

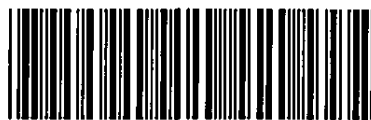
KAMES CAPITAL MANAGEMENT LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

COMPANY NUMBER 212159

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KAMES CAPITAL MANAGEMENT LIMITED

COMPANY INFORMATION

Chairman	John Olcay, BA, MBA
Directors	Andrew N R Fleming, BA (Chief Executive) Philip J G Smith, MA, CA (Resigned 17/05/2012) Martin J Harris, BSc Sarah Russell, MAF Arnab K Banerji, MA, BM, BCh David K Watson, BSc, ACA Gregory R Cooper, BCom, ICAA (Appointed 17/05/2012)
Secretary	Alison Talbot LLB
Company Number	212159
Registered Office	Kames House 3 Lochside Crescent Edinburgh Park Edinburgh EH12 9SA
Auditors	Ernst & Young LLP Ten George Street Edinburgh EH2 2DZ

KAMES CAPITAL MANAGEMENT LIMITED

CONTENTS

DIRECTORS' REPORT	3
STATEMENT OF DIRECTORS' RESPONSIBILITIES	6
INDEPENDENT AUDITORS' REPORT	7
STATEMENT OF COMPREHENSIVE INCOME	9
STATEMENT OF FINANCIAL POSITION	10
STATEMENT OF CHANGES IN EQUITY	11
CASH FLOW STATEMENT	12
NOTES TO THE FINANCIAL STATEMENTS	13

KAMES CAPITAL MANAGEMENT LIMITED

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2012

The Directors present their report and the audited financial statements for the year ended 31 December 2012.

Structure of these accounts

The Company's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union as they apply to the financial statements of the Company for the year ended 31 December 2012 and applied in accordance with the Companies Act 2006.

Principal and ongoing activity

The principal activity is the provision of asset management services. The Company is incorporated and domiciled in Scotland.

Results and dividends

The results for the period are set out on page 9.

The Company delivered profits after tax but before dividends of £7,164k (2011: £2,216k). The Company did not pay a dividend during the year (2011: £3.0m). This was equivalent to nil per share (2011: 300p). The Board of Directors consider the results to be satisfactory.

Net assets at the end of the year were £11,593k (2011: £4,429k). This was in line with Directors' expectations.

The Directors recommend payment of a final dividend of £5.8m. This is equivalent to 580p per share.

Development and Performance of the Business

The following review covers the results of Kames Capital Management Limited and, where appropriate, its parent Kames Capital Plc. The Board of the Company monitors key management information on a quarterly basis to track business performance. This information includes investment performance, assets under management, revenues, expenses, headcount and capital position. Combined assets under management increased by 6.2% during 2012 (2011: increase of 0.4%) with strong growth in our Retail assets offset by the run-off of insured assets. Revenues have increased (8.4%) due to the increase in the proportion of retail assets within our portfolio. Administrative expenses have decreased by 2.3% (2011: increase of 14%). Expenses increased in the prior year due to rebranding costs which were not repeated in 2012. The combined total average number of employees during the year increased by 2% (2011: 4%) from 253 FTEs to 258 FTEs.

On 27th March 2013, Kames Capital announced senior management changes to expand its leadership team and broaden the foundations for further growth across a diverse range of asset classes. The roles of Chief Executive Officer (CEO) and Chief Investment Officer (CIO) were split, reinforcing the organization's focus on investments as its core expertise and key growth driver. Stephen Jones, currently Co-Head of Fixed Income together with David Roberts, has been appointed as CIO, subject to regulatory approval. Andrew Fleming stepped down as joint CEO and CIO after eight successful years with the company. Sarah Russell, CEO of AEGON Asset Management, will assume the role of interim CEO at Kames Capital (also subject to regulatory approval) while the search is conducted for Mr Fleming's replacement.

Directors and their Interests

The Directors who held office at the date of this report are shown on page 1. On 17 May 2012 Philip J G Smith resigned as an Executive Director. On 17 May 2012 Gregory R Cooper was appointed as an Executive Director. All other Directors served throughout the year. The Directors have declared that they had no interest in the share capital of the Company in the year to 31 December 2012.

KAMES CAPITAL MANAGEMENT LIMITED

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2012

Each of the Directors has been granted a qualifying third party indemnity by the Company, in terms of the relevant sections of the Companies Act 2006.

Creditor payment policy

The objective is to treat our suppliers fairly and in accordance with good commercial practice. Suppliers' invoices are settled in accordance with agreed contractual terms or, if no terms are scheduled, generally within 30 days of the appropriate invoice date.

Corporate governance, capital management and financial instruments

Consistent with the governance framework promulgated by AEGON Asset Management the Company has established a governance framework for monitoring and overseeing strategy, conduct of business standards and operations of the business across the group that includes a clearly stated corporate organisational structure, appropriate delegated authorities and independent internal audit and risk management functions. Risk management for the Company operated within this governance framework.

The Company's objective in managing its capital is to ensure that there are adequate resources to meet the Company's liabilities as they fall due, and to allocate capital efficiently to support growth and repatriate excess capital where appropriate. The Company's capital is managed in conjunction with that of other Companies in the group. The Company manages its capital by measuring its resources and cash available on a regular basis. The Company's capital position and the movement in this from the prior year are disclosed within the Statement of Changes in Equity.

The Company is a wholly owned subsidiary of Kames Capital Plc, an entity regulated by the Financial Conduct Authority. The Company does not have individual capital requirements, but is included within the scope of consolidated capital supervision.

The Company is not exposed to significant financial instrument risk. Credit risk is significantly reduced as assets are primarily cash and short term deposits, which are placed with major banks of acceptable credit standing, and inter-company receivables from AEGON companies.

Risk and Capital Management and Financial Instruments

The Company has a very simple Balance Sheet consisting largely of cash and short-term assets and liabilities.

Credit Risk

The Company offers standard industry credit terms to clients and has an appetite for limited credit risk for this purpose. Aged items exceeding these terms are monitored against set thresholds for acceptable overdue debts. Action is taken to recover such debts (through deduction from client assets if appropriate). The Company's main sources of non-client related credit risk are other AEGON Group companies. These are considered inherent in the business activities of the Company. No restrictions are imposed on the size of such debts, but there is an aim to collect these in a timely way.

The Company has no appetite for on-balance sheet trading activity that might create excessive counterparty risk. The Company has no appetite for direct market risk and is subject to indirect market risk through market impacts on fee income. The Company considers this risk to be uncontrollable; it is inherent in the business of asset management. This risk is mitigated through the diversification of our asset management capabilities across various asset classes. Potential market risk is monitored through scenario analysis.

KAMES CAPITAL MANAGEMENT LIMITED

**DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2012**

Liquidity Risk

The Company has a low tolerance for liquidity risk. It operates a liquidity risk management policy setting out minimum threshold levels. Its liquidity position is reported to key management personnel on a monthly basis as part of our regular reporting. The Company's assets are in cash or short term deposits and invoices are settled as they fall due without the need to realise illiquid assets.

Market Risk

Revenues can be impacted by market risk as they are dependent upon the value of assets under management (Note 13).

Interest Rate Risk

Interest rate risk is significant only in that the impact of interest rate movements upon the Company's assets under management affects fee income. The Company considers this risk uncontrollable, as it is inherent in the business of asset management (Note 13).

Going Concern

The Directors have considered the performance of the Company in 2012, its Statement of Financial Position on 31 December 2012, its future plan and its approach to capital and risk management. The Directors consider that the Company has adequate resources to continue to operate for the foreseeable future. Accordingly, they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Auditors

An elective resolution was passed on 10 August 2001 to dispense with (a) the requirement to lay the Report and Accounts before the Company in a general meeting, (b) the holding of an Annual General Meeting for 2001 and subsequent years, and (c) the obligation to appoint auditors annually.

Disclosure of information to auditors

The Directors who held office at the date of approval of this report confirm that, so far as they are each aware, there is no relevant audit information of which the auditors are unaware; and each Director has taken all steps that he ought to have taken as Director to make himself aware of any relevant audit information and to establish that the auditors are aware of that information.

This report was approved by the Board of Directors and authorised for issue on 9th April 2013

Signed on its behalf by



Gregory R Cooper
Director

KAMES CAPITAL MANAGEMENT LIMITED

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Annual Report and the Company financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union,

Under Company Law the directors must not approve the Company financial statements unless they are satisfied that they present fairly the financial position, financial performance and cash flows of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies in accordance with IAS 8: *Accounting Policies, Changes in Accounting Estimates and Errors* and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance; and
- state that the Company has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the Company financial statements comply with the Companies Act 2006 and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

KAMES CAPITAL MANAGEMENT LIMITED

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF KAMES CAPITAL MANAGEMENT LIMITED

We have audited the financial statements of Kames Capital Management Limited for the year ended 31 December 2012 which comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Cash Flow Statement and the related notes 1 to 16. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 6, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Directors' Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

KAMES CAPITAL MANAGEMENT LIMITED

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF KAMES CAPITAL MANAGEMENT LIMITED

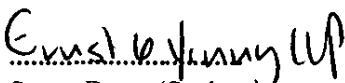
Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Susan Dawe (Senior statutory auditor)

for and on behalf of Ernst & Young LLP, Statutory Auditor

Edinburgh

Date : 9th April 2013

KAMES CAPITAL MANAGEMENT LIMITED

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2012 COMPANY NUMBER 212159

	Notes	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Revenue			
Revenue from rendering of services	2	46,241	54,575
Cost of sales	3	<u>(4,011)</u>	<u>(5,407)</u>
Gross profit		42,230	49,168
Administrative expenses	4	<u>(32,690)</u>	<u>(46,294)</u>
Operating profit		9,540	2,874
Finance revenue	5	<u>77</u>	<u>109</u>
Profit before tax		9,617	2,983
Tax charge	6	<u>(2,453)</u>	<u>(767)</u>
Profit for the year		7,164	2,216
Other Comprehensive Income			
Other comprehensive income for the year net of income tax		<u>-</u>	<u>-</u>
Total comprehensive income for the year		<u>7,164</u>	<u>2,216</u>

The result for the year relates wholly to continuing activities.

The profit for the year is attributable to the equity shareholders of the Company.

KAMES CAPITAL MANAGEMENT LIMITED

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2012 COMPANY NUMBER 212159

	<u>Notes</u>	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Non-current assets			
Deferred tax	7	1,905	1,851
Trade and other receivables	8	193	-
		<u>2,098</u>	<u>1,851</u>
Current assets			
Trade and other receivables	8	2,366	3,218
Cash and short term deposits	9	21,579	17,306
		<u>23,945</u>	<u>20,524</u>
Total assets		<u>26,043</u>	<u>22,375</u>
Current liabilities			
Tax payables		2,720	1,261
Trade and other payables	10	11,391	16,326
		<u>14,111</u>	<u>17,587</u>
Non-current liabilities			
Trade and other payables	10	339	359
Total liabilities		<u>14,450</u>	<u>17,946</u>
Net assets		<u>11,593</u>	<u>4,429</u>
Capital and reserves			
Issued capital	11	1,000	1,000
Retained earnings		10,593	3,429
Total equity		<u>11,593</u>	<u>4,429</u>

The financial statements were approved for issue by the Board on 9th April 2013 and signed on its behalf by



Gregory R Cooper
Director

KAMES CAPITAL MANAGEMENT LIMITED

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2012 COMPANY NUMBER 212159

	<u>Issued capital £000's</u>	<u>Retained earnings £000's</u>	<u>Total £000's</u>
At 1 January 2012	1,000	3,429	4,429
Profit for the year	-	7,164	7,164
At 31 December 2012	1,000	10,593	11,593

FOR THE YEAR ENDED 31 DECEMBER 2011

	<u>Issued capital £000's</u>	<u>Retained earnings £000's</u>	<u>Total £000's</u>
At 1 January 2011	1,000	4,213	5,213
Profit for the year	-	2,216	2,216
Dividends paid	-	(3,000)	(3,000)
At 31 December 2011	1,000	3,429	4,429

All equity is attributable to equity shareholders of the Company.

The Company did not recognise any income or expense directly in equity (2011 - £nil).

KAMES CAPITAL MANAGEMENT LIMITED

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2012 COMPANY NUMBER 212159

	Note	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Operating activities			
Profit before interest and tax		9,540	2,874
<i>Adjustment to reconcile profit before tax to net cash inflow from operating activities:</i>			
Decrease in trade and other receivables		604	2,341
(Decrease) in trade and other payables		(4,902)	(978)
Income tax paid		(1,046)	(389)
Interest received	5	77	109
Net cash flow from operating activities		<u>4,273</u>	<u>3,957</u>
Financing activities			
Dividends paid	15	-	(3,000)
Net cash flow used in financing activities		-	(3,000)
Net Increase in cash and cash equivalents		4,273	957
Cash and cash equivalents at 1 January		<u>17,306</u>	<u>16,349</u>
Cash and cash equivalents at 31 December	9	<u>21,579</u>	<u>17,306</u>

The cash flow statement is prepared according to the indirect method.

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

1. Accounting Policies

1.1. Basis of preparation

The Company's financial statements have been prepared on a going concern basis and in accordance with International Financial Reporting Standards as adopted by the European Union as they apply to the financial statements of the Company for the year ended 31 December 2012 and applied in accordance with the Companies Act 2006.

The financial statements of Kames Capital Management Limited were authorised for issue in accordance with a resolution of the directors on 9th April 2013.

The functional currency of the company is pounds sterling (GBP). Amounts displayed within these accounts are rounded into thousands (£000s).

1.1.1. Adoption of new IFRS accounting standards

New standards become effective on the date specified by IFRS, but may allow companies to opt for an earlier adoption date. In 2012, the following new standard issued by the IASB became mandatory:

- IFRS 7 Financial Instruments : Disclosures – Transfers of Financial Assets

IFRS 7 Financial Instruments: Disclosures – Transfers of Financial Assets

The amendments to IFRS 7 are effective for annual periods beginning on or after July 1, 2011 and requires the disclosure of transfer transactions of financial assets including the possible effects of any risks that may remain within the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of transfer transactions are undertaken around the end of a reporting period. The amendment did not have any impact on the 2012 financial statements.

In addition, the following new standards, amendments to existing standards and interpretations are mandatory for the first time for the financial year beginning January 1 2012 but are not currently relevant for the Company:

- IAS 12 Income Taxes – Recovery of Tax Assets
- IFRS 1 First Time Adoption – Severe Hyperinflation and Removal of Fixed Dates for First Time Adopters.

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

1.1.2. Future adoption of new IFRS accounting standards

The following standards, amendments to existing standards and interpretations, published prior to January 1 2013, were not early adopted by the Company and will be applied in future years:

- IFRS 7 Financial Instruments: Disclosures¹ – Offsetting Financial Assets and Financial Liabilities;
- IFRS 9 Financial Instruments; ¹
- IFRS 10 Consolidated Financial Statements; ¹
- IFRS 11 Joint Arrangements; ¹
- IFRS 12 Disclosure of Interests in Other Entities; ¹
- IFRS 13 Fair Value Measurement; ¹
- IAS 1 Financial Statement Presentation – Presentation of Items of Other Comprehensive Income; ¹
- IAS 19 Employee Benefits; ¹
- IAS 27 Separate Financial Statements ; ¹
- IAS 28 Investments in Associates and Joint Ventures; ¹
- IAS 32 Financial Instruments : Presentation – Offsetting Financial Assets and Financial Liabilities; ¹
- Annual Improvements 2009-2011 Cycle

IFRS 7 Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities

The amendments to IFRS 7 are effective for annual periods beginning on or after January 1, 2013. The amendments enable users of the financial statements to better compare financial statements prepared in accordance with IFRS and US GAAP with regard to offsetting of financial assets and financial liabilities. The new disclosures will provide users of the financial statements with information about the effect or potential effect of netting arrangements on an entity's financial position. The Company does not expect this to impact its disclosures.

IFRS 9 Financial Instruments

IFRS 9 Financial Instruments: Classification and Measurement is part of the project to replace IAS 39 with a new standard. The project is divided into multiple components, classification and measurement of financial instruments, impairment and hedge accounting. IFRS 9 is available for early adoption immediately, but mandatory for accounting periods beginning on or after January 1, 2015. The IASB decided to reopen IFRS 9 in order to consider interaction with insurance projects as well as the FASB's classification and measurement model for financial instruments. IFRS 9 is not expected to have a significant impact on the Company's financial statements.

IFRS 10 Consolidated Financial Statements

The standard applies to financial years beginning on or after January 1 2013, and identifies the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. The Company is currently assessing the impact

¹ Not yet endorsed by the European Union

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

of this standard on the financial position and performance, however, based on preliminary analyses, no material impact is anticipated.

IFRS 11 Joint Arrangements

The standard applies to financial years beginning on or after January 1 2013, and provides a reflection of joint arrangements by focusing on the rights and obligations of the arrangement rather than its legal form. The standard requires a single method to account for interests in jointly controlled entities. The Company does not expect this standard to impact the financial statements.

IFRS 12 Disclosure of Interests in Other Entities

The standard applies to financial years beginning on or after January 1 2013, and provides disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, structured entities and other off balance sheet vehicles. The Company is currently assessing the impact of this standard on the financial position and performance, however, based on preliminary analyses, no material impact is anticipated.

IFRS 13 Fair Value Measurement

The standard applies to financial years beginning on or after January 1 2013, and provides a definition of fair value and a single source of fair value measurement, and disclosure requirements for use across IFRSs. The Company is currently assessing the impact of this standard on the financial position and performance, however, based on preliminary analyses, no material impact is anticipated.

IAS 1 Financial Statement Presentation – Presentation of Items of Other Comprehensive Income

The amendments apply to financial years beginning on or after July 1 2012. The amendments require the grouping together of items within other comprehensive income that may be reclassified to the profit or loss section of the income statement. The amendments also reaffirm existing requirements that items in other comprehensive income and profit or loss should be presented as either a single statement or two consecutive statements. The Company is currently assessing the impact of this standard on the financial position and performance, however, based on preliminary analyses, no material impact is anticipated.

IAS 27 Separate Financial Statements (as revised in 2011)

As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The amendment becomes effective for annual periods beginning on or after January 1 2013. The Company does not expect any impact on the financial position or performance.

IAS 28 Investments in Associates and Joint Ventures (as revised in 2011)

As a consequence of the new IFRS 11 and IFRS 12, IAS 28 has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after January 1 2013. The Company does not expect any impact on the financial position or performance.

IAS 32 Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities. The amendments to IAS 32 Financial Instruments: Presentation, clarify the application of the offsetting requirements. The amendments are effective for annual periods beginning on or after

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

January 1, 2014, with earlier application permitted. The Company is currently assessing the impact of this standard on the financial position and performance, however, based on preliminary analyses, no material impact is anticipated.

Annual Improvements 2009-2011 Cycle. The IASB issued, in May 2012, a number of minor amendments to five different standards and interpretations. These amendments, which are effective from January 1, 2013, deal with minor changes to the wordings used in the individual standards and seek to remove editorial and other inconsistencies in the literature. The Company expects that the improvements project does not result in any changes to the classification, measurement or presentation of any items in the financial statements.

The following amendment to the existing standard and interpretation, published prior to January 1, 2013, were not early adopted by the Company as this amendment to existing standard and interpretation are not relevant for the Company:

- IAS 19 Employee Benefits
- IFRS 1 First Time Adoption – Government Loans; and
- IFRIC 20 – Stripping Costs in the Production Phase of a Surface Mine.

1.2. Significant accounting judgements, estimates and assumptions

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the amounts reported for assets and liabilities as at the Statement of Financial Position date and the amounts reported for revenues and expenses during the year. However, the nature of estimation means that actual outcomes could differ from those estimates.

Taxes

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future profits together with future tax planning strategies.

Deferred tax assets also exist in respect of timing differences relating to the payment of LTIP and DCIP incentives to employees.

The company has deferred tax balances amounting to £1,905k (2011: £1,851k).

1.3. Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding VAT. The following specific recognition criteria must also be met before revenue is recognised:

Rendering of services

Fees are recognised as revenue over the period in which related services are provided.

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

Interest income

Interest income is recognised on interest on an accruals basis.

1.4 Cost of sales

Cost of sales represents Loyalty Bonus payments made to customers of the Scottish Equitable Pooled Funds. Such payments are recognised over the period in which the related services are provided.

1.5 Deferred transaction costs

Incremental costs, such as initial commission, that are directly attributable to securing future investment management services are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. This is reported within prepayments and accrued income.

The deferred transaction costs are amortised in line with fee income, unless there is evidence that another method better represents the provision of services under the contract.

1.6 Deferred revenue

Initial fees, margins and front-end loadings paid by clients, for future investment management services, are deferred and recognised as revenue when the related services are rendered. This is reported within accruals and deferred revenue.

The deferred revenue is amortised over a period of four years in line with fee income, unless there is evidence that another method better represents the provision of services under the contract.

1.7 Taxation

Current income tax

Current income tax assets and liabilities for the current period and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities, or paid to or recovered from other group companies in respect of group relief surrendered or received. The tax rates and laws used to compute the amount are those that are enacted or substantively enacted by the Statement of Financial Position date.

Current income tax relating to items recognised directly in equity is recognised in equity and not in the statement of comprehensive income.

Deferred income tax

Deferred income tax is provided using the liability method on temporary differences at the Statement of Financial Position date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences except:

- When the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss, and

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised except:

- When the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor the taxable profit or loss; and
- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interest in joint ventures, deferred income tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each Statement of Financial Position date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred income tax assets are reassessed at each Statement of Financial Position date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the Statement of Financial Position date.

Deferred income tax relating to items recognised directly in equity is recognised directly in equity and not in the statement of comprehensive income.

Deferred income tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred income tax relates to the same taxable entity and the same taxation authority.

1.8. Trade and other receivables

Trade receivables, which generally have 30 day terms, are recognised and carried at the lower of their original invoice's value and recoverable amount. Where the time value of money is material, receivables are carried at amortised cost. Provision is made when there is objective evidence that the Company will not be able to recover balances in full. Balances are written off when the probability of recovery is assessed as being remote.

1.9. Cash and cash equivalents

Cash and short-term deposits in the Statement of Financial Position comprise cash at banks and in hand and short-term deposits with an original maturity of three months or less.

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

For the purpose of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

1.10. Long term Incentive Plan (LTIP)

The LTIP meets the definition of employee benefits as defined in IAS 19. It is a defined contribution plan and the contributions are payable by the Company based on achievement of targets in specified calendar years. The cost of the scheme is recognised as an expense and liability upon achievement of the targets. The Company pays the set amount to an independent employee benefits trust in the year following recognition of the contribution. Once the contribution has been made, the Company has no ability to recover any amount paid to the trust.

1.11. Deferred Cash Incentive Plan (DCIP)

The DCIP (which operated in prior years) is a deferred bonus scheme which is classified as an other long-term employee benefit under IAS 19. It falls under the definition of a defined benefit plan with contributions to the scheme spread over the term of service provision. Contributions are based on achievement of targets over the period of the plan. The cost of the scheme is recognised as an expense and liability based on the measurement of that liability in a given year. This is re-assessed over the period of the plan, increasing or decreasing the liability as required until vesting. In the current year the final costs have been reflected in the income statement and no further costs will be incurred in respect of prior year DCIP schemes.

2. Revenue from rendering of services

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Management Fees	45,244	52,298
Performance Fees	382	1,353
Security Lending Fees	615	924
Fees	<u>46,241</u>	<u>54,575</u>

Revenue represents fees receivable from other AEGON NV subsidiary companies in respect of the provision of investment management services by the Company.

For terms and conditions relating to related party transactions, refer to note 14.

3. Cost of sales

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Loyalty Bonus	4,011	5,407
Cost of Sales	<u>4,011</u>	<u>5,407</u>

Cost of sales relates to Loyalty Bonuses paid to customers of the Scottish Equitable Pooled Funds.

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

4. Administrative expenses

Administrative expenses include £29,745k (2011: £44,827k) relating to recharges to the Company by AEGON UK Corporate Services Limited, a fellow subsidiary of AEGON NV. For terms and conditions relating to related party transactions, refer to note 14.

AEGON UK Corporate Services Limited, a fellow subsidiary of AEGON NV, employs all staff whose costs are included in administrative expenses.

Details of Directors' emoluments for the year ended 31 December 2012 can be found in the parent company accounts of Kames Capital Plc.

5. Finance revenue

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Cash and short term deposits income	77	95
Interest income on loan to Parent company	-	14
	<u>77</u>	<u>109</u>

Interest income on the loan to the Parent company in the prior year was calculated at LIBOR plus 0.51%.

6. Taxation

(a) Current year tax charge

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
<u>UK current tax</u>		
Corporation tax for the year	(2,754)	(723)
Adjustments in respect of prior years	247	(147)
Total current tax charge	<u>(2,507)</u>	<u>(870)</u>
<u>UK deferred tax</u>		
Origination of temporary differences	394	(55)
Adjustments in respect of prior years	(177)	302
Change in deferred tax rate	(163)	(144)
Total deferred tax charge	<u>54</u>	<u>103</u>
Total tax charge reported in the statement of comprehensive income	<u>(2,453)</u>	<u>(767)</u>

The Finance Bill 2012 was substantively enacted on 3rd July 2012. The reduction to the standard rate of corporation tax from 24% to 23% will be effective from 1st April 2013. Accordingly the deferred tax balances at 31st December 2012 have been stated at 23%. A further reduction of 2% has been

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

announced on 5th December 2012 which will reduce the tax rate to 21% in 2014. These reductions have not yet been substantively enacted and are therefore not included in the above figures. The maximum effect on deferred tax of the reduction in the UK corporation tax rate to 21% is expected to be £156,309.

(b) Reconciliation of tax charge

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Accounting profit before tax	<u>9,617</u>	<u>2,983</u>
Accounting profit multiplied by the UK standard rate of corporation tax of 24.5% (2011: 26.5%)	(2,356)	(791)
Non deductible expenses and non-taxable income	(5)	13
Impact of deferred tax rate	(162)	(144)
Prior year adjustment	70	155
Total tax charge reported in the statement of comprehensive income	<u>(2,453)</u>	<u>(767)</u>

7. Deferred Taxation

Recognised deferred tax

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when income taxes relate to the same fiscal authority. The amounts are as follows:

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Deferred tax assets comprise		
Incentive plans	1,669	1,851
Deferred acquisition costs/ Deferred initial margin	35	-
Bonus Deferral	201	-
	<u>1,905</u>	<u>1,851</u>
	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Deferred tax assets		
At 1 January	1,851	1,748
Prior Year Adjustments	(177)	302
Change in deferred tax rate	(163)	(144)
Amounts recorded in statement of comprehensive income	394	(55)
At 31 December	<u>1,905</u>	<u>1,851</u>

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

8. Trade and other receivables

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Non-current trade and other receivables		
Prepayments and accrued income	193	-
Current trade and other receivables		
Amounts owed by fellow AEGON NV subsidiary undertakings	2,366	3,216
Prepayments and accrued income	-	2
	<u>2,366</u>	<u>3,218</u>
	<u>2,559</u>	<u>3,218</u>

For terms and conditions relating to related party transactions, refer to note 14.

9. Cash and short term deposits

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Short term deposits	<u>21,579</u>	<u>17,306</u>
	<u>21,579</u>	<u>17,306</u>

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short term deposits are made for varying periods of between one day and three months, depending on the immediate cash requirements of the Company, and earn interest at the respective short-term deposit rates. The fair value of cash and short term deposits is £21,579k (2011: £17,306k).

The Company only deposits cash surpluses with major banks of acceptable credit standing.

10. Trade and other payables

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Current trade and other payables		
Payables to fellow AEGON NV subsidiary undertakings	8,333	11,772
DCIP accrual	-	2,757
LTIP Payable to employee trust	2,878	1,764
Accruals and deferred income	180	33
	<u>11,391</u>	<u>16,326</u>
Non-current trade and other payables		
Accruals and deferred income	339	359
	<u>339</u>	<u>359</u>
	<u>11,730</u>	<u>16,685</u>

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

Terms and conditions of the above financial liabilities:

- For terms and conditions relating to related parties, refer to note 14.
- Trade payables are non-interest bearing and are normally settled in 30 days.
- The LTIP payable is non-interest bearing and normally settled 3 months after the year end.
- The DCIP accrual (which operated in prior years) payable is non-interest bearing and normally settled within 1 month of the vesting date.

11. Capital and reserves

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Authorised share capital		
10,000,002 Ordinary shares of £1 each	<u>10,000</u>	<u>10,000</u>
Allotted, called up and fully paid		
1,000,002 Ordinary shares of £1 each	<u>1,000</u>	<u>1,000</u>

Information on capital management and risk management is included in the Directors' Report under 'Corporate governance, capital management and financial instruments'.

12. Capital Commitments, contingent liabilities and charges

The lease disclosure has been included within the financial statements of Kames Capital Plc, Kames Capital Management Limited's parent company.

13. Risk Management

General

The Company is exposed to financial risks. The main financial risks are credit risk, liquidity risk and market risk, with the principal elements of market risk being interest rate risk and price risk. The Company is not exposed to significant currency risk other than through indirect exposure to changes in the value of the funds it manages and hence its fee income. This risk is managed as for Market risk. The Risk and Capital Management and Financial Instruments section of the Report of the Directors describes the Company's general approach to risk management and the management of financial risks.

Credit Risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Company. The carrying amounts of financial assets best represent the maximum credit risk exposure at the balance sheet date.

At the reporting date the Company's financial assets exposed to credit risk amounted to the following:

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

	<u>2012</u>	<u>2011</u>
	<u>£000s</u>	<u>£000s</u>
Cash and cash equivalents	21,579	17,306
Interest, dividends and other receivables	2,366	3,218

The Company is exposed to credit risk on standard industry credit available to clients and has an appetite for limited credit risk for this purpose. Aged items exceeding these terms are monitored against set thresholds for acceptable overdue debts. Action is taken to recover such debts (through deduction from client assets if appropriate). The Company's main sources of non-client related credit risk are HMRC, or other AEGON Group companies. These are considered inherent in the business activities of the Company. The Company does not hold financial instruments which give rise to concentrations of risk. Details of these balances are listed under note 8.

The company's cash balances are currently held by a number of counterparties. Bankruptcy or insolvency of any of these counterparties may cause the company's rights with respect to the cash balances to be delayed or limited. The Company operates a counterparty management policy which sets minimum levels for the number of counterparties which must be used and tolerance limits over the cash holdings. The Company monitors the credit quality of the relevant counterparties and should the credit quality or the financial position of these counterparties deteriorate significantly the Company would move the cash holdings over to another bank.

There were no significant concentrations of credit risk to counterparties at 31 December 2012 or 31 December 2011.

Liquidity Risk

The Company has only limited exposure to liquidity risk as balances are held in cash and short term deposits. It operates a liquidity risk management policy setting out minimum threshold levels. Amounts due are settled without the need to realise illiquid assets. Details of these balances are listed under note 9.

The table below summarises the maturity profile of the Company's financial liabilities at 31 December 2012 and 2011 based on contractual undiscounted payments.

Maturity Analysis

FOR THE YEAR ENDED 31 December 2012

	<u>On</u>	<u>Less</u>				
	<u>Demand</u>	<u>than 3</u>	<u>3 to 12</u>	<u>1 to 5 yrs</u>	<u>>5 yrs</u>	<u>Total</u>
	<u>£000</u>	<u>months</u>	<u>months</u>	<u>years</u>	<u>years</u>	<u>£000</u>
	<u>£000</u>	<u>£000</u>	<u>£000</u>	<u>£000</u>	<u>£000</u>	<u>£000</u>
Non Derivative Financial Liabilities						
Trade and other payables	-	8,332	3,059	339	-	11,730

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

FOR THE YEAR ENDED 31 December 2011

	<u>On</u>	<u>Less</u>	<u>3 to 12</u>	<u>1 to 5 yrs</u>	<u>>5 yrs</u>	<u>Total</u>
	<u>Demand</u>	<u>than 3</u>	<u>months</u>	<u>months</u>	<u>years</u>	
	<u>£000</u>	<u>months</u>	<u>£000</u>	<u>£000</u>	<u>£000</u>	<u>£000</u>
Non Derivative Financial Liabilities						
Trade and other payables	-	11,813	4,513	359	-	16,685

Market Risk

Results of the Company's sensitivity analyses are presented throughout this section to show the estimated sensitivity of Profit for the year and Shareholder's Equity to various scenarios. For interest rate risk and equity market risk, the analysis shows how these measures would have been affected by changes in the relevant risk variables that were reasonably possible at the reporting date. In performing the analyses and determining the impact for the financial year, the assumption is made that the financial instrument exposures at the Statement of Financial Position date were in existence for a full year. For each sensitivity test, the impact of a reasonably possible change in a single factor is shown.

The sensitivities do not reflect what the results for the period would have been if risk variables had been different, because, for financial instruments, the analysis is based on the exposures in existence at the reporting date rather than on those that actually occurred during the year. The analysis does not take into account the impact of future new business, which is an important component of the Company's future earnings. It also does not consider all instruments available to management to respond to changes in the financial environment. Furthermore, the results of the analyses cannot be extrapolated for wider variations since effects are not always linear. No risk management process can clearly predict future results.

Interest Rate Risk

The sensitivity analysis in the table below shows an estimate of the effect of a parallel shift in the yield curve on Profit for the year and Shareholders' Equity. The effect of an increase in the yield curve would be to reduce the overall asset valuations thereby reducing fee income earned. The converse applies for a reduction in yield. Because assets are not held within the Statement of Financial Position of the Company the only equity impact of this change is on Fee Income earned and is carried directly through the Statement of Comprehensive Income to impact Retained Profits.

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

	<u>Impact on</u> <u>profit for</u> <u>the year</u> <u>2012</u> <u>£000's</u>	<u>Impact on</u> <u>equity</u> <u>2012</u> <u>£000's</u>
Immediate change		
Shift up 100 basis points	(964)	(964)
Shift down 100 basis points	964	964

	<u>Impact on</u> <u>profit for</u> <u>the year</u> <u>2011</u> <u>£000's</u>	<u>Impact on</u> <u>equity</u> <u>2011</u> <u>£000's</u>
Immediate change		
Shift up 100 basis points	(547)	(547)
Shift down 100 basis points	547	547

Equity price risk

The sensitivity analysis of Profit for the year and Shareholders' Equity to changes in equity prices is presented in the table below. The sensitivity of Profit for the year and Shareholders' Equity primarily reflects changes in the value of Assets under Management leading to corresponding increases or decreases in fee income and therefore profits.

	<u>Impact on</u> <u>profit for</u> <u>the year</u> <u>2012</u> <u>£000's</u>	<u>Impact on</u> <u>equity</u> <u>2012</u> <u>£000's</u>
Immediate change		
Equity increase 10%	699	699
Equity decrease 10%	(699)	(699)

	<u>Impact on</u> <u>profit for</u> <u>the year</u> <u>2011</u> <u>£000's</u>	<u>Impact on</u> <u>equity</u> <u>2011</u> <u>£000's</u>
Immediate change		
Equity increase 10%	1,124	1,124
Equity decrease 10%	(1,124)	(1,124)

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

14. Related party transactions

(a) Immediate parent undertaking

The immediate parent company is Kames Capital Plc which, is registered in Scotland. Copies of Kames Capital Plc accounts are available from the Company Secretary, Kames Capital Plc, Kames House, 3 Lochside Crescent, Edinburgh Park, Edinburgh, EH12 9SA.

(b) Ultimate parent undertaking

The ultimate parent company is AEGON NV, which is incorporated in the Netherlands. The group accounts of AEGON NV are available from the Company Secretary, Kames Capital Plc, Kames House, 3 Lochside Crescent, Edinburgh Park, Edinburgh, EH12 9SA.

(c) Year end balances and transactions with related parties

The Company provides investment management services to other members of the AEGON UK Plc Group at prices which are agreed from time to time between the Company and the recipients of the service, taking into account the size and nature of the service (see note 2 for total amount of such transactions). Income for these services is derived from Management Fees, Performance Fees and Security Lending Fees. For further detail of these transactions refer to Note 2.

Administrative expenses are recharged to the Company at cost plus a 5% mark-up by AEGON UK Corporate Services Limited, a fellow subsidiary of AEGON NV (see note 4 for total amount of such transactions).

The Company also provides and receives shared services from other members of the AEGON Asset Management Group. Expenses relating to these shared services are recharged at cost plus a 7.1% mark up. Group companies included within this recharge are AEGON Investment Management BV, AEGON USA Investment Management LLC, TKP Investments, AEGON Asset Management (Asia) Ltd and AEGON Asset Management Holding BV.

The Company also receives shared services from AEGON NV. Expenses relating to these shared services are recharged at cost plus a 7.1% mark up.

Outstanding balances are unsecured, interest free and cash settlement is generally expected within 30 days of invoice. The Company has not provided or benefited from any guarantees for any related party receivables or payables. During the year ended 31 December 2012 the Company has not made any provision for doubtful debt relating to amounts owed by related parties (2011: nil).

Year end balances for related party transactions are detailed in notes 8 and 10.

KAMES CAPITAL MANAGEMENT LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

(d) Compensation of key management personnel (including directors)

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Short term employee benefits	465	1,346
Post employment employee benefits	30	110
Other long term benefits	248	826
	<u>743</u>	<u>2,282</u>

15. Dividends paid and proposed

	<u>2012</u> <u>£000's</u>	<u>2011</u> <u>£000's</u>
Declared and paid during the year		
Equity dividend on ordinary shares		
Final dividend for 2012 – nil (2011: 300p)	-	3,000
 Proposed for approval by shareholders		
Final dividend for 2012 – 580p (2011: nil)	<u>5,800</u>	<u>-</u>

16. Post balance sheet events

There were no significant events in the period from 1st January 2013 to the date of signing of the financial statements.