Managers plc.

Synopses of the board members appear on page 12 of the annual report. Each director has the requisite high level and range of business and financial experience which enables the board to provide clear

	Ordinary 25p shares 31.10.02	Ordinary 25p shares 31.10.01	Nature of interest
The Earl of Dalhousie	4,000	4,000	Beneficial
R M Entwistle	3,000	3,000	Beneficial
M G N Walker	2,000	2,000	Beneficial
N M Yarrow	4,000	4,000	Beneficial

Table 1 Directors and their holdings in the company

Directors' Report

and effective leadership and proper stewardship of the company. The senior independent director is Mr Walker.

The board meets at least four times each year and more frequently when business needs require. The board has a schedule of matters reserved to it for decision and the requirement for board approval on these matters is communicated directly to the senior staff of the manager. Such matters include strategy, borrowings, treasury and dividend policy. Full and timely information is provided to the board to enable the directors to function effectively and to discharge their responsibilities. The board also reviews the financial statements, performance and revenue budgets.

The board considers that the post of chief executive officer is not relevant for an investment trust company as this role has effectively been delegated to the manager under the terms of the investment management agreement.

There is an agreed procedure for directors to take independent professional advice if necessary and at the company's expense. This is in addition to the access which every director has to the advice and services of the company secretary, Edinburgh Fund Managers plc, which is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are complied with.

Appointments to the board of directors are considered by the whole board. Possible new directors are identified against the requirements of the company's business and the need to have a balanced board. External search consultants may be used to ensure that a wide range of candidates can be considered. Every director is entitled to receive appropriate training as deemed necessary.

A director appointed during the year is required, under the provisions of the company's articles of association, to retire and seek election by shareholders at the next annual general meeting. The articles also require that one third of the directors retire by rotation each year and seek re-election at the annual general meeting. In addition, all directors are required to submit themselves for re-election at least every three years.

Relations with shareholders

The directors place a great deal of importance on communication with shareholders. The report and accounts are widely distributed to other parties who have an interest in the company's performance. Shareholders and investors may obtain up to date information on the company through the manager's freephone information service and the company responds to letters from shareholders on a wide range of issues.

The notice of the annual general meeting included within the annual report and accounts is sent out at least 20 working days in advance of the meeting. All shareholders have the opportunity to put questions at the company's annual general meeting.

Proxy voting as an institutional shareholder

Responsibility for actively monitoring the activities of investee companies has been delegated by the board to the manager. The manager is responsible for reviewing, on a regular basis, the annual reports, circulars and other publications produced by the investee company, and for attending company meetings. The manager, in the absence of explicit instruction from the board, is empowered to exercise discretion in the use of the company's voting rights. The manager's policy is to vote all shares held by the company.

Socially responsible investment policy

The company's manager encourages companies to adhere to best practice in the area of Corporate Governance and Socially Responsible Investing.

They believe that this can best be achieved by entering into a dialogue with company management to encourage them, where necessary, to improve their policies in both areas. The manager's ultimate objective however is to deliver superior investment return for their clients.

Accordingly, whilst they will seek to favour companies which pursue best practice in these areas, this must not be to the detriment of the return on the investment portfolio.

Accountability and audit

The respective responsibilities of the directors and the auditors in connection with the financial statements appear on pages 16 and 17.

Internal control

The board confirms that as at 31 October 2002 there is an ongoing process for indentifying, evaluating and managing the company's significant business and operational risks, that it has been in place for the year ended 31 October 2002 and up to the date of approval of the annual report and accounts, that it is regularly reviewed by the board and accords with the internal control guidance for directors on the Combined Code.

The board has overall responsibility for ensuring that there is in place a system of internal control and for reviewing its effectiveness. Any system of internal control can only provide reasonable and not absolute assurance of meeting the internal control objectives. During the year the board has reviewed the effectiveness of the systems.

The manager is responsible for the design, implementation and maintenance of controls and procedures to safeguard the assets of the company and to manage its affairs properly. The system extends to operational and compliance controls and risk management. Clear lines of accountability have been established between the board and the manager and regular reports on controls and compliance issues are provided to the board. In carrying out its review, the board has had regard to the activities of the manager, the manager's internal audit and compliance function and the external auditors.

The directors have appointed an audit and management engagement committee, chaired by Mr Yarrow. The committee considers reports from the external auditors, as well as from the manager. The scope and effectiveness of the external audit is also kept under review. The independence and objectivity of the external auditors is also considered on a regular basis with particular regard to the level of non-audit fees.

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.

Auditors

The company's auditors, KPMG Audit Plc, are willing to continue in office and resolutions will be proposed at the annual general meeting to re-appoint them and to authorise the directors to fix their remuneration.

Substantial share interests

At 17 December 2002 the substantial interests in the ordinary share capital which had been notified to the company are shown in Table 2 overleaf.

Annual general meeting - special business

Resolutions relating to the following items of special business will be proposed at the forthcoming anual general meeting:-

(i) Authority to allot shares

An ordinary resolution will be proposed to authorise the directors to allot up to 4,250,000 unissued ordinary shares being up to an aggregate maximum nominal amount of £1,062,500. This maximum nominal amount represents 25.7% of the company's total ordinary share capital currently in issue and meets institutional guidelines. These guidelines permit such authorities to be calculated on the basis of the lesser of one-third of the existing issued share capital or the unissued equity share capital.

(ii) Limited disapplication of pre-emption provisions

A special resolution will be proposed to give the directors power to allot ordinary shares up to an aggregate nominal amount of £206,875 being 5% of the current issued share capital of the company, for cash other than to existing shareholders pro rata to their holdings. Under this authority, ordinary shares would only be issued for cash at a price not

Directors' Report

less than the net asset value per share. A maximum of £1,062,500 of unissued ordinary share capital may also be allotted for cash pursuant to a rights issue made *pro rata* to shareholders in the future. Ordinary shares would only be issued for cash pursuant to a rights issue at a price not less than the net asset value per share.

The directors consider that the powers proposed to be granted by the resolutions described at (i) and (ii) above are necessary to retain flexibility. The directors do not have any intention of exercising such powers at the present time. The authority conferred by these resolutions will expire on 12 February 2008.

(iii) Purchase of the company's own ordinary shares
A special resolution will be proposed to authorise the company to make market purchases of its own shares. The maximum number of ordinary shares which may be purchased pursuant to the authority shall be 14.99% of the issued share capital of the company as at the date of the passing of the resolution (approximately 2.4 million ordinary shares). The minimum price which may be paid for an ordinary share shall be 25p. The maximum price for an ordinary share (exclusive of expenses) shall be an amount equal to 105% of the average of the middle market quotations for the company's ordinary shares for the five business days immediately preceding the date of purchase.

This authority, if conferred, will only be exercised if to do so would enhance the net asset value and is in the best interests of shareholders generally.

Holder	No of ordinary shares	%
Royal London Asset Management	1,654,002	10.0
ISIS Asset Management plc*	1,207,000	7.3
AXA Sun Life Investment Management	952,076	5.8
Aegon Asset Management UK plc	882,677	5.3
Derbyshire County Council	650,000	3.9
Deutsche Bank AG*	625,000	3.8
Edinburgh Fund Managers Group plc*	649,008	3.9
DC Thomson & Company Ltd	580,000	3.5

Table 2 Substantial share interests * non-beneficial interest

By order of the board,

Edinburgh Fund Managers plc
Secretary
Edinburgh, 17 December 2002

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.

Independent Auditors' Report

Independent auditors' report to the members of Dunedin Smaller Companies Investment Trust PLC
We have audited the financial statements on pages 18 to 28.

Respective responsibilities of directors and auditors
The directors are responsible for preparing the Annual Report. As described on page 16 this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the company is not disclosed.

We review whether the statement on pages 13 to 15 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the company's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit 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 presentation of information in the financial statements.

Opinion
In our opinion the financial statements give a true and fair view of the state of affairs of the company as at 31 October 2002 and of the return for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc KPMG Audit Plc
Chartered Accountants
Registered Auditor

Edinburgh, 17 December 2002

Statement of Total Return

for the year ended 31 October

	Notes	2002 Revenue £000	2002 Capital £000	2002 Total £000	2001 Revenue £000	2001 Capital £000	2001 Total £000
Realised losses on investments	14	—	(10,766)	(10,766)	—	(131)	(131)
Unrealised losses on investments	15	—	(9,905)	(9,905)	—	(30,684)	(30,684)
Income from investments	2	1,933	—	1,933	2,571	—	2,571
Interest receivable on short term deposits		390	—	390	370	—	370
Other income		15	—	15	15	—	15
Investment management fee	3/14	(105)	(314)	(419)	(142)	(802)	(944)
Other administrative expenses	4	(270)	—	(270)	(253)	—	(253)
NET RETURN BEFORE FINANCE COSTS AND TAXATION		1,963	(20,985)	(19,022)	2,561	(31,617)	(29,056)
Interest payable and similar charges	5	(316)	(949)	(1,265)	(316)	(949)	(1,265)
RETURN ON ORDINARY ACTIVITIES BEFORE TAXATION		1,647	(21,934)	(20,287)	2,245	(32,566)	(30,321)
Taxation	6	—	—	—	(2)	—	(2)
RETURN ON ORDINARY ACTIVITIES AFTER TAXATION		1,647	(21,934)	(20,287)	2,243	(32,566)	(30,323)
Dividends in respect of equity shares	7	(2,135)	—	(2,135)	(2,154)	—	(2,154)
		(488)	(21,934)	(22,422)	89	(32,566)	(32,477)
RETURN PER ORDINARY SHARE	8	9.92p	(132.09p)	(122.17p)	13.43p	(195.01p)	(181.58p)

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	2002		2001	
		£000	£000	£000	£000
FIXED ASSETS					
Investments	9		56,331		83,006
CURRENT ASSETS					
Debtors	10	408		568	
UK Treasury Bills		4,975		9,932	
AAA Money Market Funds		8,000		—	
Cash and short term deposits	20	4,693		9,430	
		18,076		19,930	
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR	11	(2,365)		(7,896)	
NET CURRENT ASSETS			15,711		12,034
TOTAL ASSETS LESS CURRENT LIABILITIES			72,042		95,040
CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR	12		(14,818)		(14,809)
			57,224		80,231
CAPITAL AND RESERVES					
Called up share capital – equity	13		4,138		4,175
Capital reserve – realised	14		79,333		91,947
Capital reserve – unrealised	15		(28,704)		(18,799)
Capital redemption reserve	16		487		450
Revenue reserve	17		1,970		2,458
TOTAL EQUITY SHAREHOLDERS' FUNDS			57,224		80,231
NET ASSET VALUE PER 25P ORDINARY SHARE	22		344.67p		479.28p

The financial statements on pages 18 to 28 were approved by the board on 17 December 2002 and were signed on its behalf by:

THE EARL OF DALHOUSIE, Director

Dalhousie

Cashflow Statement

for the year ended 31 October

	Notes	2002 £000	2002 £000	2001 £000	2001 £000
NET CASH INFLOW FROM OPERATING ACTIVITIES	18		1,690		1,653
SERVICING OF FINANCE					
Interest paid		(1,256)		(1,256)	
NET CASH OUTFLOW FROM SERVICING OF FINANCE			(1,256)		(1,256)
TAXATION					
Overseas tax paid		—		(4)	
TOTAL TAX PAID			—		(4)
FINANCIAL INVESTMENT					
Purchase of investments		(32,502)		(24,937)	
Sale of investments		33,107		38,803	
NET CASH INFLOW FROM FINANCIAL INVESTMENT			605		13,866
EQUITY DIVIDENDS PAID			(2,148)		(2,154)
NET CASH (OUTFLOW)/INFLOW BEFORE USE OF LIQUID RESOURCES AND FINANCING			(1,109)		12,105
NET CASH OUTFLOW FROM MANAGEMENT OF LIQUID RESOURCES	21		(3,043)		(5,003)
FINANCING					
Buyback of ordinary shares			(585)		—
(DECREASE)/INCREASE IN CASH	20/21		(4,737)		7,102

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 equity investments, including taxes deducted at source, 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 between revenue and capital, in line with the board's expectation of returns from the company's investments over the long term in the form of revenue 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 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. The capital element of the investment management fee along with the associated irrecoverable VAT and relevant finance costs are charged to this reserve. Any 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 capital reserve.

(e) Taxation – Deferred taxation is provided on all timing differences, calculated at the current rate of tax relevant to the benefit or liability. Deferred tax assets are recognised only to the extent that it will be more likely than not that there will be taxable profits from which underlying timing differences can be deducted.

2 Income from investments

	2002		2001	
	Franked £000	Unfranked £000	Franked £000	Unfranked £000
Dividends				
Listed: United Kingdom	1,933	—	2,559	—
Unlisted: Overseas	—	—	—	12
	1,933	—	2,559	12
Total investment income	1,933		2,571	

Notes to the Accounts

	2002 £000	2001 £000
3 Investment management fee		
Investment management fee (including irrecoverable VAT)	419	944
Charged against capital reserve – realised	(314)	(802)
	(105)	142

The management fee paid to Edinburgh Fund Managers plc, a subsidiary of Edinburgh Fund Managers Group plc, is calculated at 0.4% per annum of the gross assets of the company after deducting current liabilities and excluding commonly managed funds ("adjusted gross assets"). The fee is subject to VAT at the appropriate rate.

In addition Edinburgh Fund Managers plc is entitled to a performance-related fee calculated quarterly in arrears, at a rate of 0.1% per annum (up to a maximum of 0.5% per annum) of the adjusted gross assets for every 1% by which the company's net asset value performance outperforms the capital performance of the FTSE SmallCap Index (ex investment companies) over the twelve month period. The investment management fee includes the performance related fee earned during the year of nil (2001–£377,000).

The management agreement between the company and Edinburgh Fund Managers plc is normally terminable by either party on 1 year's notice.

The management fee is chargeable 75% to capital and 25% to revenue. The performance-related management fee is chargeable wholly to capital.

4 Administrative expenses		
Secretarial fees	57	56
Directors' fees	44	43
Investment trust initiative	40	19
Registrar's fees	26	32
'its' marketing campaign	—	10
Irrecoverable VAT	28	21
Other expenses	75	72
	270	253

The secretarial fee of £57,000 (2001–£56,000) is paid to Edinburgh Fund Managers plc. A contribution of £40,000 (2001–£19,000) was paid to Edinburgh Fund Managers plc in respect of marketing and promotion of the company through their Investment Trust Initiative.

The chairman who was the highest paid director received £12,817 (2001–£12,583). The emoluments of the other directors were £10,250 each (2001–£10,067).

Auditors' remuneration amounted to £6,100 (2001–£6,050). Remuneration paid to the auditors for non-audit services amounted to £2,700 (2001–£1,350).

5 Interest payable and similar charges

	2002 £000	2001 £000
8.375% debenture stock interest	1,256	1,256
Amortised debenture stock premium and issue expenses	9	9
	1,265	1,265
Charged against capital reserve – realised	(949)	(949)
	316	316

6 Taxation

	2002 £000	2001 £000
Overseas tax	—	2

There is no liability to corporation tax for the year (2001 – nil).

At the year end, the company has surplus management expenses and loan relationship losses of £9,118,000 (2001–£7,608,000) which are not recognised as a deferred tax asset. This is because the company is not expected to generate taxable income in a future period in excess of deductible expenses for that period and, accordingly, is unlikely to be able to reduce future tax liabilities by offsetting these losses.

7 Dividends

	2002 £000	2001 £000
Interim dividend of 4.0p (2001–4.0p) paid 28 June 2002	662	668
Final dividend of 8.9p (2001–8.9p) payable 14 February 2003	1,473	1,486
	2,135	2,154

8 Return per ordinary share

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

	2002	2001
Revenue return	£1,647,000	£2,243,000
Capital return	(£21,934,000)	(£32,566,000)
Weighted average number of ordinary shares in issue	16,605,479	16,700,000

9 Investments

	Listed in UK £000	Unlisted £000	Total £000
Valuation at 31 October 2001	82,943	63	83,006
Unrealised depreciation at 31 October 2001	(18,862)	63	(18,799)
Book cost at 31 October 2001	101,805	—	101,805
Additions at cost	27,022	—	27,022
Disposals at cost	(43,792)	—	(43,792)
Book cost at 31 October 2002	85,035	—	85,035
Unrealised depreciation at 31 October 2002	(28,739)	35	(28,704)
Valuation at 31 October 2002	56,296	35	56,331

Notes to the Accounts

	2002 £000	2001 £000
10 Debtors		
Accrued income	238	310
Amounts due from brokers	104	64
Other debtors	66	194
	408	568

11 Creditors: amounts falling due within one year

Amounts due to brokers	149	5,629
Debenture interest	611	611
Other creditors	132	170
Final dividend	1,473	1,486
	2,365	7,896

12 Creditors: amounts falling due after one year

Repayable after more than 5 years:		
8.375% debenture stock 2022	15,000	15,000
Unamortised debenture stock premium and issue expenses	(181)	(191)
	14,819	14,809

The debenture stock is redeemable at par on 6 May 2022 and interest is payable in half-yearly instalments in May and November each year. The debenture stock is secured by a floating charge over the whole of the assets of the company.

The market value of the debenture stock as at 31 October 2002 was £18,562,500 (2001–£18,750,500). The effect on the net asset value of deducting the debenture stock at market value rather than at par is disclosed in note 22.

13 Called up share capital

Authorised:		
20,800,000 (2001–20,800,000) ordinary shares of 25p each	5,200	5,200
Issued and fully paid:		
16,550,000 (2001–16,700,000) ordinary shares of 25p each	4,138	4,175

During the year the company repurchased and subsequently cancelled 150,000 ordinary shares at a cost of £585,000. This represented 0.90% of the company's issued ordinary share capital and reduced the number of ordinary shares in issue from 16,700,000 to 16,550,000.

14 Capital reserve – realised

	2002 £000	2001 £000
Balance at 31 October 2001	91,947	93,829
Realised net loss on investments	(10,766)	(131)
Debenture stock interest	(942)	(942)
Amortised debenture stock premium and issue expenses	(7)	(7)
Management fee	(314)	(425)
Performance fee	—	(377)
Cost of ordinary shares repurchased	(585)	—
Balance at 31 October 2002	79,333	91,947

15 Capital reserve – unrealised

	2002 £000	2001 £000
Balance at 31 October 2001	(18,799)	11,885
Decrease on revaluation of investments	(9,905)	(30,684)
Balance at 31 October 2002	(28,704)	(18,799)

16 Capital redemption reserve

	2002 £000	2001 £000
Balance at 31 October 2001	450	450
Transfer from called up share capital arising from the buy back of ordinary shares	37	—
Balance at 31 October 2002	487	450

17 Revenue reserve

	2002 £000	2001 £000
Balance at 31 October 2001	2,458	2,369
Transferred (from)/to revenue account	(488)	89
Balance at 31 October 2002	1,970	2,458

This represents the only reserve from which dividends can be funded.

Notes to the Accounts

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

	2002 £000	2001 £000
Revenue before interest and taxation	1,963	2,561
Decrease in accrued income	72	78
Decrease in other debtors	8	1
Decrease in creditors	(39)	(185)
Management fee charged to capital	(314)	(425)
Performance fee charged to capital	—	(377)
	1,690	1,653

19 Analysis of changes in financing during the year

	2002		2001	
	Equity share capital £000	Debentures & loans £000	Equity share capital £000	Debentures & loans £000
Balance at 31 October 2001	4,175	14,809	4,175	14,800
Share buybacks	(37)	—	—	—
Amortisation of premium and expenses of issue	—	9	—	9
Balance at 31 October 2002	4,138	14,818	4,175	14,809

20 Analysis of changes in cash during the year

	2002 £000	2001 £000
Balance at 31 October 2001	9,430	2,328
Net cash (outflow)/inflow	(4,737)	7,102
Balance at 31 October 2002	4,693	9,430

21 Analysis of changes in net debt

	Balance at 31 October 2001 £000	Cash flows £000	Amortisation of issue expenses and premium £000	Balance at 31 October 2002 £000
Cash and short term deposits	9,430	(4,737)	—	4,693
UK Treasury Bills	9,932	(4,957)	—	4,975
AAA Money Market Funds	—	8,000	—	8,000
Debt due after more than one year	(14,809)	—	(9)	(14,818)
Net debt	4,553	(1,694)	(9)	2,850

22 Net asset value per share

Total shareholders' funds have been calculated in accordance with the provisions of Financial Reporting Standard 4 'Capital Instruments'. The analysis of total shareholders' funds on the face of the balance sheet does not reflect the rights, under the articles of association, of the ordinary shareholders on a return of assets. These rights are reflected in the net asset value and the net asset value per share attributable to ordinary shareholders at the year end, adjusted to reflect the deduction of the debenture stock at par. A reconciliation between the two sets of figures is given below:-

	2002	2001
Total shareholders' funds	£57,224,000	£80,231,000
Adjusted net assets	£57,042,000	£80,040,000
Number of equity shares in issue at year end	16,550,000	16,700,000
Total shareholders' funds per share	345.77p	480.42p
Less: Unamortised debenture stock premium and issue expenses	(1.10p)	(1.14p)
Adjusted net asset value per share	344.67p	479.28p

	2002 £000	2001 £000
The movements during the year of the assets attributable to the ordinary shares were as follows:		
Adjusted net assets at 31 October 2001	80,040	112,508
Total recognised capital losses for the year	(21,934)	(32,566)
Revenue return for the year	1,647	2,243
Dividends appropriated in the year	(2,135)	(2,154)
Movement in unamortised debenture stock premium and issue expenses	9	9
Share buybacks	(585)	—
Adjusted net assets at 31 October 2002	57,042	80,040

The net asset value adjusted to include the debenture stocks at a market value of £18,562,500 (2001–£18,750,000) rather than at par is 323.15p (2001–456.83p).

23 Reconciliation of movement in equity shareholders' funds

Equity shareholders' funds at 31 October 2001	80,231	112,708
Total recognised capital losses for the year	(21,934)	(32,566)
Net revenue for the year	(488)	89
Share buybacks	(585)	—
Equity shareholders' funds at 31 October 2002	57,224	80,231

24 Commitments and contingencies

There are no placing commitments (2001–nil) at 31 October 2002.

25 Risk management, financial assets and liabilities

Risk management

The major risks associated with the company are market risk, gearing risk, liquidity risk and interest rate risk. The company has established a framework for managing these risks which is evolving continually as the company's investment activities change in response to market developments. The board has provided the manager with guidelines and limits for the management of gearing, investments and financial instruments.

Market risk arises from changes in interest rates, valuations accorded to equities, movements in prices and the liquidity of financial instruments. Market price risk is managed through investment guidelines agreed by the board with the manager and is discussed at each board meeting. It is the company's policy to increase its exposure to equity market price risk through the investment of borrowings, thus increasing the opportunity for growth of assets in rising markets but also the risk when markets fall. The downside risk may be reduced by increasing the level of cash balances and cash equivalents through the sale of equities.

All of the company's long term debt is fixed rate, which exposes the company to changes in market value in the event that the debt is repaid before maturity. The debenture stocks in issue provide secure long term funding while short term flexibility is achieved through overdraft and short term borrowing facilities. Information on the debenture stocks is shown in note 12.

Financial assets and liabilities

The company's financial instruments comprise equity investments, treasury bills, cash balances, AAA money market funds, debenture stocks and debtors and creditors that arise directly from its operations; for example, in respect of sales and purchases awaiting settlement.

Fixed asset investments (see note 9) are valued at middle market prices which equate to their fair values. The fair values of all other assets and liabilities other than the debenture stock, as detailed in note 22, are represented by their carrying values in the balance sheet.

Notice is hereby given that the seventy fifth annual general meeting of Dunedin Smaller Companies Investment Trust PLC will be held at Tayforth House, 9 Luna Place, Technology Park, Dundee on Thursday 13 February 2003 at 12 noon, for the following purposes:

ORDINARY BUSINESS

1. To receive the reports of the directors and auditors and the accounts for the year to 31 October 2002;
2. To propose a final dividend of 8.9p on the ordinary shares;
3. To re-elect The Earl of Dalhousie as a director of the company;
4. To re-appoint KPMG Audit Plc as auditors of the company;
5. To authorise the directors to fix the remuneration of the auditors for the year to 31 October 2003.

SPECIAL BUSINESS

To consider and, if thought fit, to pass Resolution 6 as an ordinary resolution and Resolutions 7 and 8 as special resolutions.

Ordinary resolution

6. That, in substitution for any existing authority under Section 80 of the Companies Act 1985 ("the Act"), but without prejudice to the exercise of any such authority prior to the date hereof, the directors be and they are hereby generally and unconditionally authorised, pursuant to Section 80 of the Act, to allot relevant securities (as defined in Section 80(2) of the Act) up to an aggregate nominal amount of £1,062,500, such authority to expire on 12 February 2008 unless previously revoked, varied or extended by the company in general meeting, save that the company may, at any time prior to the expiry of such authority, make an offer or enter into an agreement which would or might require relevant securities to be allotted after the expiry of such authority and the directors may allot relevant securities in pursuance of such an offer or agreement as if such authority had not expired.

Special resolutions

7. That, in substitution for any existing authority, 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 the authority under Section 80 of the Act conferred on the directors on the passing of resolution 6 as if Section 89(1) of the Act did not apply to any such allotment, up to an aggregate nominal amount of £1,062,500 provided that this power shall be limited:

(i) 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

(ii) to the allotment (otherwise than pursuant to paragraph (i) of this resolution) of equity securities up to an aggregate nominal amount of £206,875 being 5% of the nominal value of the existing issued share capital of the company;

and such power shall expire on 12 February 2008, unless previously revoked, varied or extended by the company in general meeting, 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.

Notice of Meeting

8. That in substitution for any existing authority, the company be and it is hereby authorised in accordance with section 166 of the Companies Act 1985 ("the Act") to make market purchases (within the meaning of section 163 (3) of the Act) of ordinary shares of 25p each in the company ('shares') provided that:

   (i) the maximum number of shares hereby authorised to be purchased is 14.99% of the issued share capital of the company as at the date of the passing of this resolution;

   (ii) the minimum price which may be paid for a share shall be 25p;

   (iii) the maximum price (exclusive of expenses) which may be paid for a share shall be an amount equal to 105% of the average of the middle market quotations (as derived from the Daily Official List of the London Stock Exchange) for the shares for the five business days immediately preceding the date of purchase; and

   (iv) unless previously varied, revoked or renewed, the authority hereby conferred shall expire at the conclusion of the annual general meeting of the company to be held in 2004 save that the company may, prior to such expiry, enter into a contract or contracts to purchase shares under such authority which will or might be executed wholly or partly after the expiration of such authority and may make a purchase of shares pursuant to any such contract.

By order of the board

Edinburgh Fund Managers plc
Secretary,
6 January 2003

Registered office: Donaldson House, 97 Haymarket Terrace, Edinburgh EH12 5HD

Notes:

1. A member who is entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and, on a poll, vote on his/her behalf. A proxy need not be a member of the company.

2. A form of proxy for use by shareholders is enclosed with these accounts. Completion and return of the form of proxy will not prevent any shareholder from attending the meeting and voting in person. To be valid, the form of proxy should be lodged, together with any Power of Attorney or other authority (if any) under which it is signed or an extract from the Books of Council and Session or a notarially certified copy of such power or authority at the address stated thereon, so as to be received not less than 48 hours before the time of the meeting.

3. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the company specifies that only those shareholders entered on the register of members of the company as at 6.00pm on 11 February 2003 or, in the event that the meeting is adjourned, on the register of members 48 hours before the time of any adjourned meeting, shall be entitled to attend and vote at the meeting in respect of the number of ordinary shares registered in their name at that time. Changes to the entries on the register of members after 6.00pm on 11 February 2003 or, in the event that the meeting is adjourned, in the register of members 48 hours before the time of any adjourned meeting, shall be disregarded in determining the rights of any person to attend or vote at the meeting, notwithstanding any provisions in any enactment, the articles of association of the company or other instrument to the contrary.

4. There are special arrangements for holders of shares through The Edinburgh Fund Managers Investment Trust Savings Plan, Investment Trust PEP/ISA and Investment Trust Pension. These are explained in the 'Letter of Direction' which such holders will have received with this report.

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.

January – Annual report and accounts published.

February – Annual General Meeting and final dividend paid.

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

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

Information for Investors

EDINBURGH FUND MANAGERS

Edinburgh Fund Managers plc was formally established in 1969 and has grown steadily since that time now with offices in Edinburgh, Dundee, London and Newcastle. Today Edinburgh Fund Managers is one of the larger managers of investment trusts in the UK with over £1.4 billion of funds under management as at 31 October 2002. Total assets managed by the group at the same date were over £4.4 billion.

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 Dunedin Smaller Companies Investment Trust directly through a stockbroker or indirectly through a lawyer, accountant or other professional adviser. Alternatively shares can be bought directly through The Edinburgh Fund Managers Investment Trust Savings Plan, Investment Trust ISA and Investment Trust Pension.

PRODUCT DETAILS

InvestIT – The Edinburgh Fund Managers Investment Trust Savings Plan

InvestIT provides a straightforward way to invest in Dunedin Smaller Companies Investment Trust and other investment trusts managed 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). Lower amounts of £20, £150 and £20 respectively can be made in InvestIT for children. Existing shareholders can also transfer their shares into the Plan and have their dividends reinvested. There is no charge for buying or holding shares through InvestIT other than 0.5% Government Stamp Duty which is currently payable on all share purchases. There is a nominal £10+VAT transaction fee applied to all sales.

Edinburgh Fund Managers Investment Trust ISA/PEP

ISA

The Edinburgh Fund Managers Investment Trust Individual Savings Account (ISA) is a tax efficient savings vehicle. There are two types of ISAs available, a Maxi and a Mini. A Maxi ISA allows investors to maximise the amounts placed in stocks and shares. Investors will have the opportunity to invest up to £7,000 in each of the tax years up to 2005/2006 in Dunedin Smaller Companies Investment Trust where they take out a Maxi ISA.

A feature of the Edinburgh Fund Managers Investment Trust ISA is its low charges. The initial charge is £30 +VAT and the annual management fee is 0.5%+VAT (capped at £60 +VAT). No charges are made for buying or selling shares other than Government Stamp Duty on share purchases.

PEP

PEP investors can continue to hold their existing PEPs after 5 April 1999 but these will be ringfenced. No further contributions can therefore be made to Dunedin Smaller Companies Investment Trust through a PEP other than reinvestment of any income generated. However, investors will be able to transfer between different PEP funds and different PEP providers without losing their tax advantages. To enable new investors to take advantage of investing in a PEP in Dunedin Smaller Companies Investment Trust, a PEP transfer brochure is available. Again charges are low with no transfer fee being charged. An annual management charge of 0.5%+VAT capped at £40+VAT is charged.

The Edinburgh Fund Managers Investment Trust Pension

The Investment Trust Pension enables investors to

Companies Investment Trust. A wide range of investors can enjoy the benefits of a Personal Pension. Contributions can be made regularly or by lump sums, and there are low minimum investment amounts.

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.

As with all equity investments, the value of investment trusts purchased will immediately be reduced by the difference between the buying and selling prices of the shares, the market maker's spread.

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 ISAs, may be changed by future legislation.

Keeping you informed

The company's share price appears under the heading 'Investment Trusts' in the Financial Times, and other national newspapers. Investors can also obtain the latest share price by phoning FT Cityline on 0906-843 2385. All calls cost 60p per minute.

For internet users, detailed data on Dunedin Smaller Companies Investment Trust, including price and performance information, is available on the Edinburgh Fund Managers website (www.edfd.com) and the TrustNet website (www.trustnet.co.uk).

Lloyds TSB Registrars also have a website (www.lloydstsb-registrars.co.uk) which includes a page entitled 'Shareholder Services', which gives shareholders an insight into their shareholding. The website also has information about how to register a change of name and what to do if you have lost your share certificate.

For information concerning your shareholding, please contact:

Registrar

Lloyds TSB Registrars Scotland
PO Box 28448
Finance House
Orchard Brae
Edinburgh EH4 1WQ
Telephone: 0870-601 5366
Text Phone: 0870-600 3950
Website: www.shareview.co.uk

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

Support Desk

Edinburgh Fund Managers plc
Donaldson House
97 Haymarket Terrace
Edinburgh EH12 5HD
Telephone: 0131-313 1000
or FREE on 0800-028 6789 (24 hours)

InvestIT Administrator

Lloyds TSB Registrars Scotland
Registrar Department (SP)
PO Box 28448
Finance House
Orchard Brae
Edinburgh EH4 1WQ
Telephone: 0870-606 0268

Individual Savings Account/Personal Equity Plan Administrator

Bank of New York Europe Ltd
(Edinburgh Fund Managers plc)
ISA/PEP Department
12 Blenheim Place
Edinburgh EH7 5ZR
Telephone: 0800-028 6789

Pension Administrator

Edinburgh Pension Centre
Personal Pension Management Limited
141 Castle Street, Salisbury
Wiltshire SP1 3TB
Telephone: 0800-137 079

The above has been approved for the purposes of Section 21 of the Financial Services and Markets Act 2000 by Edinburgh Fund Managers plc which is regulated by the Financial Services Authority.