# F&C US Smaller Companies PLC
## Report and Accounts 2004

The objective of F&C US Smaller Companies PLC is to achieve long-term capital growth by investing in a diversified portfolio of quoted US smaller and medium sized companies.

# Contents

## SUMMARY OF RESULTS

| Attributable to equity shareholders | 30 June 2004 | 30 June 2003 | % change |
|---|---|---|---|
| Net assets | **£64.76m** | £53.27m | 21.59 |
| Net assets per share | **244.53p** | 200.06p | 22.23 |
| Russell 2000 Index (sterling adjusted) | **326.18** | 271.71 | 20.05 |
| Share price | **216.50p** | 192.00p | 12.76 |
| Increase in net asset value per share since inception on 8 March 1993 | | | 153.29 |
| Increase since 8 March 1993 in the Russell 2000 Index (sterling adjusted) | | | 106.84 |



## FINANCIAL CALENDAR

| | |
|---|---|
| Annual General Meeting | 27 October 2004 |
| Interim results for 2004/2005 announced | March 2005 |
| Final results for 2004/2005 announced | September 2005 |

Company Registration Number: 02781968

# Chairman's Statement

I am pleased to report a better performance for US equity markets during the Company's financial year. The net asset value (NAV) per share of the Company rose 22.2% to 244.53p, compared to an increase of 20.0% in our benchmark, the sterling-adjusted Russell 2000 Index.

Your Company's NAV performance has exceeded its benchmark for the last four years and in ten of the eleven years since formation in March 1993. Since then, the NAV per share has risen by 153.3%, whereas the sterling-adjusted Russell 2000 Index gained only 106.8%.

During the year under review the Russell 2000 rose by 31.9%, in dollar terms, significantly better than the other major indices such as the Standard & Poor's Composite Index 500 and the more technology-orientated NASDAQ Index. These increased in dollar terms by 17.1% and 26.2% respectively.

**MARKET REVIEW**

The recovery in the US economy became apparent a year ago. The equity market has responded with a robust rise in the first half of the Company's financial year followed by a more measured gain in the second half. This reflects the shift in focus from economic recovery to concerns about rising interest rates and energy prices. At the same time the rally in technology shares faded.

The best performing areas within the Russell 2000 were economically sensitive sectors, such as other (diversified companies), other energy, producer durables and materials and processing. The reason for this seems to have been surprisingly strong global growth and tightness in energy markets. The laggards were utilities, technology and financials. The latter have been affected by rising interest rates.

**DISCOUNT AND BUYBACKS**

The price of the shares rose by 12.8% to 216.5p over the year. The discount to NAV per share widened during the year from 4.0% to 11.5% and at 13 September 2004 was 13.1%. The average discount over the financial year was 9.4%.

The Company bought back shares during the year. There were purchases of 140,000 shares at an average discount of 12.6%.

The Board will continue to apply its policy of buying back shares at appropriate times with a view to limiting the discount in the longer term to around 10%.

**OUTLOOK**

Whilst we remain optimistic on the future prospects for the smaller company sector in the US, some caution may be called for given prospects for rising interest rates and a Presidential election. The Board believes that the Company's risk averse approach will continue to benefit shareholders over the longer term.

**AGM**

The Annual General Meeting will be held on 27 October 2004 and I hope that you will attend. The meeting will be held in the offices of F&C Management Limited at Exchange House, Primrose Street, London EC2A 2NY. A map showing the location is on an enclosed card. If you are going to attend, would you please kindly return the reply card.

**Gordon Grender**
September 2004

# Manager's Review

It has been a more buoyant year for the US smaller company sector. After last year's disappointing performance, when small companies lagged large ones, this year the situation was reversed and the sector led blue chips. During the year, technology stocks at first dominated the market but then suffered a set back and attention switched to companies with more stable growth characteristics.

**PERFORMANCE**

Performance of the Company's portfolio was strong for the financial year, exceeding the benchmark. Some of the largest individual contributions to performance came from the long term holding SCP Pool, healthcare stocks such as NeighborCare and Invitrogen, as well as recreational vehicle ('RV') manufacturer Monaco Coach, and energy producer Harvest Natural Resources. SCP Pool has continued to deliver strong results and has been helped by better weather this year. NeighborCare (institutional pharmacy), the new name for Genesis HealthVentures following the spin out of its nursing home business, rose after receiving an unsolicited bid from Omnicare. Invitrogen was helped by a recovery in sentiment towards biotech-related companies. Monaco Coach benefited from a recovery in sales of RVs at dealerships. Harvest Natural Resources successfully disposed of its Russian assets and was helped by growing production in Venezuela.

Not all was plain sailing and the performance of some stocks was disappointing. The biggest negative impacts to performance were from Insight Communications (cable broadcaster), Pride International (oil driller) and Boston Communications (telecommunications software provider). Insight was hit by worries about competition from satellite broadcasters. Our view is that this is overdone. Pride failed to achieve expected asset sales and ran into problems with certain rig manufacturing contracts. Management has been replaced and we expect a recovery. Boston Communications was a big winner in the previous financial year but subsequently ran into problems as customers indicated they might reverse the outsourcing of services to the company. We had already taken profits but sold the remainder of the position.

The emphasis of the portfolio on the other energy sector, which includes small exploration and production as well as energy service companies, also benefited performance.

**PORTFOLIO REVIEW**

As the economy began to show clear signs of recovery in the second half of 2003, we changed the emphasis of the portfolio's strategy. We began to reduce cyclical stocks, where valuations fully reflected the benefits of recovery, for example, the exposure to the autos and transportation sector was reduced and commodity-related stocks were sold. At the same time we added to more defensive areas where we expected growth to continue even if the economy slowed, such as healthcare services. Separately as the other energy sector sold off at the end of 2003, we increased the portfolio's weighting in this area. The reason is that we expect persistent shortages of natural gas in the USA and of oil globally. We held our underweight position in banks and real estate investment trusts in anticipation of rising interest rates.

The portfolio's emphasis on the consumer discretionary sector and tilt away from technology stocks reflects the Company's investment style, which focuses on companies with a strong franchise, free cash flow and insider ownership by management and whose shares are cheap.

In the autos and transportation sector we sold Monaco Coach, a successful holding that had more than doubled in price in the last three years. It seemed fully valued with the risk that the economy might decelerate. Similar reasoning led us to sell Freeport McMoran Copper and Gold, the world's lowest cost copper producer. Although we had bought it more recently, in 2002, its rapid rise as metals prices rebounded, led us to take profits.

In the healthcare sector, we added further new holdings in service companies. In particular we bought Lifepoint Hospitals and Sunrise Senior Living. We like rural hospital operators like Lifepoint because of the limited competition and the potential to grow by improving acquired hospitals. Sunrise plays to the growing demand from well-off retirees for high quality accommodation. At the same time we reduced exposure to biotech-related stocks, such as Invitrogen, which had enjoyed a recovery in the last two years.

Another example of a more defensive purchase has been in real estate within the materials and processing sector. We bought the St Joe Company, a residential real estate developer, whose key asset is the ownership of a huge tract of undeveloped land in NW Florida, the last part of the State with significant waterside development possibilities. The stock lagged the market for much of 2003, giving us the opportunity to buy it.

Our positive outlook on energy prices led us to buy Evergreen Natural Resources, a leader in developing unconventional gas supplies based on coal bed methane, and also to add to several other existing holdings. Our confidence in Evergreen was reinforced when it received a bid from Pioneer Natural Resources.

Other examples of new holdings are Checkers Drive-In Restaurants and LKQ Corporation. Checkers is a quick service restaurant that is being helped by the less aggressive pricing stance taken by the large burger chains. This followed public concern about the role of fast food in the growth of obesity in the USA. Its use of a double drive-in gives it a cost advantage as well as improving the free cash flow of the business. LKQ is a distributor that focuses on recycling original equipment car parts. There is growing demand for these from insurance companies needing to reduce the claims costs and LKQ is the only national player. The business is especially attractive because of its good cash flow.

We sold several longer-term holdings where recent developments had given us concerns for the future. Examples included Bisys Group (a provider of back office services for financial institutions), Emmis Communications (a radio and TV broadcaster), SPX Corp (a diversified manufacturer) and Waddell & Reed (an investment management company). Bisys' strategy of buying insurance brokers did not seem to be working; Emmis showed signs of wishing to make further acquisitions rather than reduce debt; we were concerned about heavy selling of SPX's shares by insiders; and Waddell & Reed appeared to be struggling to counter industry competition. All four stocks went on to under-perform the market following our sale.

**OUTLOOK**

Whereas a year ago the direction of the US smaller company sector seemed comparatively easy to call at a time when the economy was accelerating, the immediate outlook is less clear. Concerns include rising interest rates, high energy prices and the influence of the Presidential Election. Despite this the longer-term outlook appears brighter. There seems to be a good chance that this cycle of tightening by the Federal Reserve will not lead to a recession soon. Furthermore, following a long period during the 1980s and 1990s when large companies led the market, we believe that smaller companies are more likely to lead the market in the future.

**Robert Siddles**
September 2004

# Twenty Largest Equity Holdings

**at 30 June 2004**

| **This** Last<br>**Year** Year | | **Company**<br>Description | **Value**<br>**£'000s** | **% of total**<br>**investments** |
|---|---|---|---|---|
| **1** | (1) | **Kirby**<br>This leading operator of inland tank barges in the United States has a strong market position in this business which is characterised by strong cash flow and little new competition. | **2,039** | **3.2** |
| **2** | (2) | **Cousins Properties**<br>This Atlanta-based real estate investment trust operates in one of the most attractive growth areas in the US. Management are risk averse and focus on commercial property development. They have used their land bank around Atlanta to their advantage. | **2,017** | **3.2** |
| **3** | (3) | **SCP Pool**<br>SCP Pool is the leading US distributor of swimming pool supplies. It has successfully consolidated its position in this fragmented but growing industry and should benefit from rising margins. | **1,948** | **3.1** |
| **4** | (4) | **BankUnited Financial**<br>This Florida-based community bank is run by well-regarded management and has the opportunity to grow by offering better customer service than its much larger national rivals. | **1,548** | **2.4** |
| **5** | (5) | **Fred's**<br>The company operates discount general merchandise stores in the South East, mostly in non-urban locations. The store size is between that of the larger Wal-Mart and the smaller dollar stores. It offers a combination of convenience and low prices that is attractive to elderly and low-income customers. Sales are growing rapidly. | **1,473** | **2.3** |
| **6** | (9) | **Community Health Systems**<br>Community Health has a strong record of buying and improving rural acute hospitals. The rural locations mean there is limited competition. | **1,411** | **2.2** |
| **7** | (6) | **Republic Services**<br>Republic Services provides solid waste collection and disposal services. It concentrates on markets where it can win long-term contracts. It has a strong emphasis on generating free cash flow. | **1,404** | **2.2** |
| **8** | (10) | **Roper Industries**<br>Roper is a manufacturer of niche products in industrial controls, fluid handling and analytical instrument markets. These niches typically experience limited competition. It uses its free cash flow to make bolt-on acquisitions in similar areas. | **1,368** | **2.1** |
| **9** | (7) | **American Capital Strategies**<br>This is a business development company specialising in private mezzanine lending. It takes equity positions in the companies it lends to. High returns are available in the private debt market. It is structured as a registered investment company and pays out its earnings as a large dividend. | **1,221** | **1.9** |
| **10** | (17) | **Pride International**<br>Pride International is a leading offshore driller. New management should strengthen the balance sheet and improve operations to benefit from better energy markets. | **1,205** | **1.9** |

| This Year | Last Year | Company<br>Description | Value<br>£'000s | % of total investments |
|---|---|---|---|---|
| **11** | (14) | **Harte-Hanks**<br>The company is the leader in direct marketing, an area with good growth prospects. Its strong balance sheet is an advantage as new growth opportunities often come from acquisitions. | **1,197** | **1.9** |
| **12** | (8) | **Renal Care Group**<br>Renal Care specialises in providing kidney dialysis services in out-patient centres. Kidney disease can result from conditions such as diabetes and high blood pressure. This is a growing market and the company achieves some of the best clinical results in the industry. | **1,152** | **1.8** |
| **13** | (19) | **Iron Mountain**<br>This is the leader in record archiving and information management. Growth comes from the need by companies to retain document records as a result of new regulations or potential litigation. It has made several acquisitions in Europe which should be a fruitful area for expansion | **1,143** | **1.8** |
| **14** | (–) | **Airgas**<br>A leading distributor of packaged gases in the US. It is a rental business with a high rate of customer retention and good cash flow. | **1,138** | **1.8** |
| **15** | (–) | **Genesis Healthcare**<br>An East Coast based regional nursing home provider. Following its spin out from NeighborCare, management have been able to focus on improving operations. | **1,132** | **1.8** |
| **16** | (–) | **Jones Lang LaSalle**<br>This is a major global real estate service company, based in Chicago. It should benefit from growth in Asia and a recovery in the US commercial real estate market. | **1,091** | **1.7** |
| **17** | (–) | **LKQ Corporation**<br>The company specialises in the recycling of original equipment manufacturers' car parts. It will be helped by industry consolidation and pressure from insurance companies to use more recycled parts for repairs. | **1,071** | **1.7** |
| **18** | (–) | **Harvest Natural Resources**<br>This Houston-based energy company excels in operating in countries which are politically difficult but crucial to the oil market, such as Venezuela and Russia. It exploits under-developed oil and gas fields, which means that exploration risks are low. | **1,052** | **1.6** |
| **19** | (–) | **Martin Marietta Materials**<br>A leading aggregate producer in North America. This is a local business that enjoys good pricing flexibility and produces strong cash flow. | **1,045** | **1.6** |
| **20** | (–) | **Michaels Stores**<br>The leading US retailer of arts and crafts. It is an attractive market segment because of its resilience to the economic cycle and good growth that is driven by demographic change. | **1,038** | **1.6** |

The value of the twenty largest equity holdings represents 41.8% (June 2003: 46.4%) of the Company's total investments.

# List of Investments

| Listed Investments | Holding | 30 June 2004 Value £'000s |
|---|---|---|
| **AUTOS & TRANSPORTATION** | | |
| Genesee & Wyoming | 60,000 | 784 |
| Kirby | 95,050 | 2,039 |
| | | **2,823** |
| **CONSUMER DISCRETIONARY** | | |
| Checkers Drive-In Restaurant | 141,800 | 890 |
| Cox Radio 'A' | 51,490 | 493 |
| Fred's | 120,950 | 1,473 |
| Furniture Brands International | 71,450 | 987 |
| Harte-Hanks | 88,950 | 1,197 |
| Insight Communications | 179,370 | 916 |
| Iron Mountain | 42,935 | 1,143 |
| Lamar Advertising 'A' | 38,950 | 931 |
| Laureate Education | 47,390 | 999 |
| Lithia Motors 'A' | 72,880 | 996 |
| LKQ Corporation | 104,381 | 1,071 |
| Michaels Stores | 34,220 | 1,038 |
| Regis | 30,180 | 742 |
| Republic Services | 88,000 | 1,404 |
| SCP Pool | 78,500 | 1,948 |
| Sonic Automotive | 66,180 | 808 |
| SOURCECORP | 55,670 | 845 |
| Vail Resorts | 97,200 | 1,027 |
| | | **18,908** |
| **FINANCIALS** | | |
| Allied Capital | 75,000 | 1,010 |
| American Capital Strategies | 79,000 | 1,221 |
| Apollo Investment | 124,800 | 948 |
| Arthur J Gallagher & Co | 41,000 | 688 |
| BankUnited Financial | 108,800 | 1,548 |
| CapitalSource | 70,020 | 944 |
| CNA Surety | 137,310 | 829 |
| Cousins Properties | 111,000 | 2,017 |
| HCC Insurance Holdings | 33,000 | 608 |
| Jones Lang LaSalle | 73,010 | 1,091 |
| Mercantile Bankshares | 29,840 | 770 |
| Midland | 57,160 | 934 |
| NDCHealth | 66,760 | 854 |
| ProAssurance | 42,880 | 806 |
| Saxon Capital | 67,960 | 856 |
| | | **15,124** |
| **HEALTHCARE** | | |
| Community Health Systems | 93,440 | 1,411 |
| Genesis Healthcare | 70,650 | 1,132 |
| Harvard Bioscience | 202,790 | 501 |
| Invitrogen | 22,440 | 891 |
| Lifepoint Hospitals | 40,000 | 821 |
| Neighborcare | 57,765 | 998 |

| Listed Investments | Holding | 30 June 2004 Value £'000s |
|---|---|---|
| Prime Medical Services | 88,200 | 386 |
| Renal Care Group | 63,075 | 1,152 |
| SRI/Surgical Express | 126,950 | 490 |
| Sunrise Senior Living | 40,460 | 873 |
| | | **8,655** |
| **MATERIALS & PROCESSING** | | |
| Airgas | 86,310 | 1,138 |
| Martin Marietta Materials | 42,770 | 1,045 |
| Mueller Industries | 38,500 | 760 |
| Shaw Group | 89,970 | 503 |
| The St Joe Company | 44,220 | 968 |
| | | **4,414** |
| **OTHER ENERGY** | | |
| Evergreen Resources | 39,350 | 877 |
| FMC Technologies | 41,900 | 665 |
| Forest Oil | 55,150 | 831 |
| Grant Prideco | 22,870 | 233 |
| Harvest Natural Resources | 128,020 | 1,052 |
| Pride International | 127,740 | 1,205 |
| | | **4,863** |
| **PRODUCER DURABLES** | | |
| Actuant 'A' | 43,190 | 929 |
| Andrew | 56,780 | 626 |
| Dupont Photomasks | 61,600 | 691 |
| Goodrich | 55,350 | 987 |
| Roper Industries | 43,600 | 1,368 |
| | | **4,601** |
| **TECHNOLOGY** | | |
| Cherokee International | 11,400 | 72 |
| Concord Communications | 75,580 | 474 |
| MAPICS | 106,960 | 623 |
| Mentor Graphics | 102,500 | 874 |
| Reynolds & Reynolds | 54,670 | 697 |
| Symantec | 35,980 | 869 |
| | | **3,609** |
| **UTILITIES** | | |
| Price Communications | 103,986 | 846 |
| | | **846** |
| **TOTAL INVESTMENTS** | | **63,843** |

The total number of companies in the portfolio is 68 (2003: 68).

# Directors

**GORDON GRENDER** CHAIRMAN

A Director of the Company since its inception in 1993, he became Chairman in October 1998. He has been actively involved in fund management in North American stockmarkets since 1974. He has been the investment adviser to GAMerica Inc., GAM North American Unit Trust, GAMerica Capital Fund and GAM Star America since their respective inceptions in 1983, 1985, 1995 and 1998 and is a director of GAM International Management Limited. *Age 60.*

**NORMAN BACHOP**

He was with Mercury Asset Management PLC and its predecessor companies for 30 years, 21 of which were spent managing US equities. He was appointed to the Board in February 1999. *Age 57.*

**PETER BARTON**

Appointed to the Board in February 1998. He is a solicitor, investment banker and a Deputy Lieutenant of Greater London. He has many years experience in the finance sector including nine years with Lehman Brothers International and four years with Robert Fleming & Co Limited following a career of over 20 years as a corporate lawyer. He is deputy chairman of Alliance & Leicester PLC, chairman of Howard de Walden Estates Limited and vice-chairman of the Guinness Trust Group. *Age 67.*

**DAVID HUNTER** SENIOR INDEPENDENT DIRECTOR

He has worked in the City for more than 45 years. He is also a director of NCL Investments Limited, Aurora Investment Trust PLC, Bermuda Capital Limited and Mid Ocean World Investments. He joined the Board in April 1994. *Age 68.*

All the Directors are Members of the Audit Committee

# Management and Advisers

**ROBERT SIDDLES**

Responsible for the US portfolio. He joined F&C in 2001.

**SIMON CORDERY**

Investor Relations Manager responsible for marketing F&C US Smaller Companies to private client stockbrokers. He joined F&C in 1993 and took up his present position in 2000.

**ROBERT DOWDALL**

Group Finance Director of F&C since 1990. He is responsible for all the financial information reported by F&C US Smaller Companies.

**CAMERON FLEMING**

Group Director of Audit & Risk at F&C since 2000. He is responsible for the Internal Audit and Operational Risk departments and the provision of the Internal Corporate Governance Report from F&C to F&C US Smaller Companies.

**ROWAN HOSTLER**

Carries out the company secretarial duties of the Company on behalf of F&C Management Limited. She joined the Group in 1992.

**NICK PITT-LEWIS**

Group Director of Legal and Compliance at F&C since 1992. He is responsible for ensuring that F&C complies with its regulatory responsibilities to investors and others.

**JEREMY TIGUE**

Director and Head of Investment Trusts. He joined F&C in 1981 and has been manager of Foreign & Colonial Investment Trust since 1997 and is also a director of the Association of Investment Trust Companies.

**INVESTMENT MANAGER, SECRETARY AND REGISTERED OFFICE:**

F&C Management Limited
Exchange House
Primrose Street
London EC2A 2NY
Telephone: 020 7628 8000
Facsimile: 020 7628 8188
Website: www.fandc.com
email: info@fandc.com
Authorised and regulated in the UK by the Financial Services Authority. Registered in England.

**AUDITORS:**

PricewaterhouseCoopers LLP
Southwark Towers
32 London Bridge Street
London SE1 9SY

**BANKERS:**

JPMorgan Chase
The Royal Bank of Scotland plc

**REGISTRARS:**

Computershare Investor Services PLC
PO Box 82, The Pavilions
Bridgewater Road
Bristol BS99 7NH
Telephone: 0870 702 0130
Facsimile: 0870 703 6143
Authorised and regulated in the UK by the Financial Services Authority.

**SOLICITORS:**

Charles Russell
8–10 New Fetter Lane
London
EC4A 1RS

**STOCKBROKERS:**

Cazenove & Co Ltd
20 Moorgate
London EC2R 6DA

Member of The Association of Investment Trust Companies

# Report of the Directors

## STATUS OF COMPANY

The Company carries on the business of an investment trust and has conducted its affairs during the year under review, and subsequently, so as to qualify as such under the provisions of Section 842 of the Income and Corporation Taxes Act 1988. The last accounting period for which the Company has been treated as approved by the Inland Revenue was the year ended 30 June 2003. This approval is subject to there being no subsequent enquiry under Corporation Tax Self-Assessment. In the opinion of the Directors, the Company has subsequently conducted its affairs so as to enable it to continue to obtain Section 842 approval.

The Company is an investment company as defined by Section 266 of the Companies Act 1985.

The Company's shares are eligible for inclusion in an Individual Savings Account ('ISA') and are also eligible as an investment for Private Equity Plan ('PEP') transfers.

Note 1 to the accounts contains full details of the accounting policies adopted.

## GOING CONCERN

The Directors believe that it is appropriate to continue to adopt the going concern basis in preparing the accounts as the Company has adequate resources to continue in operation for the foreseeable future and its assets consist mainly of securities that are readily realisable.

## INVESTMENT POLICY

The Company's investment objective is to achieve long-term capital growth by investing in a diversified portfolio of quoted US smaller and medium sized companies and there will be no material change to investment policy without prior shareholder approval.

Further to the announcement made on 15 October 2003 in accordance with the publication of the Investment Entities (Listing Rules and Conduct of Business) Instrument 2003, the Directors confirm that the Company's policy is to invest in a diversified portfolio of quoted US smaller and medium sized companies.

## REVIEW OF THE BUSINESS

A review of the Company's activities is given in the Chairman's Statement on page 2 and in the Manager's Review on pages 3 and 4.

## DIVIDENDS

No dividend is recommended for payment on the ordinary shares.

## CAPITAL

At the Annual General Meeting held on 14 November 2003 shareholders renewed the Board's authority to buy back up to 3,991,050 of the Company's ordinary shares for cancellation. During the year under review 140,000 shares were purchased for cancellation at prices ranging from 209p to 211p per share. Since the year end, the Company has purchased a further 525,000 ordinary shares for cancellation at prices ranging from 192p to 198p per share.

## DURATION OF THE COMPANY

At the Annual General Meeting in 2002 the shareholders voted in favour of the continuance of the Company as an investment trust for an indefinite period. At that time the Articles of Association were amended and a continuation vote will be put to shareholders every three years, starting at the Annual General Meeting in 2005.

## SUBSTANTIAL SHARE INTERESTS

As at 14 September 2004 the Company had received notification of the following holdings of more than 3% of its ordinary share capital:

| | Ordinary shares of 25p each | % |
|---|---|---|
| Close Wealth Management Limited | 1,307,208 | 4.9 |
| F&C Management Limited | 3,029,208 | 11.7 |
| (including Foreign & Colonial Investment Trust PLC | 2,968,169 | 11.4) |

## DIRECTORS

The Directors are listed on page 8 and all held office throughout the year under review. It is the Company's policy for all the Directors to stand for re-election annually.

Each Director has signed a letter of appointment setting out the terms of his engagement as a non-executive Director. No Director has a service contract with the Company. The Board continues to believe that each of the Directors provides a relevant and significant contribution and brings a wealth of knowledge and experience to the Board, and the re-election of each of them is recommended to shareholders.

Details of the Directors' shareholdings in the Company and their interests in contracts and agreements to which the Company is a party are contained in note 5 of the accounts.

**DIRECTORS' REMUNERATION**

The Company has no employees or executive directors and therefore does not have a Remuneration Committee.

The Directors' Remuneration Report on page 17 and note 5 to the accounts provide detailed information on the remuneration arrangements for the Directors. Shareholders will be asked to approve the Directors' Remuneration Report at the Annual General Meeting (Resolution 2). The Directors' remuneration is not conditional upon the passing of the Resolution.

**MANAGEMENT**

Note 3 to the accounts provides details of the Company's Management Agreement with F&C Management Limited (the 'Manager'). The Manager provides investment management, marketing, company secretarial, financial and general administrative services to the Company for a quarterly management fee, payable in arrears, equal to 0.20% of the funds under management. In addition the Manager is eligible for a performance-related fee, charged through capital reserves, of 5% of any annual outperformance by the net asset value of "target performance" as defined in note 3 to the accounts. Either party may terminate the management agreement upon one year's notice.

The Directors review the activities and performance of the Manager on an ongoing basis. In addition, the Audit and Management Engagement Committee ("Audit Committee") carries out a thorough formal annual review of the Manager's investment strategy, process, risk controls, resources and performance. Such a review was carried out in respect of the year under review. The Audit Committee reviewed the Company's investment record over short and long-term periods, taking into account both the net asset value and the share price, as well as the performance and competence of the Manager, both as a management company and with regard to Mr Siddles as the nominated manager. The Audit Committee reported that it was satisfied with the past performance and with the way the Company was currently being managed. Based on this recommendation, it is the Board's opinion that the continuing appointment of F&C Management Limited as Manager on the agreed terms is in the best interest of shareholders as a whole.

**POLICY ON PAYMENTS TO SUPPLIERS**

The Company's principal supplier, the Manager, is paid monthly in arrears, in accordance with the terms of the Management Agreement. Other suppliers are paid in accordance with individual payment terms agreed with each supplier. As at 30 June 2004 the Company's outstanding trade creditors were equivalent to 2 days payments to suppliers.

**RISK CONTROL**

A summary of risk control measures taken by the Board is set out in the Corporate Governance section on pages 15 and 16. By means of procedures set out in the summary, and in accordance with the "Internal Control: Guidance for Directors on the Combined Code" published by the Working Party for the Institute of Chartered Accountants in England and Wales, the Board has established an ongoing process for identifying, evaluating and managing the significant risks faced by the Company and has regularly reviewed the effectiveness of the internal control systems for the period. This process has been in place throughout the year under review and to the date hereof and will continue to be regularly reviewed by the Board going forward.

**AUDITORS**

PricewaterhouseCoopers LLP have indicated their willingness to continue in office and a resolution to re-appoint them and to authorise the Directors to determine their remuneration will be proposed at the Annual General Meeting.

**INVESTOR RELATIONS**

Communications with shareholders are given a high priority. In addition to the information provided in the annual and interim accounts, updated information is available on the F&C website at www.fandc.com. Regular dialogue is maintained with the Company's institutional investors and, at the Annual General Meeting, all investors have the opportunity to question the Chairman and the Board.

**SPECIAL BUSINESS AT THE ANNUAL GENERAL MEETING**

Shareholders will find the Notice of the Annual General Meeting of the Company to be held at Exchange House, Primrose Street, London EC4A 2NY on Wednesday 27 October 2004 on pages 33 and 34. In addition to the ordinary business of the meeting, two resolutions (numbered 8 and 9) will be proposed as special business.

**AUTHORITY TO ALLOT SHARES (RESOLUTION 8)**

Resolution 8 is similar in content to the authorities given to the Directors at previous Annual General Meetings. By law, Directors are not permitted to allot new shares (or to grant rights over shares) unless authorised to do so by shareholders. In addition Directors require specific authority from shareholders before allotting new shares (or granting rights over shares) for cash without first offering them to existing shareholders in proportion to their holdings. Resolution 8 gives the Directors, for the period until the conclusion of the Annual General Meeting in 2005, the necessary authority to allot securities up to an aggregate nominal amount of £324,497, which is equivalent to approximately 5% of the issued share capital of the Company at the date of this report, and empowers the Directors to allot such securities for cash otherwise than to existing shareholders on a pro-rata basis. This authority and power provides the Directors with a degree of flexibility to increase the assets of the Company by the issue of new shares should any favourable opportunities arise to the advantage of the Company.

The Directors can, if necessary, use this authority to satisfy demand from participants in the F&C Private Investor and Pension Savings Plans and from holders of F&C Individual Savings Accounts when they believe it is advantageous to plan participants and the Company's shareholders to do so.

Under no circumstances would the Directors use the authority and power to dilute the interests of existing shareholders by issuing shares at a price which is less than the net asset value attributable to the shares at the time of issue.

**AUTHORITY FOR THE COMPANY TO PURCHASE ITS OWN SHARES (RESOLUTION 9)**

At the Annual General Meeting held on 14 November 2003 the Company was authorised to purchase up to 3,991,050 of its own ordinary shares (representing approximately 14.99% of the then issued ordinary share capital) in the market at a minimum price of 25p per share and a maximum price per share of not more than 5% above the average of the middle market quotations for an ordinary share (as derived from The London Stock Exchange Daily Official List) for the five business days immediately preceding the date of the purchase.

Resolution 9 seeks to renew this authority in respect of 3,891,369 ordinary shares, representing approximately 14.99% of the ordinary shares in issue at the date of this report. This authority will continue until the conclusion of the Annual General Meeting in 2005 or, if earlier, the expiry of 15 months from the date of the passing of such resolution.

The Directors would use this authority with the objective of enhancing shareholder value. Purchases would only be made, within guidelines established from time to time by the Board, through the market for cash at prices below the prevailing net asset value per ordinary share which would have the effect of increasing the net asset value per ordinary share for the remaining shareholders. Any ordinary shares that are purchased would be cancelled.

The Directors consider that it would be advantageous to shareholders for the Company to have the authority to make such purchases as and when it considers the timing to be favourable. However, use of this authority, if given, will depend upon market conditions and the Board's judgement of its likely effectiveness in increasing net asset value per share and/or reducing the discount. It is proposed that any purchase of ordinary shares would be financed out of realised revenue and/or capital reserves and funded from the Company's own cash resources or, if appropriate, from short term borrowings.

The Board intends to seek a renewal of such authority at subsequent annual general meetings.

By Order of the Board
F&C Management Limited, Secretary
14 September 2004

For and on behalf of
F&C MANAGEMENT LIMITED

..................................................Secretary

# Corporate Governance

The Company is committed to high standards of corporate governance. The Board has considered the principles set out in the Combined Code on Corporate Governance issued by the UK Listing Authority (the "Code") in 1998 and believes that the Company's current practice, given the special circumstances of an investment trust company, is in all material respects consistent with the principles of the Code. The Company complied throughout the year under review with the provisions set out in Section 1 of the Code.

The Board notes the publication of the revised Combined Code on Corporate Governance issued by the Financial Reporting Council in July 2003 (the "revised Code"), which is effective for financial years starting on or after 1 November 2003. The Board has also reviewed the AITC Code of Corporate Governance (the 'AITC Code') issued in July 2003 and is putting appropriate procedures into place to ensure that it will be able to report in full on compliance with the AITC Code in the annual report for the year to 30 June 2005.

**THE BOARD**

The Board is currently comprised of four non-executive directors. There is no chief executive position within the Company as day to day management of the Company's affairs has been delegated to the Manager. The Board regularly reviews the independence of its members and, having due regard to the definitions and current guidelines on independence of the AITC Code, considers all Directors to be independent of the Company's Manager. There are no relationships or circumstances relating to the Company that are likely to affect their judgement. Mr D H Hunter is the Senior Independent Director.

All the Directors of the Company are resident in the UK and their biographical details on page 8 of this annual report demonstrate the wide range of skills and experience that they bring to the Board. Each Director has signed a letter of appointment to formalise the terms of his engagement as a non-executive Director. Copies of these letters are available for inspection at the Company's registered office during normal business hours and at the Annual General Meeting.

Notwithstanding the requirement of the Company's articles of association that one third of the Board is subject to retirement by rotation each year, the Board has adopted a policy whereby all Directors stand for re-election annually. The Board is of the view that length of service does not compromise the independence or contribution of Directors of an investment trust company, where continuity and experience can add significantly to the strength of the Board, which is supported by the views on independence expressed by the AITC Code. Whilst Mr Grender and Mr Hunter have served as Directors of the Company for more than nine years, the Board have assessed them as continuing to be independent of the Company, on the grounds that each have always been, and remain, independent in character and judgement.

The Board recognises the value of progressive refreshing of, and succession planning for, company boards and regularly reviews the structure of the Board, including the balance of expertise and skills brought by individual Directors. The Board, being small in size and comprised entirely of independent non-executive Directors, operates without a Nomination Committee and believes that this is appropriate in the circumstances. Appointments of new Directors will be made on a formalised basis with the Chairman agreeing a job specification and other relevant selection criteria and the method of recruitment, selection and appointment with his colleagues. The potential Director will meet with the Board members prior to formal appointment. An induction process has been agreed, with new appointees to the Board being given a full briefing on the workings and processes of the Company and the management company by the Chairman, the Manager, the Secretary and other appropriate persons. They will also be issued with a Company Handbook, which details relevant information on the Company, and other key documentation. All appointments are subject to confirmation by shareholders.

The revised Code provides that the Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual Directors. Having regard to the AITC guidelines, the Board has evaluated its performance and that of its committees and individual Directors in respect of the year under review. The Directors also reviewed the performance of the Manager and Company Secretary in September 2004 to assess its performance and effectiveness.

It is compulsory for all Directors to hold shares in the Company. Details of these holdings are to be found in note 5 to the accounts.

It is the responsibility of the Board to ensure that there is effective stewardship of the Company's affairs. Strategic issues and all operational matters of a material nature are determined by the Board. A formal schedule of matters reserved for the decision of the Board has been adopted. In order to enable them to discharge their responsibilities, all Directors have full and timely access to all relevant information. The Board meets regularly and at each Meeting reviews management, investment and marketing performance as well as other high level management information including financial reports and other reports of a strategic nature. It monitors compliance with the Company's objectives and is directly responsible for approving asset allocation, investment strategy and gearing decisions within which the Manager is given discretion to act. Key representatives of the Manager attend Board Meetings. Board and Committee Meetings are also held on an ad hoc basis to consider particular issues as they arise.

The quorum for any Board Meeting is two directors but attendance by all directors at each meeting is strongly encouraged. During the year under review, a total of five meetings were held and, with the exception of a telephone Board Meeting in which Mr Barton was not able to participate, all directors attended each meeting.

The Board has established a procedure whereby directors, wishing to do so in the furtherance of their duties, may take independent professional advice at the Company's expense. No professional advice has been taken by the Directors during the year under review.

The Board has direct access to the advice and services of the Company Secretary, F&C Management Limited, whose responsibility it is to ensure that the Board and Committee procedures are followed and that applicable regulations are complied with.

During the year under review, the Board has maintained appropriate insurance cover in respect of legal action against the Directors.

**AUDIT & MANAGEMENT ENGAGEMENT COMMITTEE**

The Board has appointed an Audit & Management Engagement Committee (the "Audit Committee"). The Audit Committee operates within written terms of reference that clearly set out its authority and duties. These terms of reference were reviewed and updated during the year. Copies of the terms of reference are available on request and can also be found on the F&C website at www.fandc.com.

The Audit Committee is comprised of the Directors who are considered to be independent, currently the whole Board, and meets at least twice a year. Mr G D Grender was chairman of the Audit Committee throughout the year under review until 15 June 2004, when he was replaced as chairman by Mr M P S Barton. There is a range of recent and relevant financial experience amongst the members of the Audit Committee. Two meetings were held during the year under review, attended by all members at the time.

The primary role of the Audit Committee is to review the Company's accounting policies, the contents of the financial statements, the adequacy and scope of the external audit and compliance with regulatory and financial reporting requirements. In addition it reviews the provision of non-audit services by the external auditor, the risks to which the Company is exposed and the controls in place to mitigate those risks. The Audit Committee also reviews, on an annual basis, the performance and fee paid to the Manager for the services provided under the management agreement together with the terms of the agreement.

The Audit Committee reviews, from time to time, the 'whistle blowing' policy that has been put in place by the Manager under which its staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters insofar as they may affect the Company.

The Audit Committee has access to the compliance and internal audit directors of the Manager and to the Manager's group audit committee and reports its findings to the Board. The Board retains ultimate responsibility for all aspects relating to the annual and interim accounts and other published financial information.

**AUDITORS**

The Audit Committee has direct access to the auditors, PricewaterhouseCoopers LLP. The auditors attend the Audit Committee meeting to review the annual results and provide a comprehensive review of the audit of the Company. The Audit Committee also meets with the auditors without the Manager being present.

The Audit Committee, together with the Manager, has reviewed the work carried out by PricewaterhouseCoopers LLP for the audit of the annual financial statements. On the basis of this and the auditors' expertise in auditing the affairs of the Company, the Audit Committee has assessed the effectiveness of the external audit. The Audit Committee has taken into account the standing, experience and tenure of the audit partner, the nature and level of service provided and confirmation that the auditors have complied with all relevant UK and professional, regulatory and independence standards. The Audit Committee considers PricewaterhouseCoopers LLP to be independent both of the Company and the Manager in all respects.

The Audit Committee has reviewed the provision of non-audit services by the auditors. During the year under review total fees for these services amounted to £4,000 and these services were in relation to taxation, the review of corporate governance matters and attendance at meetings. The Audit Committee considers that the services provided are cost effective and do not impair the independence of the auditors.

**INVESTMENT MANAGEMENT, ADMINISTRATION AND CUSTODY**

The Board has contractually delegated the management of the investment portfolio, the operation of custodial services and the provision of accounting, company secretarial and marketing services to the Manager. Details of the Terms of Agreement with the Manager are set out in note 3 to the accounts.

The Manager outsourced certain of its administrative functions to Mellon Bank N.A. (London Branch) in November 2003. The Manager retains full responsibility for these functions.

The Company has appointed JPMorgan Chase to act as custodian of the Company's assets. Operational matters with the custodian are carried out by the Manager in accordance with the provisions of the Management Agreement.

**INTERNAL CONTROLS AND MANAGEMENT OF RISKS**

The Board has overall responsibility for the Company's systems of internal controls and for reviewing their effectiveness and ensuring that the risk management and control processes are embedded in day to day operations. These controls aim to ensure that the assets of the Company are safeguarded, proper accounting records are maintained and the financial information used within the business and for publication is reliable. Typical areas of risk material to investment trusts in general, and which have been identified and are monitored as part of the control process include excessive gearing, inappropriate long-term investment strategy, inappropriate asset allocation, loss of management personnel and potential loss of Section 842 status under the provisions of the Income and Corporation Taxes Act 1988.

Control of the risks identified covering financial, operational, compliance and overall risk management is exercised by the Board through quarterly reports provided by the Manager on investment performance, performance attribution and other management issues. The Board has agreed with the Manager the investment policy and restrictions under which the Manager operates and the Manager reports on compliance at every Meeting. The Board also receives a quarterly control report from the Manager that provides details of any known internal control failure. This report incorporates a key risk table that identifies the risks to which the Company is exposed and the controls in place to mitigate them, including risks that are not directly the responsibility of the Manager.

The systems of internal control are designed to manage rather than eliminate risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement, loss or fraud.

In common with most investment trusts, the Company does not have an internal audit function. All the Company's management functions are delegated to the Manager which has its own internal audit and risk department and whose controls are monitored by the Board. It is therefore felt that there is no need for the Company to have its own internal audit function. However, this need will be reviewed periodically with the Audit Committee.

The Board has carried out a risk control assessment, including a review of the Manager's risk management infrastructure. A key element of the assessment is the Statement of Internal Corporate Governance for the year to 31 December 2003 (the 'Statement') prepared by the Manager for its investment trust clients to the standards of the Financial Reporting & Auditing Group Technical Release 21/94 (FRAG21) issued by the Institute of Chartered Accountants in England and Wales. Containing a report from independent external accountants, the Statement sets out the Manager's control policies and procedures with respect to the management of its clients' investments. The effectiveness of these controls is monitored by the Manager's group audit committee, which receives regular reports from the Manager's compliance and audit and risk departments. The Audit Committee has reviewed the Statement, together with a report from the Manager's group audit committee on the effectiveness of the internal controls maintained on behalf of the Company and an annual compliance report from the Manager's director of compliance, updated by control reports to 30 June 2004 from the Manager's director of group audit and risk.

**REMUNERATION COMMITTEE**

The Company has no executive Directors and no employees, and consequently does not have a remuneration committee. The Directors' Remuneration Report, which can be found on page 17, and note 5 to the accounts provide detailed information on the remuneration arrangements for the Directors of the Company.

**INVESTOR RELATIONS**

Communication with shareholders is given a high priority. The Company's annual report and accounts, containing a detailed review of performance and investment portfolio, is sent to all shareholders. At the half year stage, an interim report, containing updated information in a more abbreviated form, is also sent to all shareholders. Updated information is available on the F&C website at www.fandc.com.

Shareholders wishing to communicate with the Chairman, the Senior Independent Director or other members of the Board may do so by writing to the Company at its registered office address, which can be found on page 9.

All shareholders are encouraged to attend the Annual General Meeting, where a presentation is made by the Manager and where shareholders are given the opportunity to question the Chairman, the Board and the Manager. Proxy voting figures are announced to shareholders at the Meeting.

**CORPORATE GOVERNANCE, VOTING POLICY AND SOCIALLY RESPONSIBLE INVESTMENT**

The Manager has developed and published a policy on Corporate Governance, Voting Policy and Socially Responsible Investment ('SRI'). The policy reflects the Statement of Principles on the Responsibilities of Institutional Shareholders and Agents drawn up in 2002 by the Institutional Shareholders' Committee. The Manager believes that the interests of its clients are served by investing in companies that adopt best practice in corporate governance.

The Board has considered the Manager's policy and it is the Company's policy to exercise its voting rights at shareholders' meetings of investee companies. In accordance with generally accepted policy in the US, however, investee companies do not normally publish their corporate governance policies, which inhibits the monitoring of corporate governance and socially responsible investment of investee companies.

# Directors' Remuneration Report

**REMUNERATION COMMITTEE**

As the Board of Directors is comprised solely of non-executive directors, it is exempt under the Listing Rules from appointing a remuneration committee. The determination of the Directors' fees is a matter dealt with by the whole Board.

The Company's Articles of Association limit the aggregate fees payable to the Board of Directors to a total of £75,000 per annum. Subject to this overall limit, it is the Company's policy to determine the level of Directors' fees having regard to the level of fees payable to non-executive directors in the industry generally, the role that individual Directors fulfil in respect of Board and Committee responsibilities, and the time committed to the Company's affairs.

No element of the Directors' remuneration is performance related.

No Director has a service contract with the Company.

No Director past or present has any entitlement to pensions, and the Company has not awarded any share options or long-term performance incentives to any of the Directors.

Directors' and Officers' liability insurance cover is maintained by the Company on behalf of the Directors.

**Remuneration for Qualifying Services**

| Director | **2004 Fees for services to the Company £'000s** | 2003 Fees for services to the Company £'000s |
|---|---|---|
| G D Grender | **20** | 20 |
| N M Bachop | **12** | 12 |
| M P S Barton | **12** | 12 |
| D H Hunter | **12** | 12 |
| **Totals** | **56** | 56 |

The information in the above table has been audited (see Independent Auditors Report on page 19).

The amounts paid by the Company to the Directors were for services as non-executive Directors.

The Board of Directors has resolved that from 1 July 2004, in addition to the above fees which will not increase, the Chairman of the Audit and Management Engagement Committee, M P S Barton, will receive a fee of £5,000 per annum and the other members of the Audit and Management Engagement Committee, G D Grender, N M Bachop and D H Hunter will each receive a fee of £2,500 per annum.

By order of the Board
F&C Management Limited, Secretary
14 September 2004

For and on behalf of
F&C MANAGEMENT LIMITED
..................Secretary

# Directors' Statement of Responsibilities

As required by company law, the Directors are responsible for the preparation of financial statements which give a true and fair view of the state of affairs of the Company at 30 June 2004 and of the results for the year then ended. In preparing the financial statements, suitable accounting policies have been used and applied consistently, and reasonable and prudent judgements and estimates have been made. The financial statements are prepared in accordance with applicable accounting standards and on a going concern basis. The Directors are also responsible for ensuring that adequate accounting records are maintained and 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 detect fraud and other irregularities.

The financial statements are published on the www.fandc.com website, which is a website maintained by F&C Management Limited ("F&C"). The maintenance and integrity of the website maintained by F&C or any of its subsidiaries is, so far as it relates to the Company, the responsibility of F&C. The work carried out by the auditors does not involve consideration of the maintenance and integrity of this website and accordingly, the auditors accept no responsibility for any changes that have occurred to the financial statements since they were initially presented on the website. Visitors to the website need to be aware that legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in their jurisdiction.

# Independent Auditors' Report

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF F&C US SMALLER COMPANIES PLC**

We have audited the financial statements, which comprise the statement of total return, the balance sheet, the cash flow statement and the related notes. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the Directors' Remuneration Report ("the auditable part").

**RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS**

The Directors' responsibilities for preparing the annual report and accounts in accordance with applicable United Kingdom law and accounting standards are set out in the statement of Directors' responsibilities. The Directors are also responsible for preparing the Directors' Remuneration Report.

Our responsibility is to audit the accounts and the auditable part of the Directors' Remuneration Report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the accounts and the auditable part of the Directors' Remuneration Report have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Report of the Directors is not consistent with the accounts, 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 regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. The other information comprises only the Chairman's Statement, the Manager's Review, the Report of the Directors, the unaudited part of the Directors' Remuneration Report and the Corporate Governance Statement.

We review whether the Corporate Governance Statement reflects the Company's compliance with the seven provisions of the Combined Code issued in June 1998 specified for our review by the Listing Rules of 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 to form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

**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 accounts and the auditable part of the Directors' Remuneration Report. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the accounts, 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 and the auditable part of the Directors' Remuneration Report are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

**OPINION**

In our opinion:

- the accounts give a true and fair view of the state of the Company's affairs at 30 June 2004 and of its total return and cash flows for the year then ended;
- the accounts have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the Directors' Remuneration Report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London,
14 September 2004

# Statement of Total Return

| Revenue Notes | Capital Notes | (incorporating the Revenue Account)* for the year ended 30 June | 2004 Revenue £'000s | 2004 Capital £'000s | 2004 Total £'000s | 2003 Revenue £'000s | 2003 Capital £'000s | 2003 Total £'000s |
|---|---|---|---|---|---|---|---|---|
| | 8 | Gains/(losses) on investments | **–** | **12,005** | **12,005** | – | (8,632) | (8,632) |
| | 17 | Exchange losses on currency balances | **–** | **(148)** | **(148)** | – | (2) | (2) |
| 2 | | Income | **714** | **–** | **714** | 526 | – | 526 |
| 3 | | Management fee | **(496)** | **–** | **(496)** | (430) | – | (430) |
| 4 | 17 | Other expenses | **(175)** | **(2)** | **(177)** | (164) | (6) | (170) |
| | | **Net return before finance costs and taxation** | **43** | **11,855** | **11,898** | (68) | (8,640) | (8,708) |
| | | Interest payable and similar charges | **–** | **–** | **–** | – | – | – |
| | | **Return on ordinary activities before taxation** | **43** | **11,855** | **11,898** | (68) | (8,640) | (8,708) |
| 6 | | Taxation on ordinary activities | **(104)** | **–** | **(104)** | (75) | – | (75) |
| | | **Return attributable to equity shareholders** | **(61)** | **11,855** | **11,794** | (143) | (8,640) | (8,783) |
| | | Dividends on ordinary shares (equity) | **–** | **–** | **–** | – | – | – |
| 17 | 17 | **Amount transferred (from)/to reserves** | **(61)** | **11,855** | **11,794** | (143) | (8,640) | (8,783) |
| 7 | 7 | **Return per ordinary share – pence** | **(0.23)** | **44.53** | **44.30** | (0.49) | (29.62) | (30.11) |

*The revenue column of the statement is the profit and loss account of the Company.

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

# Balance Sheet

**at 30 June**

| Notes | | 2004 £'000s | 2004 £'000s | 2003 £'000s | 2003 £'000s |
|---|---|---|---|---|---|
| | **Fixed Assets** | | | | |
| 8 | Listed investments | | **63,843** | | 52,135 |
| | **Current assets** | | | | |
| 9 | Debtors | **171** | | 20 | |
| | Cash at bank and short-term deposits | **1,381** | | 1,295 | |
| | | **1,552** | | 1,315 | |
| | **Current liabilities** | | | | |
| 10 | Creditors: amounts falling due within one year | **(632)** | | (185) | |
| | Net current assets | | **920** | | 1,130 |
| | Net assets | | **64,763** | | 53,265 |
| | **Capital and reserves** | | | | |
| 12 | Called up equity share capital | | **6,621** | | 6,656 |
| 13 | Capital redemption reserve | **6,731** | | 6,696 | |
| 14 | Share premium | **2,468** | | 2,468 | |
| 15 | Non-distributable reserve | **841** | | 841 | |
| 16 | Special reserve | **10,713** | | 11,009 | |
| 17 | Capital reserves | **38,988** | | 27,133 | |
| 17 | Revenue reserve | **(1,599)** | | (1,538) | |
| | | | **58,142** | | 46,609 |
| 18 | **Total shareholders' funds – equity** | | **64,763** | | 53,265 |
| 19 | **Net asset value per ordinary share - pence** | | **244.53** | | 200.06 |

Approved by the Board on 14 September 2004 and signed on its behalf by:

Gordon Grender

# Cash Flow Statement

**for the year ended 30 June**

| Notes | | | 2004 | | 2003 |
|---|---|---|---|---|---|
| | | **£'000s** | **£'000s** | £'000s | £'000s |
| | **Operating activities** | | | | |
| | Investment income received | **678** | | 508 | |
| | Interest received | **3** | | 27 | |
| | Fee paid to the management company | **(473)** | | (472) | |
| | Cash paid to and on behalf of Directors | **(84)** | | (28) | |
| | Other cash payments | **(116)** | | (86) | |
| 20 | **Net cash inflow/(outflow) from operating activities** | | **8** | | (51) |
| | **Taxation** | | | | |
| | Overseas tax paid | **(104)** | | (76) | |
| | **Total tax paid** | | **(104)** | | (76) |
| | **Financial investment** | | | | |
| | Purchases of investments | **(15,980)** | | (14,131) | |
| | Sales of investments | **16,310** | | 26,721 | |
| | Other capital expenses | **(1)** | | (9) | |
| | **Net cash inflow from financial investment** | | **329** | | 12,581 |
| | **Net cash inflow before use of liquid resources and financing** | | **233** | | 12,454 |
| | **Financing** | | | | |
| | Net cash inflow from conversion of warrants | **-** | | 2,538 | |
| | Purchase of ordinary shares | **-** | | (15,079) | |
| | **Net cash outflow from financing** | | **-** | | (12,541) |
| 21 | **Increase/(decrease) in cash** | | **233** | | (87) |

# Notes on the Accounts

**1 ACCOUNTING POLICIES**

**(a) Basis of accounting**
The accounts have been prepared on the historical cost basis of accounting, modified to include fixed asset investments at valuation and in accordance with accounting standards applicable in the United Kingdom and with the Statement of Recommended Practice "Financial Statements of Investment Trust Companies" (SORP) issued in January 2003.

**(b) Valuation of investments**
As an investment trust, the Company treats all transactions on the realisation and the revaluation of investments held as fixed assets as transactions on capital account. These items, whether profits or losses, are not part of and are not reflected in the revenue account but are charged or credited to capital reserves. Listed investments are shown at middle market value and unlisted investments at Directors' valuation.

**(c) Foreign currency**
Foreign currency assets and liabilities are expressed in Sterling at rates of exchange ruling at the balance sheet date. Purchases and sales of investment securities, dividends and interest income and expenses are translated at rates of exchange prevailing on the respective dates of such transactions. Exchange profits and losses on currency balances are charged or credited to capital reserves except where they relate to revenue items.

**(d) Income**
Income from equity shares is brought into the revenue account (except where, in the opinion of the Directors its nature indicates it should be recognised as capital) on the ex-dividend date or, where no ex-dividend date is quoted, when the Company's right to receive payment is established.

Where the Company has elected to receive its dividends in the form of additional shares rather than in cash, the amount of the cash dividend foregone is recognised as income. Any excess in the value of the shares received over the amount of the cash dividend foregone is recognised in the capital reserve.

**(e) Expenses**
All expenses are accounted for on an accruals basis. Expenses are charged through the revenue account except those expenses incidental to the acquisition or disposal of investments and performance-related management fees (calculated under the terms of the management agreement) which are charged through capital reserves.

**(f) Finance costs**
Finance costs are accounted for on an accruals basis and are charged through the revenue account.

**(g) Taxation**
Deferred tax is provided in accordance with FRS19 on all timing differences that have originated but not reversed by the balance sheet date. Deferred tax assets and liabilities are not discounted to reflect the time value of money. Deferred tax assets are only recognised to the extent that they are regarded as recoverable.

**(h) Capital reserves**

**Capital reserve – realised**
The following are accounted for in this reserve:
- gains and losses on the realisation of investments
- realised exchange differences of a capital nature
- losses on warrants purchased for cancellation
- costs of purchasing ordinary share capital (prior to establishment of the special reserve).
- other capital charges and credits charged or credited to this account in accordance with the above policies.

**Capital reserve – unrealised**
The following are accounted for in this reserve:
- increases and decreases in the valuation of investments held at the year end
- unrealised exchange differences of a capital nature.

## 2 INCOME

| | 2004 £'000s | 2003 £'000s |
|---|---|---|
| Overseas dividends | **711** | 499 |
| Interest on cash and short-term deposits | **3** | 27 |
| Total income | **714** | 526 |

## 3 MANAGEMENT FEE

| | 2004 £'000s | 2003 £'000s |
|---|---|---|
| Management fee | **495** | 430 |
| Irrecoverable VAT thereon | **1** | - |
| | **496** | 430 |

Under the terms of a management agreement dated 11 February 1993, the Manager provides investment management and general administrative services to the Company, for a quarterly management fee payable in arrears equal to 0.20% of the funds under management.

The Manager is also eligible for a performance-related management fee, charged through capital reserves, of 5% of any annual outperformance by the net asset value (NAV) of "target performance", defined as a margin of 2% over the Russell 2000 Smaller Companies Index (in both cases converted to sterling). If the NAV performance (adjusted to exclude the relevant performance-related fee) exceeds the target, the performance-related fee is payable on the excess. If the NAV underperforms the Russell 2000 Smaller Companies Index by 2% or more, the under-performance will be carried forward and no further performance-related fee will be payable until the NAV has both recovered the accumulated under-performance and exceeded the target performance for the year. The maximum performance-related fee which may be payable in respect of any year is 0.7% of gross assets. No performance-related fee is payable in respect of the year ended 30 June 2004 (2003: £nil) due to underperformance brought forward.

The management agreement may be terminated upon one year's notice given by either party.

## 4 OTHER EXPENSES

| | 2004 £'000s | 2003 £'000s |
|---|---|---|
| Auditors' remuneration: | | |
| for audit services | **15** | 14 |
| for other services | **4** | 5 |
| Directors' emoluments: | | |
| fees for services to the Company (see note 5) | **56** | 56 |
| Directors' and Officers' liabilities insurance | **21** | 7 |
| Printing and postage | **17** | 16 |
| Private Investor Plan expenses | **17** | 14 |
| General expenses | **45** | 52 |
| | **175** | 164 |

## 5 DIRECTORS' REMUNERATION AND CONTRACTS

### (a) Remuneration

The Company had no employees during the year.

The amounts paid by the Company to the Directors of the Company, which were for services as non-executive Directors and did not include any payments or rights to pensions, are detailed in the Directors' Remuneration Report on page 17.

None of the Directors of the Company received any other remuneration from the Company.

### (b) Directors' interests in shares

The beneficial interests of the Directors in the ordinary shares of the Company were as follows:

| | **30 June 2004 Ordinary Shares** | 30 June 2003 Ordinary Shares |
|---|---|---|
| N M Bachop | **10,000** | 10,000 |
| M P S Barton | **5,000** | 5,000 |
| G D Grender | **18,000** | 18,000 |
| D H Hunter | **10,000** | 10,000 |

No Director held any interest, beneficial or otherwise, in the issued shares of the Company other than stated above.

## 6 TAXATION ON ORDINARY ACTIVITIES

### (a) Analysis of tax charge for the year

| | **Revenue £'000s** | **Capital £'000s** | **2004 Total £'000s** | Revenue £'000s | Capital £'000s | 2003 Total £'000s |
|---|---|---|---|---|---|---|
| Overseas tax | **104** | **–** | **104** | 75 | – | 75 |
| Current tax charge on ordinary activities (note 6 (b)) | **104** | **–** | **104** | 75 | – | 75 |

### (b) Factors affecting the current tax charge for the year

| | **Revenue £'000s** | **Capital £'000s** | **2004 Total £'000s** | Revenue £'000s | Capital £'000s | 2003 Total £'000s |
|---|---|---|---|---|---|---|
| Return on ordinary activities before tax | **43** | **11,855** | **11,898** | (68) | (8,640) | (8,708) |
| Return on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% | **13** | **3,556** | **3,569** | (20) | (2,592) | (2,612) |
| Income taxable in different periods | **(12)** | **–** | **(12)** | 3 | – | 3 |
| Disallowed expenses | **3** | **–** | **3** | 4 | – | 4 |
| Expenses (utilised)/not utilised in the year | **(4)** | **–** | **(4)** | 36 | – | 36 |
| Overseas taxation not relieved | **104** | **–** | **104** | 52 | – | 52 |
| Capital returns* | **–** | **(3,556)** | **(3,556)** | – | 2,592 | 2,592 |
| Current tax charge for the year (note 6 (a)) | **104** | **–** | **104** | 75 | – | 75 |

*These capital returns are not subject to corporation tax within an investment trust company.

The deferred tax asset of £532,000 in respect of unutilised expenses and excess unrelieved overseas tax at 30 June 2004 (2003: £506,000) has not been recognised as it is unlikely that these will be utilised.

## 7 RETURN PER ORDINARY SHARE

**Revenue return**

The revenue return per share is based on the revenue return attributable to equity shareholders of £61,000 loss (2003: £143,000 loss).

**Capital return**

The capital return per share is based on the capital return attributable to equity shareholders of £11,855,000 profit (2003: £8,640,000 loss). Both the revenue and capital returns are based on a weighted average of ordinary shares in issue during the year of 26,623,867 (2003: 29,169,023).

## 8 LISTED INVESTMENTS

| | Total £'000s |
|---|---|
| Cost at 1 July 2003 | 52,505 |
| Unrealised depreciation at 1 July 2003 | (370) |
| Valuation at 1 July 2003 | 52,135 |
| Movements in the year: | |
| Purchases at cost | 16,131 |
| Sales – proceeds | (16,428) |
| – realised gains on sales | 4,938 |
| Increase in unrealised appreciation | 7,067 |
| **Valuation at 30 June 2004** | **63,843** |
| Cost at 30 June 2004 | 57,686 |
| Unrealised appreciation at 30 June 2004 | 6,157 |
| **Valuation at 30 June 2004** | **63,843** |

**Gains/(losses) on investments**

| | **2004 £'000s** | 2003 £'000s |
|---|---|---|
| Realised gains/(losses) based on historical cost | **5,478** | (4,960) |
| Less: amounts recognised as unrealised in previous years | **(540)** | (871) |
| Realised gains/(losses) based on carrying value at previous balance sheet date | **4,938** | (5,831) |
| Increase/(decrease) in unrealised appreciation | **7,067** | (2,801) |
| Gains/(losses) on investments | **12,005** | (8,632) |

## 9 DEBTORS

| | **2004 £'000s** | 2003 £'000s |
|---|---|---|
| Investment debtors | **118** | – |
| Prepayments and accrued income of a revenue nature | **53** | 20 |
| | **171** | 20 |

## 10 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

| | **2004 £'000s** | 2003 £'000s |
|---|---|---|
| Investment creditors | **170** | 18 |
| Purchase of ordinary shares | **296** | – |
| Payable to and on behalf of Directors | – | 28 |
| Creditors and accruals of a revenue nature | **165** | 139 |
| Other creditors and accruals | **1** | – |
| | **632** | 185 |

## 11 INDUSTRIAL CLASSIFICATION: TOTAL ASSETS LESS CURRENT LIABILITIES

| | **2004 Total %** | 2003 Total % |
|---|---|---|
| **Investments** | | |
| Autos & Transportation | **4.4** | 7.2 |
| Consumer Discretionary | **29.2** | 26.7 |
| Financials | **23.4** | 21.6 |
| Healthcare | **13.4** | 12.4 |
| Materials & Processing | **6.8** | 7.8 |
| Other | **-** | 1.9 |
| Other Energy | **7.5** | 5.8 |
| Producer Durables | **7.1** | 7.2 |
| Technology | **5.5** | 5.1 |
| Utilities | **1.3** | 2.2 |
| **Total investments** | **98.6** | 97.9 |
| **Net current assets** | **1.4** | 2.1 |
| **Total assets less current liabilities** | **100.0** | 100.0 |

## 12 EQUITY SHARE CAPITAL

| | Authorised | | Issued and fully paid | |
|---|---|---|---|---|
| | Number | £'000s | Number | £'000s |
| Ordinary shares of 25p each | | | | |
| Balance brought forward | 75,000,000 | 18,750 | 26,624,769 | 6,656 |
| Purchase of own shares* | – | – | (140,000) | (35) |
| Balance carried forward | **75,000,000** | **18,750** | **26,484,769** | **6,621** |

* 140,000 ordinary shares were purchased during the year at a total cost of £296,000. Since the year end a further 525,000 ordinary shares have been purchased at a total cost of £1,027,000.

## 13 CAPITAL REDEMPTION RESERVE

| | **2004 £'000s** | 2003 £'000s |
|---|---|---|
| Balance brought forward | **6,696** | 4,507 |
| Transferred from equity share capital | **35** | 2,189 |
| Balance carried forward | **6,731** | 6,696 |

## 14 SHARE PREMIUM

| | **2004 £'000s** | 2003 £'000s |
|---|---|---|
| Balance brought forward | **2,468** | 565 |
| Received on issue of ordinary shares on conversion of warrants | **-** | 1,903 |
| Balance carried forward | **2,468** | 2,468 |

## 15 NON-DISTRIBUTABLE RESERVE

| | 2004 £'000s | 2003 £'000s |
|---|---|---|
| Balance brought forward | **841** | – |
| Transferred from warrant reserve | **–** | 841 |
| Balance carried forward | **841** | 841 |

## 16 SPECIAL RESERVE

| | 2004 £'000s | 2003 £'000s |
|---|---|---|
| Balance brought forward | **11,009** | 26,088 |
| Cost of purchase of ordinary shares | **(296)** | (15,079) |
| Balance carried forward | **10,713** | 11,009 |

## 17 OTHER RESERVES

| | Capital reserve – realised £'000s | Capital reserve – unrealised £'000s | Capital reserves total £'000s | Revenue reserve £'000s |
|---|---|---|---|---|
| Realised gains on investments | 4,938 | – | 4,938 | – |
| Transfers on disposal of investments | 540 | (540) | – | – |
| Exchange losses on currency balances | (148) | – | (148) | – |
| Other capital charges | (2) | – | (2) | – |
| Increase in unrealised appreciation | – | 7,067 | 7,067 | – |
| Amount transferred from revenue reserve | – | – | – | (61) |
| | 5,328 | 6,527 | 11,855 | (61) |
| Balance brought forward | 27,503 | (370) | 27,133 | (1,538) |
| Balance carried forward | **32,831** | **6,157** | **38,988** | **(1,599)** |

## 18 RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS

| | 2004 £'000s | 2003 £'000s |
|---|---|---|
| Revenue return on ordinary activities after taxation | **(61)** | (143) |
| Capital return on ordinary activities after taxation | **11,855** | (8,640) |
| Net increase/(decrease) in equity shareholders' funds | **11,794** | (8,783) |
| New share capital subscribed on exercise of warrants | **–** | 2,537 |
| Cost of purchase of ordinary shares out of special reserve | **(296)** | (15,079) |
| Total equity shareholders' funds brought forward | **53,265** | 74,590 |
| Total equity shareholders' funds carried forward | **64,763** | 53,265 |

## 19 NET ASSET VALUE PER ORDINARY SHARE

Net asset value per ordinary share is based on total net assets of £64,763,000 (2003: £53,265,000) and on 26,484,769 (2003: 26,624,769) ordinary shares in issue at 30 June 2004.

## 20 RECONCILIATION OF REVENUE RETURN BEFORE FINANCE COSTS AND TAXATION TO NET CASH INFLOW/(OUTFLOW) FROM OPERATING ACTIVITIES

| | **2004 £'000s** | 2003 £'000s |
|---|---|---|
| Net revenue return before finance costs and taxation | **43** | (68) |
| (Increase)/decrease in accrued income | **(33)** | 9 |
| Decrease in other debtors | **–** | 46 |
| Decrease in creditors | **(2)** | (38) |
| Net cash inflow/(outflow) from operating activities | **8** | (51) |

Included within the £84,000 of cash paid to and on behalf of Directors in 2004 is £28,000 of emoluments accrued at 30 June 2003.

## 21 RECONCILIATION OF NET CASH FLOW MOVEMENT TO MOVEMENT IN NET FUNDS

| | **2004 £'000s** | 2003 £'000s |
|---|---|---|
| Increase/(decrease) in cash | **233** | (87) |
| Movement resulting from cash flows | **233** | (87) |
| Exchange movement | **(147)** | (2) |
| Movement in net funds | **86** | (89) |
| Net funds brought forward | **1,295** | 1,384 |
| Net funds carried forward | **1,381** | 1,295 |

| Represented by: | Balance at 1 July 2003 £'000s | Cash flow £'000s | Exchange movement £'000s | **Balance at 30 June 2004 £'000s** |
|---|---|---|---|---|
| Cash at bank and short-term deposits | 1,295 | 233 | (147) | **1,381** |

## 22 FUND RISK PROFILE

The Company's investment objective is to achieve long-term capital growth by investing in a diversified portfolio of quoted US smaller and medium-sized companies. The portfolio held throughout the year and at the year-end is in line with the Company's investment objective. The Company has the power to take out both short and long-term borrowings. No borrowings were entered into during the year.

In pursuing its investment objectives, the Company faces risks to both assets and revenue. These risks, and the Directors' approach to the management of the risks, which have been applied consistently throughout the current and preceding period, are set out on page 30.

### Financial Assets

The interest rate profile of the Company's financial assets (excluding short-term debtors) was:

| Currency | **2004 Floating rate financial assets £'000s** | 2003 Floating rate financial assets £'000s |
|---|---|---|
| US Dollar | **1,358** | 1,125 |
| Sterling | **23** | 170 |
| | **1,381** | 1,295 |

The Company's investments in equity shares and similar instruments have been excluded from the interest rate risk profile, as they have no maturity date and would distort the weighted average period information.

Floating rate financial assets generate interest based on competitive rates set by JPMorgan Chase.

**22 FUND RISK PROFILE (CONTINUED)**

**Financial Liabilities**

The Company had no financial liabilities (excluding short-term creditors) at 30 June 2004 (2003: £nil).

**Currency Exposure**

The profile of the Company's net monetary assets, by currency, was:

| Currency | **2004** **£'000s** | 2003 £'000s |
|---|---|---|
| US Dollar | **65,193** | 53,253 |
| Sterling | **(430)** | 12 |
| | **64,763** | 53,265 |

**Fair Value**

The Directors are of the opinion that the financial assets and liabilities of the Company are stated at fair value in the balance sheet.

## Risk Management

| Risk | Management of Risk |
|---|---|
| **Credit**<br>Failure by counterparties to deliver securities which the Company has paid for, or to pay for securities which the Company has delivered. | All transactions are settled on the basis of delivery against payment. Only approved counterparties are used. |
| **Liquidity**<br>Difficulty in realising assets or otherwise raising funds to meet commitments associated with financial instruments. | The Company's investments are principally quoted equities and are readily realisable. The Company has the power to take out borrowings, both short and long-term, and in addition has an overdraft facility of £1 million. |
| **Market Price**<br>The Company's assets consist principally of quoted equities, the values of which are determined by market forces. | The Board manages the market price risks inherent in the Company's portfolio by ensuring full and timely access to relevant information from the Manager. The Board meets regularly and at each meeting reviews investment performance and financial results. It monitors compliance with the Company's objectives and is directly responsible for investment strategy, asset allocation and gearing. |
| **Currency**<br>The majority of the Company's assets and liabilities are denominated in currencies other than sterling. As a result movements in exchange rates may affect the sterling value of the portfolio, cash, investment purchases and sales and income. | All transactions in shares and securities are settled on the basis of delivery versus payment, using approved counterparties. |

# Ten Year Record

**ASSETS**
at 30 June

| £'000s | 1994 | 1995 | 1996† | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Total assets less current liabilities | 50,448 | 60,217 | 79,282 | 88,386 | 107,900 | 115,955 | 80,946 | 86,743 | 74,590 | 53,265 | **64,763** |
| Prior charges | – | – | – | – | – | – | – | – | – | – | – |
| Available for ordinary shares | 50,448 | 60,217 | 79,282 | 88,386 | 107,900 | 115,955 | 80,946 | 86,743 | 74,590 | 53,265 | **64,763** |

**NET ASSET VALUE**
at 30 June

| | 1994 | 1995 | 1996† | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| NAV per share | 100.70p | 120.0p | 157.9p | 175.8p | 214.4p | 230.3p | 243.4p | 267.1p | 277.1p | 200.1p | **244.5p** |
| NAV per share – fully diluted | 100.60p | 116.7p | 148.3p | 164.9p | 202.1p | 217.8p | 228.4p | 249.2p | 218.4p | # | **#** |
| NAV total return on 100p – 5 years (per AITC) | | | | | | | | | | | **112.2p** |
| NAV total return on 100p – 10 years (per AITC) | | | | | | | | | | | **250.4p** |

**SHARE PRICE**
at 30 June

| | 1994 | 1995 | 1996† | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Mid-market price per share | 98.5p | 106.5p | 136.5p | 137.5p | 168.0p | 183.3p | 200.0p | 222.5p | 207.0p | 192.0p | **216.5p** |
| Discount/(premium) to NAV | 2.1% | 8.7% | 8.0% | 16.6% | 16.9% | 15.8% | 12.5% | 10.7% | 5.2% | 4.0% | **11.5%** |
| Share price High | 119.0p | 109.5p | 136.5p | 155.0p | 179.0p | 189.5p | 215.8p | 232.5p | 254.0p | 206.0p | **231.0p** |
| Share price Low | 97.0p | 90.0p | 107.0p | 123.0p | 138.0p | 119.0p | 164.0p | 192.5p | 168.0p | 142.5p | **190.5p** |
| Share price total return on 100p – 5 years (per AITC) | | | | | | | | | | | **118.1p** |
| Share price total return on 100p – 10 years (per AITC) | | | | | | | | | | | **219.8p** |

**REVENUE**
for the year ended 30 June

| £'000s | 1994* | 1995 | 1996† | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Available for ordinary shares | 89 | (8) | (197) | (103) | (215) | (2) | (319) | (357) | (322) | (143) | **(61)** |
| Earnings per share | 0.18p | (0.02)p | (0.39)p | (0.21)p | (0.43)p | 0.00p | (0.86)p | (1.09)p | (0.99)p | (0.49p) | **(0.23)p** |
| Dividends per share | – | – | – | – | – | – | – | – | – | – | **–** |

**PERFORMANCE**

| (rebased at 30 June 1994) | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| NAV per share | 100.0 | 116.0 | 147.4 | 163.9 | 200.9 | 216.5 | 227.0 | 247.7 | 217.1 | 198.9 | **243.1** |
| Mid-market price per share | 100.0 | 108.1 | 138.6 | 139.6 | 170.6 | 186.1 | 203.0 | 225.9 | 210.2 | 194.9 | **219.8** |
| Russell 2000 Index (sterling adjusted) | 100.0 | 114.5 | 143.3 | 153.0 | 176.1 | 186.5 | 219.4 | 234.2 | 195.0 | 174.5 | **209.5** |
| RPI | 100.0 | 103.4 | 105.9 | 109.3 | 113.0 | 114.8 | 118.1 | 120.3 | 122.2 | 125.8 | **129.6** |

† Restated in accordance with the Investment Trust SORP. Earlier years have not been restated.
# There is no dilution. The warrants were exercised during the year ended 30 June 2003.
* Period from 8 March 1993 to 30 June 1994.

**COST OF RUNNING THE COMPANY**

for the year-ended 30 June

| % | 1994* | 1995 | 1996† | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Operating costs as a percentage of: | | | | | | | | | | | |
| Average net assets and average total assets | 2 | 2 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | **1** |

**NET LIQUIDITY**

at 30 June

| % | 1994 | 1995 | 1996† | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Net liquidity | 1 | 4 | – | 3 | 2 | 7 | 3 | 1 | 2 | 2 | **2** |

† Stated in accordance with the Investment Trust SORP. Earlier years have not been restated

* Period from 8 March 1993 to 30 June 1994.

**Definitions**

| | |
|---|---|
| Prior charges | Loans, overdrafts, etc., used for investment purposes. |
| Operating costs | All costs charged to revenue and capital, including performance-related management fees but excluding related taxation relief, interest costs, taxation, the costs of purchase of share capital and warrants, and the costs of buying and selling of investments. |
| Net liquidity | Cash and fixed interest stocks, less prior charges at balance sheet value, as a percentage of net assets. |
| Total assets | Total assets less current liabilities before deducting prior charges. |
| NAV | Net asset value (assuming prior charges at the balance sheet value). |
| RPI | All-items Retail Price Index. |
| Average net assets | Average of net assets at end of each quarter. |
| NAV total return | Return on net assets per share assuming that all dividends paid to shareholders were reinvested. |
| Share price total return | Return to the investor on mid-market prices assuming that all dividends received were reinvested. |
| AITC | Association of Investment Trust Companies. |

# Notice of Annual General Meeting

Notice is hereby given that the Eleventh Annual General Meeting of F&C US Smaller Companies PLC will be held at the registered office of the Company, Exchange House, Primrose Street, London EC2 on 27 October 2004 at 12.30 pm for the following purposes:

**ORDINARY BUSINESS:**

1 To receive and adopt the Directors' report and accounts for the year ended 30 June 2004.
2 To approve the Directors' Remuneration Report.
3 To re-elect Mr N M Bachop as a Director.
4 To re-elect Mr M P S Barton as a Director.
5 To re-elect Mr G D Grender as a Director.
6 To re-elect Mr D H Hunter as a Director.
7 To re-appoint the Auditors, PricewaterhouseCoopers LLP, and to authorise the Directors to determine their remuneration.

**SPECIAL BUSINESS**

8 To consider and, if thought fit, pass the following resolution as a special resolution:
THAT:
(a) the Directors be and they are hereby:
(i) generally and unconditionally authorised in accordance with Section 80 of the Companies Act 1985 (the "Act") to exercise all the powers of the Company to allot relevant securities (as defined in that section) up to an aggregate nominal amount of £324,497 during the period commencing on the date of the passing of this resolution and expiring at the conclusion of the Annual General Meeting of the Company in 2005, and
(ii) empowered, pursuant to section 95 of the Act, to allot equity securities (within the meaning of section 94 of the Act) pursuant to the authority referred to in paragraph (a)(i) of this resolution as if section 89(1) of the Act did not apply to any such allotment, but so that this authority and power shall enable the Company to make offers or agreements which would or might require relevant securities or equity securities to be allotted after the expiry of this authority and power and notwithstanding such expiry the Directors may allot relevant securities and/or equity securities in pursuance of such offers or agreements; and
(b) all authorities and powers previously conferred under section 80 or section 95 of the Act be and they are hereby revoked, provided that such revocation shall not have retrospective effect.

9 To consider and, if thought fit, pass the following resolution as a special resolution:
THAT the Company be and is hereby generally and unconditionally authorised in accordance with section 166 of the Companies Act 1985 (the "Act") to make market purchases (within the meaning of section 163 of the Act) of ordinary shares of 25p each in the capital of the Company ('ordinary shares') on such terms and in such manner as the Directors may from time to time determine, provided that:
a) the maximum number of ordinary shares hereby authorised to be purchased shall be 3,891,369;
b) the minimum price which may be paid for an ordinary share is 25p;
c) the maximum price which may be paid for an ordinary share is an amount equal to 105 per cent of the average of the middle market quotations for an ordinary share (as derived from the London Stock Exchange Daily Official List) for the five business days immediately preceding the date on which the ordinary share is contracted to be purchased;
d) the minimum and maximum prices per ordinary share referred to in sub-paragraphs (b) and (c) of this resolution are in each case exclusive of any expenses payable by the Company;
e) the authority hereby conferred shall expire at the conclusion of the Annual General Meeting of the Company in 2005 or, if earlier, on the expiry of 15 months from the passing of this resolution, unless such authority is varied, revoked or renewed prior to such time by the Company in general meeting by special resolution; and
f) the Company may make a contract to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority which will or may be completed or executed wholly or partly after the expiry of such authority.

By order of the Board
F&C Management Limited
Secretary
14 September 2004

Registered Office:
Exchange House
Primrose Street
London EC2A 2NY

**LOCATION OF MEETING**

**NOTES:**

Pursuant to regulation 41 of the Uncertificated Securities Regulations 2001, only shareholders registered on the register of members of the Company at 12.30pm on 25 October 2004 shall be entitled to attend and vote at the Meeting in respect of the shares registered in their names at that time. Changes to entries on the register of members after 12.30pm on 25 October 2004 shall be disregarded in determining the rights of any person to attend and vote at the Meeting.

If the Meeting is adjourned to a time not more than 48 hours after the time applicable to the original Meeting, the above specified time will also apply for the purpose of determining the entitlement of members to attend and vote (and for the purpose of determining the number of votes they may cast) at the adjourned Meeting. If, however, the Meeting is adjourned for a longer period then, to be so entitled, members must be entered on the Company's register of members at 12.30 pm on the day which is two days before the time fixed for the adjourned Meeting, or, if the Company gives notice of the adjourned Meeting, at any time specified on that notice.

A member entitled to attend and vote at the Meeting may appoint one or more proxies to attend and vote instead of him/her. A proxy need not be a member of the Company.

To be valid, a form of proxy for use at the Meeting and the power of attorney or other authority (if any) under which it is signed, or a notarially certified or office copy of such power or authority, must be deposited with the Company's registrars, Computershare Investor Services PLC, PO Box 1075, Bristol BS99 3ZZ, not less than 48 hours before the time appointed for holding the Meeting. In view of this requirement, investors holding shares in the Company through the F&C Private Investor, Pension Savings or Private Equity Plans or in an F&C Individual Savings Account should ensure that forms of direction are returned to Computershare Investor Services PLC not later than 96 hours before the time appointed for holding the Meeting.

The register of Directors' holdings is available for inspection at the registered office of the Company during normal business hours on any weekday and will be available at the place of the Meeting from 15 minutes prior to the commencement of the Meeting until the conclusion thereof.

No Director has any contract of service with the Company.

Shareholders should note that further details of the Annual General Meeting, including an explanation of the special business proposed thereat, can be found in the Report of the Directors on pages 11 and 12 of these Report and Accounts.

# Information for Shareholders

## NET ASSET VALUE AND SHARE PRICE

The Company's Net Asset Value (NAV) is released daily, on the working day following the calculation date, to the London Stock Exchange.

The current share price of F&C US Smaller Companies PLC is shown in the investment trust or investment companies section of the stockmarket page in most leading newspapers, usually under "F&C US Smlr".

## PERFORMANCE INFORMATION

Information on the Company's performance is provided in the interim and final reports which are sent to shareholders in March and September respectively.

More up-to-date performance information is available on the Internet at www.fandc.com (select your country, click on "Private Investors", then "Funds & Products", followed by "Investment Trusts"). This website also provides a monthly update on the Company's largest holdings, along with comments from the Fund Manager.

## ASSOCIATION OF INVESTMENT TRUST COMPANIES ("AITC")

F&C US Smaller Companies PLC is a member of the AITC, which publishes a monthly statistical information service in respect of member companies. The publication also has details of ISA, PEP and other investment plans available. For further details, please contact the AITC on 020 7282 5555, or visit the website: www.itsonline.co.uk.

## UK CAPITAL GAINS TAX ("CGT")

An approved investment trust does not pay tax on capital gains. UK resident individuals may realise net capital gains of up to £8,200 in the tax year ended 5 April 2005 without incurring any tax liability.

Up to April 1998, the cost of investments for CGT purposes was adjusted to allow for inflation between the month of acquisition and the month of disposal of the investments. For investments held at 6 April 1998 and disposed of after that date, this indexation allowance will be computed for the period from the date of acquisition to April 1998, with taper relief applying after April 1998. For assets acquired on or after 6 April 1998, only taper relief applies. The taper reduces the amount of chargeable gain according to the number of complete years after 5 April 1998 for which the investment has been held.

# How to Invest

F&C Management Limited, runs a number of savings products which have been set up to provide cost effective and flexible ways to invest (details of these products are listed below). You can also buy F&C US Smaller Companies PLC shares using a bank or stockbroker or alternatively, directly through an online and telephone dealing service. The F&C website has a link to comdirect, Europe's biggest stockbroker, at www.fandc.com/comdirect.

**PENSION SAVINGS PLAN ("PSP")**

You can maximise your tax benefits and save for your retirement using this low cost Plan, which includes a Personal Pension and Free Standing AVC. Contributions can be made via a lump sum or by Direct Debit. Now that personal pensions are no longer restricted to those with earnings of their own, almost everyone under the age of 75 is eligible. This means that you can invest on behalf of non-working spouses or partners and children.

**INDIVIDUAL SAVINGS ACCOUNT ("ISA")**

You can invest up to £7,000 each year in F&C's Maxi ISA, or £3,000 in the Mini ISA, either by completing an application form or investing online. You can make regular monthly payments by Direct Debit or invest a lump sum.

**PERSONAL EQUITY PLAN ("PEP")**

Although PEPs are no longer available for new subscriptions you can transfer investments from one manager to another, subject to Inland Revenue requirements.

F&C's fixed rate charging structure provides excellent value for money as you pay one fixed annual management fee no matter how many Investment Trust PEPs or ISAs you hold with F&C.

Please note that with effect from 6 April 2004 you are no longer able to reclaim the 10% tax credit on dividends within a stocks and shares ISA and PEPs. Within the ISA and PEP capital gains remain tax-free.

**If you have trouble reading smaller print, please let us know. We can provide literature in alternative formats, for example, large print or on audio-tape. Please call 0845 600 3030 for more details.**

For further details on the savings schemes and application forms, please contact:

Investor Services on **0845 600 30 30** or
Broker Support on **0845 600 1868**
(UK calls charged at the local rate)
Fax **020 7825 2108**

You can also find more information on the website:
**www.fandc.com** under Investment Trusts.

If you wish to write, the address is:
Investor Services Team, F&C Management Limited,
Exchange House, Primrose Street, London EC2A 2NY

The information on this page has been issued and approved by F&C Management Limited, authorised and regulated in the UK by the Financial Services Authority. Potential investors are reminded that the value of investments and the income from them may go down as well as up and investors may not receive back the full amount invested. Tax benefits may vary as a result of statutory changes and their value will depend on individual circumstances.

**Registered Office:**
Exchange House, Primrose Street,
London EC2A 2NY
Tel: 020 7628 8000 Fax: 020 7628 8188
www.fandc.com info@fandc.com

**Registrars:**
Computershare Investor Services PLC,
PO Box 82, The Pavilions,
Bridgewater Road,
Bristol BS99 7NH
Tel: 0870 702 0130 Fax: 0870 703 6143
www.computershare.com
web.queries@computershare.co.uk