Profit *hunters*

# Artemis UK Smaller Companies *Fund*

## Manager's Report and Financial Statements

for the year ended 31 December 2013

Artemis

The Profit Hunter

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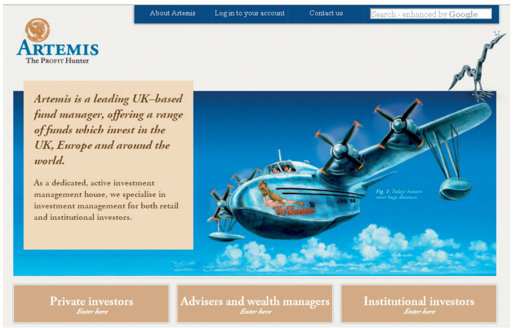


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**artemis.co.uk**

# General information

## Company profile

Independent and owner-managed, Artemis opened for business in 1997. Its aim was outstanding investment performance and client service. All Artemis' fund managers still share these two precepts – and the same flair and enthusiasm for fund management.

The company has grown to the extent that it now manages an asset base of some £17.3 billion*. This is spread across a range of unit trusts, an investment trust, a hedge fund, a venture capital trust and both pooled and segregated institutional portfolios.

The Artemis philosophy requires our fund managers to invest in Artemis funds. This means that our fund managers' interests are directly aligned with our investors.

* Source: Artemis as at 31 January 2014.

## Fund status

Artemis UK Smaller Companies Fund was constituted by a Trust Deed dated 17 March 1998 and is an authorised unit trust scheme under the Financial Services and Markets Act 2000. The fund belongs to the category of UCITS schemes as defined in the Collective Investment Schemes Sourcebook of the Financial Conduct Authority.

## Investment objective

The objective of the fund is to achieve long-term capital growth. The emphasis of the fund will be investment in smaller companies listed, quoted and/or traded in the UK and in smaller companies which are headquartered or have a significant part of their activities in the UK which are quoted on a regulated market outside the UK.

## Investment policy

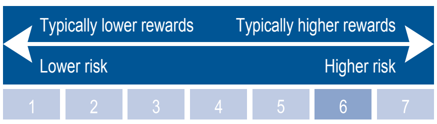
The manager actively manages the portfolio in order to achieve the objective and will not be restricted in respect of investments by industrial sectors. The securities of companies listed, quoted and/or traded in the UK but domiciled elsewhere and the securities of companies traded on ISDX may be included in the portfolio.

The fund may also invest in other transferable securities, units of collective investment schemes, money market instruments, warrants, cash and near cash, derivatives and forward transactions and other investments to the extent that each is permitted by the regulations.

## Buying and selling

Units may be bought and sold by contacting the manager by telephone, at the address on page 2 or via the website **artemis.co.uk**. Valuation of the fund takes place each business day at 12 noon on a forward pricing basis. Investors are reminded that past performance is not a guarantee of performance in the future and that the price of units and the revenue from them can fall as well as rise.

## Risk and reward profile




- This indicator is based on historical data and may not be a reliable indication of the future risk profile of the fund.
- The risk category shown is not guaranteed and may change over time.
- A risk indicator of "1" does not mean that the investment is "risk free".
- The indicator is not a measure of the possibility of losing your investment.

The risk indicator for the fund is as above because:

- The price of units, and the income from them, can fall and rise because of stockmarket and currency movements.
- Stockmarket prices, currencies and interest rates can move irrationally and can be affected unpredictably by diverse factors, including political and economic events.
- A portion of the fund's assets may be invested in a currency other than the fund's accounting currency (sterling). The value of these assets, and the income from them, may decrease if the currency falls in relation to sterling, in which the fund is valued and priced.
- Investing in small and medium-sized companies can involve more risk than investing in larger, more established companies. Shares in smaller companies are often not as easy to sell as shares in larger companies are. This can cause difficulty in buying, valuing and selling those shares. Also, reliable information for deciding their value or the risks may not be available.

## Prospectus

Copies of the most recent Prospectus are available free of charge from the manager at the address on page 2.

# General information (continued)

## Manager

Artemis Fund Managers Limited *
Cassini House
57 St James's Street
London SW1A 1LD

Dealing information:
Unit Trust Department
Artemis Fund Managers Limited
PO Box 9688
Chelmsford CM99 2AE
Telephone: 0800 092 2051
Website: artemis.co.uk

## Investment adviser

Artemis Investment Management LLP *
Cassini House
57 St James's Street
London SW1A 1LD

## Trustee

National Westminster Bank Plc *
Trustee & Depositary Services
Younger Building
1st Floor, 3 Redheughs Avenue
Edinburgh EH12 9RH

## Registrar

International Financial Data Services (UK) Limited *
IFDS House
St Nicholas Lane
Basildon
Essex SS15 5FS

## Auditor

Ernst & Young LLP
Ten George Street
Edinburgh EH2 2DZ

* Authorised and regulated by the Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

## Statement of the trustee's responsibilities

The trustee is responsible for the safekeeping of all the property of the fund (other than tangible moveable property) which is entrusted to it and for the collection of revenue that arises from that property.

It is the duty of the trustee to take reasonable care to ensure that the fund is managed in accordance with the Financial Conduct Authority's Collective Investment Schemes Sourcebook ('COLL'), as amended, the fund's Trust Deed and Prospectus, in relation to the pricing of, and dealings in, units in the fund; the application of revenue of the fund; and the investment and borrowing powers of the fund.

## Report of the trustee

Having carried out such procedures as we considered necessary to discharge our responsibilities as trustee of the fund, it is our opinion, based on the information available to us and the explanations provided, that, in all material respects, the manager:

(i) has carried out the issue, sale, redemption and cancellation, and calculation of the price of the fund's units and the application of the fund's revenue in accordance with COLL, the Trust Deed and Prospectus; and

(ii) has observed the investment and borrowing powers and restrictions applicable to the fund.

National Westminster Bank Plc
Trustee & Depositary Services

Edinburgh
14 February 2014

## Statement of the manager's responsibilities

The Collective Investment Schemes Sourcebook ('COLL') of the Financial Conduct Authority requires the manager to prepare financial statements for each annual accounting period which give a true and fair view of the financial affairs of the fund and of its revenue and expenditure for the year. In preparing the financial statements the manager is required to:

(i) select suitable accounting policies and then apply them consistently;

(ii) comply with the disclosure requirements of the Statement of Recommended Practice for Authorised Funds issued by the Investment Management Association in October 2010;

(iii) follow applicable accounting standards;

(iv) keep proper accounting records which enable it to demonstrate that the financial statements as prepared comply with the above requirements;

(v) make judgements and estimates that are reasonable and prudent; and

(vi) prepare the financial statements on the going concern basis unless it is inappropriate to presume that the fund will continue in operation.

The manager is responsible for the management of the fund in accordance with its Trust Deed, Prospectus and COLL requirements.

The manager is also responsible for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## Report of the manager

This report has been prepared in accordance with the requirements of the Collective Investment Schemes Sourcebook as issued and amended by the Financial Conduct Authority.

| | |
|---|---|
| R J Turpin | M R J Tyndall |
| Director | Director |

14 February 2014

# Independent auditor's report to the unitholders of the Artemis UK Smaller Companies Fund

We have audited the financial statements of Artemis UK Smaller Companies Fund (the "fund") for the year ended 31 December 2013 which comprise the statement of total return, the statement of change in net assets attributable to unitholders, balance sheet, the related notes 1 to 17 and the distribution table. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the unitholders of the fund, as a body, pursuant to paragraph 4.5.12 of the rules of the Collective Investment Schemes Sourcebook of the Financial Conduct Authority (formerly the Financial Services Authority). Our audit work has been undertaken so that we might state to the unitholders those matters we are required to state to them in an independent auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the fund and the unitholders as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of the manager and auditor

As explained more fully in the manager's responsibilities statement set out on page 2, the manager is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

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

## Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the financial position of the fund as at 31 December 2013 and of the net revenue and the net gains on the scheme property of the fund for the year then ended; and
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice.

## Opinion on other matters prescribed by the rules of the Collective Investment Schemes Sourcebook of the Financial Conduct Authority (formerly the Financial Services Authority)

In our opinion:

- the financial statements have been properly prepared in accordance with the Statement of Recommended Practice relating to Authorised Funds, the rules of the Collective Investment Schemes Sourcebook of the Financial Conduct Authority (formerly the Financial Services Authority) and the Trust Deed;
- the information given in the manager's report for the financial year for which the financial statements are prepared is consistent with the financial statements;
- there is nothing to indicate that proper accounting records have not been kept or that the financial statements are not in agreement with those records; and
- we have received all the information and explanations which, to the best of our knowledge and belief, are necessary for the purposes of our audit.

Ernst & Young LLP
Statutory Auditor

Edinburgh
14 February 2014

The maintenance and integrity of the Artemis Fund Managers Limited web site is the responsibility of the directors; the work carried out by the auditor does not involve consideration of these matters and, accordingly, the auditor accepts no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Investment review

- The fund returned 30.2%*, lagging behind the 36.9%* rise in its benchmark.
- Revaluations of two unquoted holdings weighed on relative performance.
- Drag from unquoted holdings now behind us.

## Performance – Focus on quality weighs on relative returns …

Investors in UK smaller companies enjoyed excellent returns in 2013, with the second half of the year even better than the first. Despite the very healthy 30.2%* return, we were disappointed not to have made headway against the benchmark. But although the fund lagged the benchmark, this was largely due to writedowns in the valuations of its two remaining unquoted investments – Vostok Energy and Hurricane Energy (these were discussed in more detail in our half-yearly report).

As we have said before, our process emphasises investing in high-quality businesses as evidenced by their high returns on capital and strong cashflows. That we struggle to keep up with some of our competitors during strong bull markets is the price we pay for preserving unitholders' capital in tougher times. Because we are seeking to produce cumulative returns, we check the downside risk inherent in our investments before we consider the upside: Siegel's paradox is important. We feel very strongly that, the more markets rise, the more investors should be concerned with the potential downside.

## Review – As risk appetite grows, we stick to stocks …

Helped by government initiatives such as 'help to buy', the UK economy began to show signs of growth in 2013. This optimism towards the economy was mirrored by equity markets. And, as is usually the case when the market is in rampant mood, not owning some of the market's higher risk companies cost the fund some relative performance. This year, for example, not owning Ocado and Thomas Cook held us back in relative terms. We prefer sticking to our tried and tested investment criteria, rather than trying to follow the exuberant herd.

Over the year, writedowns on two unquoted holdings – Vostok Energy and Hurricane Energy – cost the fund 3% and 2% respectively. Indeed, the contribution from our unquoted investments in a rapidly rising market has been a painful drag on our performance over the last five years, equivalent to around 48 percentage points. Happily, the future IPO of Hurricane Energy marks the end of this drag on returns. The final significant negative was our holding in pawnbroker H&T. We described the problems facing the company in our half-yearly report. While its shares continued to lag in the second half of the year, profits were upgraded and its debt level fell considerably as cash generation kicked in as growth in its loan book slowed.

Although its overall return lagged the benchmark, the fund also had its share of winners in 2013. Two of the strongest performers over the year were Somero (a US company that makes laser-guided machines for levelling concrete) and Polar Capital (the boutique fund manager). Both companies substantially upgraded their profit forecasts and continued to perform very strongly in the second half of the year. Another US-focused company, 4Imprint, which is the largest online provider of corporate giftware, also did well as rising confidence among US companies has translated into strong sales growth.

One of our more unusual holdings, the recently purchased Top Level Domain Holdings, performed particularly well. This pre-revenue company raised new funds to exploit the opportunity it saw in the release of new internet domain names by ICANN, the body that governs the web. By owning a number of promising new registries such as 'dot London', 'dot Miami' and 'dot Bayern', the company hopes to benefit from annual subscriptions by customers who want to use these new suffixes to launch websites for their businesses. As more commerce shifts online, we feel that revenues from these domains will effectively represent an annuity stream in perpetuity at little incremental cost. Given the early stage, high-risk nature of this investment, we initially bought a small position (a 0.5% weighting in the fund). Happily, the shares increased by around three-fold in value. Because the business remains in its infancy, the shares are quite volatile. We are prepared to tolerate this volatility: if it is successful, the business model will be a very good one.

It was a relatively quiet year on the dealing front, although we would note that four of our largest sales in the year were of FTSE Mid 250 stocks: Domino Printing Science, Dignity, Hansteen and Euromoney Institutional Investor. With shares in these companies having risen strongly, we reduced our holdings on valuation grounds and, in the case of Dignity, sold out altogether. It seems to us that many investors are focusing on the relatively liquid mid-cap market and, in so doing, are pushing some of these shares to valuations that look too rich. We felt there was better value to be found elsewhere – mostly at the smaller end of the size spectrum. We proceed cautiously, however. We want to avoid committing too great a proportion of the fund to relatively illiquid micro-cap shares, which could prove difficult to sell were markets to collapse or the fund to face large redemptions. With just under 20% of the fund invested in companies worth under £100 million and 30% invested in companies valued at over £500

* Source: Lipper Limited, R accumulation, bid to bid basis, in sterling with net income reinvested. Sector is IMA UK Smaller Companies. Benchmark is the Numis Smaller Companies (excluding Investment Trusts) Index.

million, we are comfortable with the portfolio's current balance.

Our main purchases during the year were GB Group, Hargreaves Services and Bwin.Party. As the initial investments in these companies were made in the first half of the year, the rationale for these purchases is outlined in our half-yearly report. We did, however, add to the holdings in Hargreaves Services and Bwin.Party in the second half of the year, during periods of (relative) share-price weakness. All three companies appear to be making good progress. GB Group's interim results showed good profit growth as well as the international expansion that we had hoped for. Hargreaves Services continued to consolidate what remains of the UK's open-cast coal mining industry. This puts it in the position of being the only domestic coal supplier to the UK's power stations at a time when the grid is struggling to cope with peak demand for electricity. The reaction to flooding-induced power outages over the New Year underlined the pressure that the government would face were there to be any further power cuts. Bwin.Party, meanwhile, looks to have taken a strong market lead in the early months following a change in legislation in New Jersey which has made online poker and casino games legal once again.

Elsewhere, most of our largest holdings continued to make good progress. Mears (the social housing repairer) met its forecasts. Cash generation remains strong and it won a unique homecare contract with Wiltshire council whereby they are paid for results rather than on a task-and-time basis (as is the current industry norm). Were this to be copied by other councils, we think it would greatly improve the quality of earnings of this part of Mears' business. While Brooks Macdonald's share price didn't fare quite as well, we felt this belied continued strong growth in its private client fund management business. CVS, the UK's largest chain of vets, showed a pleasing pick-up in sales growth as the year went on. It is now of sufficient size that it can start to introduce its own-branded products. These will be cheaper for their customers and also result in higher margin for CVS. Finally, it was great to see the continued recovery at Xchanging (business process outsourcing) which is starting to win new contracts. Owning shares in Xchanging has been a rough ride over the last few years, but our patience finally seems to be paying off.

## Outlook – Caution amid the consensus …

After stuttering for the last couple of years, there is a good chance that merger and acquisition (M&A) activity will pick up again in 2014. We are aware, however, that we made the same prediction a year ago and were proven thoroughly wrong. Although one of our smaller holdings, Andor Technology, will shortly be taken over by Oxford Instruments, there was little else on the M&A front. In fact, acquisition activity was pretty much at a historic low. Clearly, any increase in takeover activity would support valuations.

The reason we believe M&A will pick up is simple. Despite the good recent run that small companies have enjoyed, there is still an arbitrage trade to be made between the very low cost of borrowing (companies can borrow for less than 4%) and the free cashflow yield on equities (the current free cashflow yield for 2014 on our fund is around 6.5%). With confidence returning to company boardrooms, it only seems logical for large, cash-rich blue-chips to bolster their growth by acquiring some of their smaller competitors.

Despite the fact that UK smaller companies have been the best asset class to own over the last one, three and five years, most commentators remain bullish on their prospects. They point out that, while smaller companies may no longer be cheap, they are not particularly expensive on a historic view. The unanimity of this positive consensus makes us uncomfortable. Investors make the best returns when the consensus is gloomy. So, we feel that investors should by wary in extrapolating the great returns we have seen from smaller companies of late into the future. We remain optimistic that returns over the next year or two will be positive, albeit they are likely to be at far more modest levels.

**Mark Niznik**
**Fund manager**

# Investment information

## Five largest purchases and sales for the year ended 31 December 2013

| Purchases | Cost £'000 | Sales | Proceeds £'000 |
|---|---|---|---|
| GB Group | 5,337 | Dignity | 6,931 |
| Hargreaves Services | 5,260 | Domino Printing Sciences | 6,887 |
| Bwin.Party Digital Entertainment | 4,986 | Telecom Plus | 4,755 |
| Redrow | 2,672 | Hansteen Holdings (REIT) | 4,181 |
| Ithaca Energy | 2,338 | Euromoney Institutional Investor | 4,044 |

## Portfolio statement as at 31 December 2013

| Investment | Holding | Valuation £'000 | % of net assets |
|---|---|---|---|
| United Kingdom – 86.26% (88.96%) | | | |
| Basic Materials – 1.95% (2.02%) | | | |
| Victrex | 400,000 | 7,312 | 1.95 |
| | | **7,312** | **1.95** |
| Consumer Goods – 9.36% (8.58%) | | | |
| Cranswick | 467,806 | 5,567 | 1.49 |
| Devro | 676,104 | 1,939 | 0.52 |
| Games Workshop Group | 1,100,000 | 7,595 | 2.03 |
| Hilton Food Group | 1,700,000 | 7,234 | 1.93 |
| Hornby | 347,804 | 279 | 0.07 |
| R.E.A. Holdings | 2,000,000 | 8,805 | 2.35 |
| R.E.A. Holdings 9% (cumulative preference) | 485,436 | 544 | 0.14 |
| Redrow | 1,000,000 | 3,108 | 0.83 |
| | | **35,071** | **9.36** |
| Consumer Services – 17.08% (19.06%) | | | |
| 4Imprint Group | 900,000 | 6,012 | 1.60 |
| Centaur Media | 12,800,100 | 7,456 | 1.99 |
| Creston | 4,677,269 | 4,350 | 1.16 |
| CVS Group # | 3,500,000 | 9,100 | 2.44 |
| Domino's Pizza UK | 1,000,000 | 5,150 | 1.37 |
| Ebiquity # | 4,000,000 | 4,720 | 1.26 |
| Euromoney Institutional Investor | 469,239 | 6,297 | 1.68 |
| Greggs | 500,000 | 2,158 | 0.58 |
| ITE Group | 1,265,183 | 3,898 | 1.04 |
| Moneysupermarket.com Group | 2,800,000 | 5,065 | 1.35 |
| N Brown Group | 800,000 | 4,212 | 1.12 |
| Progressive Digital Media Group # | 2,426,200 | 5,580 | 1.49 |
| | | **63,998** | **17.08** |
| Financials – 8.22% (12.06%) | | | |
| Brewin Dolphin Holdings | 700,000 | 2,145 | 0.57 |
| Brooks MacDonald Group # | 717,900 | 10,445 | 2.79 |
| Charles Taylor | 140,772 | 355 | 0.09 |
| Conygar Investment # | 878,680 | 1,406 | 0.38 |
| H&T Group # | 2,793,416 | 3,911 | 1.04 |
| Hansteen Holdings (REIT) | 2,500,000 | 2,700 | 0.72 |
| Polar Capital Holdings # | 1,400,000 | 6,930 | 1.85 |
| Rathbone Brothers | 180,000 | 2,911 | 0.78 |
| ROK Global + | 66,097 | – | – |
| Third Advance Value Realisation + | 158,927 | – | – |
| | | **30,803** | **8.22** |

| Investment | Holding | Valuation £'000 | % of net assets |
|---|---|---|---|
| Health Care – 8.01% (6.09%) | | | |
| Abcam # | 1,350,000 | 6,629 | 1.77 |
| Advanced Medical Solutions Group # | 4,000,000 | 4,340 | 1.16 |
| Alliance Pharma # | 12,040,000 | 4,816 | 1.29 |
| Dechra Pharmaceuticals | 700,000 | 4,879 | 1.30 |
| Immunodiagnostic Systems Holdings # | 93,900 | 498 | 0.13 |
| Source Bioscience | 17,920,000 | 2,195 | 0.58 |
| Vectura Group | 4,750,000 | 6,674 | 1.78 |
| | | **30,031** | **8.01** |
| Industrials – 23.84% (22.14%) | | | |
| Andor Technology # | 400,000 | 2,088 | 0.56 |
| Diploma | 809,034 | 5,461 | 1.46 |
| Domino Printing Sciences | 250,000 | 1,920 | 0.51 |
| Driver Group # | 1,061,583 | 1,295 | 0.35 |
| Gooch & Housego # | 182,687 | 1,289 | 0.34 |
| Hargreaves Services # | 670,000 | 5,625 | 1.50 |
| Hill & Smith | 658,701 | 3,392 | 0.91 |
| James Fisher & Sons | 500,000 | 6,250 | 1.67 |
| Keller Group | 86,000 | 984 | 0.26 |
| Keywords Studios # | 1,413,000 | 1,568 | 0.42 |
| Mears Group | 2,400,000 | 11,364 | 3.03 |
| Norcros | 28,000,000 | 6,580 | 1.76 |
| Northbridge Industrial Services # | 1,600,000 | 7,312 | 1.95 |
| Northgate | 800,000 | 4,032 | 1.08 |
| RWS Holdings # | 400,000 | 3,682 | 0.98 |
| Senior | 1,750,000 | 5,371 | 1.43 |
| Smiths News | 2,000,000 | 4,710 | 1.26 |
| Tribal Group | 2,500,000 | 4,250 | 1.13 |
| Tyman | 203,138 | 461 | 0.12 |
| WYG # | 2,552,623 | 2,706 | 0.72 |
| Xchanging | 5,750,000 | 9,013 | 2.40 |
| | | **89,353** | **23.84** |
| Oil & Gas – 2.89% (7.31%) | | | |
| Energy Equity Resources (Norway) + | 14,000 | – | – |
| Enquest | 3,200,000 | 4,314 | 1.16 |
| Hurricane Energy + | 10,476,260 | 4,505 | 1.20 |
| Parkmead Group # | 876,253 | 2,000 | 0.53 |
| Timan Oil & Gas + | 1,431,667 | – | – |
| Vostok Energy + | 7,421,082 | – | – |
| | | **10,819** | **2.89** |
| Technology – 13.33% (10.00%) | | | |
| Allocate Software # | 6,000,000 | 5,760 | 1.54 |
| Aveva Group | 234,375 | 5,060 | 1.35 |
| Blinkx # | 866,000 | 1,752 | 0.47 |
| Computacenter | 700,000 | 4,414 | 1.18 |
| Craneware # | 1,419,876 | 7,312 | 1.95 |
| First Derivatives # | 292,023 | 3,624 | 0.97 |
| GB Group # | 5,660,000 | 8,150 | 2.17 |
| RM | 5,000,000 | 5,750 | 1.53 |
| SDL | 1,096,073 | 3,943 | 1.05 |

# Investment information (continued)

| Investment | Holding | Valuation £'000 | % of net assets |
|---|---|---|---|
| Statpro Group # | 5,000,000 | 4,200 | 1.12 |
| | | **49,965** | **13.33** |
| Telecommunications – 1.58% (1.70%) | | | |
| Telecom Plus | 335,967 | 5,916 | 1.58 |
| | | **5,916** | **1.58** |
| Overseas – 13.52% (9.46%) | | | |
| Bermuda – 1.79% (2.10%) | | | |
| Energy XXI (Bermuda) # | 125,000 | 2,038 | 0.54 |
| Ocean Wilsons Holdings | 449,939 | 4,679 | 1.25 |
| | | **6,717** | **1.79** |
| British Virgin Islands – 1.12% (0.00%) | | | |
| Top Level Domain Holdings # | 30,000,000 | 4,200 | 1.12 |
| | | **4,200** | **1.12** |
| Canada – 0.80% (0.00%) | | | |
| Ithaca Energy # | 1,943,365 | 3,002 | 0.80 |
| Thistle Mining + | 2,376,532 | – | – |
| | | **3,002** | **0.80** |
| Cayman Islands – 0.09% (0.31%) | | | |
| Global Market Group # | 1,163,309 | 349 | 0.09 |
| | | **349** | **0.09** |
| Gibraltar – 1.22% (0.00%) | | | |
| Bwin.Party Digital Entertainment | 3,750,452 | 4,561 | 1.22 |
| | | **4,561** | **1.22** |
| Ireland – 0.97% (0.88%) | | | |
| Kenmare Resources | 17,600,000 | 3,648 | 0.97 |
| Kenmare Resources (warrants 2019) | 320,000 | – | – |
| | | **3,648** | **0.97** |
| Jersey – 2.41% (2.66%) | | | |
| Stanley Gibbons Group # | 700,000 | 2,429 | 0.65 |
| Tarsus Group | 2,797,814 | 6,610 | 1.76 |
| | | **9,039** | **2.41** |
| Singapore – 1.78% (0.91%) | | | |
| XP Power | 425,000 | 6,656 | 1.78 |
| | | **6,656** | **1.78** |
| USA – 3.34% (1.84%) | | | |
| Cyberview Technology + | 26,866 | – | – |
| MyCelx Technologies # | 800,000 | 3,760 | 1.00 |
| ROK Entertainment Group + | 410,914 | – | – |
| Somero Enterprise # | 7,173,286 | 7,962 | 2.13 |
| Spectra Systems # | 3,196,047 | 799 | 0.21 |
| | | **12,521** | **3.34** |
| Portfolio of investments | | 373,961 | 99.78 |
| Net other assets | | 813 | 0.22 |
| Net assets attributable to unitholders | | 374,774 | 100.00 |

All holdings are listed ordinary shares unless otherwise stated.
The figures in brackets represent percentages as at 31 December 2012. At this date the portfolio included an exposure to Guernsey (0.62%) and the Isle of Man (0.14%).
# Alternative Investment Market traded investments: 37.71% (31 December 2012: 27.05%).
+ Unquoted investments: 1.20% (31 December 2012: 6.55%).
REIT represents Real Estate Investment Trusts.

## Statement of total return for the year ended 31 December 2013

| | Note | 31 December 2013 £'000 | £'000 | 31 December 2012 £'000 | £'000 |
|---|---|---|---|---|---|
| **Income** | | | | | |
| Net capital gains | 4 | | 86,673 | | 55,564 |
| Revenue | 6 | 7,951 | | 7,969 | |
| Expenses | 7 | (5,375) | | (4,925) | |
| Finance costs: interest | 9 | (4) | | (16) | |
| Net revenue before taxation | | 2,572 | | 3,028 | |
| Taxation | 8 | (13) | | – | |
| Net revenue after taxation | | | 2,559 | | 3,028 |
| **Total return before distribution** | | | **89,232** | | **58,592** |
| Finance costs: distribution | 9 | | (2,575) | | (3,028) |
| Change in net assets attributable to unitholders from investment activities | | | 86,657 | | 55,564 |

## Statement of change in net assets attributable to unitholders for the year ended 31 December 2013

| | 31 December 2013 £'000 | £'000 | 31 December 2012 £'000 | £'000 |
|---|---|---|---|---|
| Opening net assets attributable to unitholders | | 317,668 | | 283,526 |
| Amounts receivable on issue of units | 8,357 | | 15,555 | |
| Amounts payable on cancellation of units | (40,269) | | (39,826) | |
| | | (31,912) | | (24,271) |
| Stamp duty reserve tax | | (145) | | (106) |
| Change in net assets attributable to unitholders from investment activities | | 86,657 | | 55,564 |
| Retained distribution on accumulation units | | 2,506 | | 2,955 |
| Closing net assets attributable to unitholders | | 374,774 | | 317,668 |

## Balance sheet as at 31 December 2013

| | Note | 31 December 2013 £'000 | £'000 | 31 December 2012 £'000 | £'000 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Investment assets | | | 373,961 | | 312,650 |
| Debtors | 10 | 943 | | 1,010 | |
| Cash and bank balances | 11 | 393 | | 4,695 | |
| Total other assets | | | 1,336 | | 5,705 |
| **Total assets** | | | **375,297** | | **318,355** |
| | | | | | |
| **Liabilities** | | | | | |
| Creditors | 12 | 523 | | 687 | |
| **Total liabilities** | | | **523** | | **687** |
| Net assets attributable to unitholders | | | 374,774 | | 317,668 |

# Notes to the financial statements

## 1. Accounting policies

**(a) Basis of accounting.** The financial statements have been prepared under the historical cost basis, as modified by the revaluation of investments, and in accordance with the Statement of Recommended Practice for Authorised Funds issued by the Investment Management Association in October 2010.

**(b) Valuation of investments.** All investments have been valued at 12 noon on the last working day of the accounting period. Listed investments are valued at fair value which is deemed to be the bid or SETS price. Unquoted investments are valued at fair value which is determined by the investment manager, with reference to the valuation guidelines issued by the International Private Equity and Venture Capital Valuation Guidelines Board.

**(c) Foreign exchange rates.** Assets and liabilities denominated in foreign currencies are translated into sterling at the exchange rates prevailing at 12 noon on the last working day of the accounting period. Revenue and expenditure transactions are translated at the rates of exchange ruling on the dates of the transactions. Exchange differences on such transactions follow the same treatment as the principal amounts.

**(d) Derivatives.** Where appropriate, certain permitted transactions such as derivatives or forward foreign currency transactions are used for efficient portfolio management and investment purposes. Derivatives are valued at 12 noon on the last working day of the accounting period. Exchange traded derivatives are priced at fair value, which is deemed to be the bid price. Over-the-counter derivatives are priced at fair values using valuation models or data sourced from market data providers. Gains and losses on derivative instruments are recognised as either revenue or capital depending on the nature and circumstances of each particular case. Any positions on such transactions open at the year end are reflected in the balance sheet at their marked to market value.

**(e) Revenue.** Dividends receivable from equity and non-equity shares, including UK Real Estate Investment Trusts, are credited to revenue, net of attributable tax credits, when the security is quoted ex-dividend. Dividends received as shares (scrip/stock dividends), to the extent that the value of such dividends is equal to the cash dividends, are treated as revenue. Dividends on unquoted stocks are credited to revenue when the dividend is declared. Special dividends are reviewed on a case by case basis when determining if the dividend is to be treated as revenue or capital. It is likely that where a special dividend results in a significant reduction in the capital value of a holding, then the dividend will generally be treated as capital, otherwise this will be recognised as revenue. Bank interest is recognised on an accruals basis. Underwriting commission is recognised when the issue underwritten takes place.

**(f) Expenses.** All expenses (other than those relating to the purchase and sale of investments) are charged against revenue on an accruals basis.

**(g) Taxation.** Corporation tax is charged at a rate of 20% on the excess taxable revenue of the fund. In general, the tax accounting treatment follows that of the principal amount. Deferred tax is provided for all timing differences that have originated but not reversed at the balance sheet date other than those recorded as permanent differences. Deferred tax is provided for at the average rate of tax expected to apply. Deferred tax assets and liabilities are not discounted to reflect the time value of money.

## 2. Distribution policy

The distribution policy of the fund is to accumulate all available revenue, after deduction of expenses properly chargeable against revenue. Gains and losses on investments, derivatives and currencies, whether realised or unrealised, if taken to capital are not available for distribution. The fund is not more than 60% invested in qualifying investments (as defined in Section 468L, Income and Corporation Taxes Act 1988) and where applicable will pay a dividend distribution.
With the exception of the manager's annual management charge, which is directly attributable to each unit class, all income and expenses are apportioned to each unit class pro-rata to the value of the net assets of the relevant unit class on the day that the income or expense is recognised. Distributions which have remained unclaimed by unit holders for six years are credited to the capital property of the fund.

## 3. Risk management policies

The fund's financial instruments comprise equities, cash balances and liquid resources which include debtors and creditors. The fund holds such financial assets in accordance with its investment objective and policy which is provided on page 1. The fund is exposed to a number of risks that are associated with the financial instruments and markets in which it invests. The most significant risks which the fund is exposed to are market risk, credit and counterparty risk and liquidity risk.

**(a) Market risk.** Market risk, which includes interest rate risk, currency risk and other price risk, arises mainly from uncertainty about future values of financial instruments in the fund's investment portfolio. The fund, in order to meet its investment objective and policy, invests predominantly in equities and maintains an appropriate spread of investments in accordance with the Collective Investment Schemes Sourcebook, the Trust Deed and the Prospectus. The manager's investment strategy is to select investments for their fundamental value. Stock selection is therefore based on disciplined accounting, market and sector analysis, with the emphasis on long-term investments. There is no material difference between the carrying values and the fair values of the financial assets and liabilities of the fund disclosed in the balance sheet.

**(i) Interest rate risk.** As the majority of the fund's financial assets are non-interest bearing, the fund is not subject to exposure to fair value interest rate risk due to fluctuations in levels of market interest rates.

**(ii) Currency risk.** A portion of the net assets of the fund are denominated in currencies other than sterling, and therefore the balance sheet and total return can be affected by currency movements (see note 15). Therefore, the manager may decide that a proportion of the investments that are not priced in sterling, may be covered by forward foreign exchange contracts, so that the fund's exposure to currency risk is reduced. There were no open forward foreign exchange contracts as at 31 December 2013 or 31 December 2012. Revenue received in foreign currencies is converted into sterling on or near the date of receipt. No hedging is undertaken with regard to managing the currency movement risk on accrued revenue.

**(iii) Other price risk.** Other price risk is the risk that the value of an instrument will fluctuate as a result of changes in market prices (other than those relating to interest rate risk, currency risk and credit risk), whether caused by factors specific to an investment or wider issues affecting the market generally.
The value of equities is dependent on a number of factors, arising from the performance of the company itself and matters arising in the wider market (for example the state of the underlying economy and current government policy). The portfolio is invested in securities domiciled in a number of countries as detailed in the portfolio statement and will be exposed to market movements in the relevant country arising from changes in the local economy and government decisions. As part of the ongoing review of the portfolio, the manager monitors and reviews these factors.

**(b) Credit and counterparty risk.**
Credit and counterparty risk is the risk that a party to a financial instrument will fail to discharge an obligation or commitment it has entered into with the fund, resulting in a financial loss. From time to time, the fund may be subject to short-term credit risk with counterparties pending settlement of investment transactions. The manager has a pre-approved list of counterparties it uses for investment transactions, which is reviewed on a regular basis. The largest counterparty risk is with JP Morgan, the fund's custodian and banker, who holds the fund's investments and maintains the bank accounts. Bankruptcy or insolvency of JP Morgan may cause the fund's rights with respect to securities and cash held by the custodian to be delayed or limited. The trustee receives and reviews an annual report on the internal controls in place at JP Morgan. The fund is also exposed to counterparty risk through holding specific financial instruments. There were no significant concentrations of credit risk to counterparties other than to the custodian, or brokers where trades are pending settlement, at 31 December 2013 or 31 December 2012.

**(c) Liquidity risk.** Some of the fund's financial instruments can include securities that are traded on AIM or are not listed on a recognised stock exchange and which may not always be readily realisable. As a result, the fund may not be able to realise these investments quickly at their fair value to respond to specific events such as deterioration in the creditworthiness of any particular issuer. These holdings are disclosed in the portfolio statement on pages 6 to 8. In order to manage liquidity requirements, the fund seeks to maintain sufficient cash to pay creditors. The fund's overall liquidity risk is managed by the manager in accordance with the requirements stipulated in the Collective Investment Schemes Sourcebook and the Prospectus.

**(d) Derivatives.** The manager is currently empowered to enter into derivative transactions on behalf of the fund. Transactions will normally only be entered into when conventional stock selection is not the best way to either limit investment risk or maximise investment opportunities.

There were no open derivative contracts at 31 December 2013 or 31 December 2012.

# Notes to the financial statements (continued)

## 4. Net capital gains

| | 31 December 2013 £'000 | 31 December 2012 £'000 |
|---|---|---|
| Non–derivative securities | 86,674 | 55,568 |
| Currency losses | (1) | (4) |
| Net capital gains | 86,673 | 55,564 |

## 5. Portfolio transaction costs

| | 31 December 2013 | | 31 December 2012 | |
|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 |
| **Analysis of total purchases costs** | | | | |
| Purchases before transaction costs | | 67,228 | | 58,546 |
| Commissions | 107 | | 124 | |
| Taxes | 222 | | 241 | |
| Total purchases costs | | 329 | | 365 |
| Gross purchases total | | 67,557 | | 58,911 |
| **Analysis of total sales costs** | | | | |
| Gross sales before transaction costs | | 93,097 | | 84,717 |
| Commissions | (173) | | (171) | |
| Total sales costs | | (173) | | (171) |
| Total sales net of transaction costs | | 92,924 | | 84,546 |

## 6. Revenue

| | 31 December 2013 £'000 | 31 December 2012 £'000 |
|---|---|---|
| UK dividends | 7,023 | 7,213 |
| Overseas dividends | 759 | 624 |
| Revenue from UK REITs | 163 | 123 |
| Bank interest | 6 | 9 |
| Total revenue | 7,951 | 7,969 |

## 7. Expenses

| | 31 December 2013 £'000 | 31 December 2012 £'000 |
|---|---|---|
| **Payable to the manager, associates of the manager and agents of either of them:** | | |
| Annual management charge | 5,046 | 4,592 |
| **Payable to the trustee, associates of the trustee and agents of either of them:** | | |
| Trustee fee | 47 | 43 |
| **Other expenses:** | | |
| Registration fee | 132 | 132 |
| Administration fee | 85 | 103 |
| Operational fees | 49 | 36 |
| Auditor's remuneration: audit fee* | 8 | 8 |
| Safe custody fees | 8 | 7 |
| Printing and postage fee | – | 4 |
| Total expenses | 5,375 | 4,925 |

All expenditure stated above is inclusive of irrecoverable VAT where applicable.
* The amount disclosed above includes VAT at the rate of 20%. The audit fee (excluding VAT) incurred during the period was £6,600 (2012: £7,000).

# 8. Taxation

| | 31 December 2013 £'000 | 31 December 2012 £'000 |
|---|---|---|
| **a) Analysis of the tax charge for the year** | | |
| Irrecoverable overseas tax | 13 | – |
| Total taxation (note 8b) | 13 | – |
| **b) Factors affecting the tax charge for the year** | | |
| Net revenue before taxation | 2,572 | 3,028 |
| Corporation tax at 20% (2012: 20%) | 514 | 606 |
| Effects of: | | |
| Unutilised management expenses | 1,042 | 961 |
| Irrecoverable overseas tax | 13 | – |
| Utilisation of non-trade deficit carried forward | – | 1 |
| Non-taxable overseas dividends | (152) | (125) |
| Non-taxable UK dividends | (1,404) | (1,443) |
| Tax charge for the year (note 8a) | 13 | – |

**c) Provision for deferred tax**

No provision for deferred tax has been made in the current or prior accounting year.

**d) Factors that may affect future tax charges**

The fund has not recognised a deferred tax asset of £14,626,000 (2012: £13,584,000) arising as a result of having unutilised management expenses of £73,130,000 (2012: £67,920,000). It is unlikely that the fund will obtain relief for these in the future so no deferred tax asset has been recognised.

# 9. Finance costs: distribution and interest

| | 31 December 2013 £'000 | 31 December 2012 £'000 |
|---|---|---|
| Final distribution | 2,506 | 2,955 |
| Add: amounts deducted on cancellation of units | 97 | 217 |
| Deduct: amounts added on issue of units | (28) | (144) |
| **Finance costs: distribution** | **2,575** | **3,028** |
| Finance costs: interest | 4 | 16 |
| Total finance costs | 2,579 | 3,044 |
| **Movement between net revenue and distribution** | | |
| Net revenue after taxation | 2,559 | 3,028 |
| Add: revenue received on conversion of units | 16 | – |
| | 2,575 | 3,028 |

The distribution takes account of amounts added on the issue of units and amounts deducted on the cancellation of units. Details of the distribution per unit are set out in the distribution table on page 15.

# 10. Debtors

| | 31 December 2013 £'000 | 31 December 2012 £'000 |
|---|---|---|
| Accrued revenue | 725 | 891 |
| Amounts receivable for issue of units | 152 | 71 |
| Sales awaiting settlement | 54 | 47 |
| Overseas withholding tax recoverable | 12 | – |
| Prepaid expenses | – | 1 |
| Total debtors | 943 | 1,010 |

# Notes to the financial statements (continued)

## 11. Cash and bank balances

| | 31 December 2013 £'000 | 31 December 2012 £'000 |
|---|---|---|
| Amounts held in JP Morgan Liquidity Fund | 393 | 4,695 |
| Total cash and bank balances | 393 | 4,695 |

## 12. Creditors

| | 31 December 2013 £'000 | 31 December 2012 £'000 |
|---|---|---|
| Accrued annual management charge | 438 | 384 |
| Accrued other expenses | 81 | 76 |
| Accrued trustee fee | 4 | 4 |
| Amounts payable for cancellation of units | – | 223 |
| Total creditors | 523 | 687 |

## 13. Contingent liabilities and commitments

There were no contingent liabilities or outstanding commitments at the current or prior year end.

## 14. Related party transactions

The manager and trustee are deemed to be related parties. All transactions and balances associated with the manager and trustee are disclosed within the statement of total return, statement of change in net assets attributable to unitholders and the balance sheet on page 9 and notes 7, 10 and 12 on pages 12, 13 and 14 including all issues and cancellations where the manager acted as principal. The balance due to the manager as at 31 December 2013 in respect of these transactions was £286,000 (2012: £536,000). The balance due to the trustee as at 31 December 2013 in respect of these transactions was £4,000 (2012: £4,000).

## 15. Risk disclosures – currency risk

| Currency | Investments £'000 | Net other assets £'000 | Total £'000 |
|---|---|---|---|
| 31 December 2013 | | | |
| US Dollar | 2,038 | 12 | 2,050 |
| 31 December 2012 | | | |
| US Dollar | 12,029 | – | 12,029 |

## 16. Unit classes

The fund currently has two unit classes: R accumulation and I accumulation. The annual management charge on each unit class is as follows:

R accumulation: 1.50%
I accumulation: 0.75%

The net asset value per unit and the number of units in each class are given in the comparative tables on page 16. The distribution per unit class is given in the distribution table on page 15. All classes have the same rights.

## 17. Post balance sheet event

Since 31 December 2013, the net asset values per unit, on a bid basis, have changed as follows:

| | Net asset value per unit (p) | | |
|---|---|---|---|
| | 13 February 2014 | 31 December 2013 | Movement |
| R accumulation | 1,063.30 | 1,042.81 | 2.0% |
| I accumulation | 1,091.73 | 1,069.71 | 2.1% |

# Distribution table

Final dividend distribution for the year ended 31 December 2013.

Group 1 – Units purchased prior to 1 January 2013.
Group 2 – Units purchased from 1 January 2013 to 31 December 2013.

| | Net revenue per unit (p) | Equalisation per unit (p) | Distribution per unit (p) 28 February 2014 | Distribution per unit (p) 28 February 2013 |
|---|---|---|---|---|
| R accumulation | | | | |
| Group 1 | 6.3963 | – | 6.3963 | 7.2179 |
| Group 2 | 2.9874 | 3.4089 | 6.3963 | 7.2179 |
| I accumulation | | | | |
| Group 1 | 13.4033 | – | 13.4033 | 13.0988 |
| Group 2 | 5.0375 | 8.3658 | 13.4033 | 13.0988 |

Corporate unitholders should note that:

1. 100.00% of the revenue distribution together with the tax credit is received as franked investment income.

2. 0.00% of the revenue distribution is received as an annual payment received after deduction of income tax at the lower rate and may be liable to corporation tax. It is not franked investment income.

Equalisation applies only to units purchased during the distribution period (group 2 units). It is the average amount of revenue included in the purchase price of group 2 units and is refunded to the holders of these units as a return of capital. Being capital it is not liable to income tax but must be deducted from the cost of units for capital gains tax purposes.

# Comparative tables

## Fund sizes & net asset values

| Date | Net asset value of fund (£) | Net asset value per unit (p) | Units in issue |
|---|---|---|---|
| **31 December 2011** | 283,526,494 | | |
| R accumulation | | 661.85 | 42,308,174 |
| I accumulation | | 668.85 | 524,504 |
| **31 December 2012** | 317,668,072 | | |
| R accumulation | | 803.77 | 37,704,435 |
| I accumulation | | 818.42 | 1,785,407 |
| **31 December 2013** | 374,773,996 | | |
| R accumulation | | 1,042.81 | 32,824,779 |
| I accumulation | | 1,069.71 | 3,035,743 |

## Ongoing charges

| Expense | 31 December 2013 |
|---|---|
| **R accumulation** | |
| Annual management charge | 1.50% |
| Other expenses | 0.09% |
| Ongoing charges | 1.59% |
| **I accumulation** | |
| Annual management charge | 0.75% |
| Other expenses | 0.09% |
| Ongoing charges | 0.84% |

Ongoing charges shows the annual operating expenses of each unit class as a percentage of the average net assets of that class for the preceding 12 months.

## Net revenue distribution & unit price range

| Year | Net revenue per unit (p) | Highest offer price (p) | Lowest bid price (p) |
|---|---|---|---|
| **R accumulation** | | | |
| 2009 | 1.4145 | 569.30 | 347.00 |
| 2010 | 4.2556 | 705.56 | 518.45 |
| 2011 | 4.5341 | 801.49 | 642.48 |
| 2012 | 7.2179 | 868.21 | 661.67 |
| 2013 | 6.3963 | 1,124.37 | 812.96 |
| **I accumulation** | | | |
| 2010 * | 2.9481 | 680.77 | 570.14 |
| 2011 | 10.4173 | 776.31 | 647.37 |
| 2012 | 13.0988 | 850.36 | 668.72 |
| 2013 | 13.4033 | 1,109.43 | 827.87 |

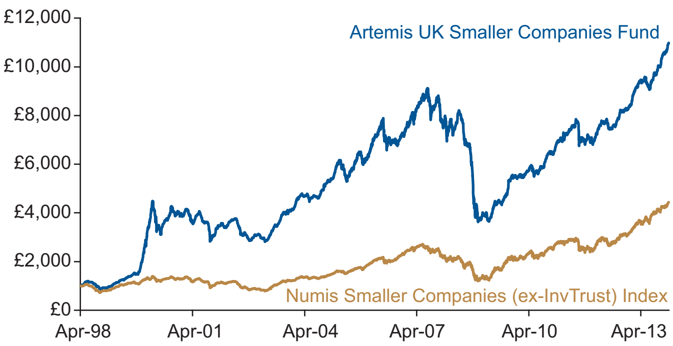
Net revenue includes all amounts paid and payable in each calendar year.
* From 1 September 2010.

## Fund performance

| | Since launch * | 5 years | 3 years | 1 year | 6 months |
|---|---|---|---|---|---|
| Artemis UK Smaller Companies Fund | 998.7 | 183.4 | 59.8 | 30.2 | 20.1 |
| Numis Smaller Companies (ex-InvTrust) Index | 343.7 | 233.9 | 61.7 | 36.9 | 21.0 |
| Sector average | 271.2 | 200.8 | 53.2 | 37.4 | 23.3 |
| Position in sector | 2/25 | 36/48 | 25/49 | 48/52 | 40/52 |
| Quartile | 1 | 3 | 2 | 4 | 4 |

* Data from 3 April 1998. Source: Lipper Limited, R accumulation units, bid to bid basis in sterling with net income reinvested to 31 December 2013. All performance figures show total return percentage growth. Sector is IMA UK Smaller Companies.

## Value of £1,000 invested at launch to 31 December 2013



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