# BLACKROCK SMALLER COMPANIES TRUST PLC

ANNUAL REPORT AND FINANCIAL STATEMENTS
28 FEBRUARY 2014

BLACKROCK®

# BlackRock Smaller Companies Trust plc

## Corporate summary

| | |
|---|---|
| **The company** | The Company is an investment trust and its shares are listed on the London Stock Exchange. The Company aims to attract long term private and institutional investors wanting to benefit from the growth prospects of smaller companies. |
| **Investment objective** | To achieve long term capital growth for shareholders through investment mainly in smaller UK quoted companies. Full details are given on page 15. |
| **Benchmark index** | Numis Smaller Companies plus AIM (excluding Investment Companies) Index. |
| **Investment manager** | BlackRock Investment Management (UK) Limited – Portfolio Manager, Mike Prentis. |
| **Board** | The Company has an independent Board of Directors which is responsible for the governance of the Company, monitors its performance, and keeps the investment strategy under review. |
| **Website** | Information about the Company can be found on the website blackrock.co.uk/brsc |
| **AIC** | The Company is a member of the Association of Investment Companies. |

**Financial calendar**

| | |
|---|---|
| 25 April 2014 | Announcement of results for year ended 28 February 2014 |
| 10 June 2014 | Annual General Meeting |
| 17 June 2014 | Payment of final dividend on ordinary shares |
| 23 October 2014 | Announcement of results for six months ended 31 August 2014 |
| 26 November 2014 | Payment of interim dividend on ordinary shares |

A MEMBER OF THE ASSOCIATION OF INVESTMENT COMPANIES

Details about the Company are available on the BlackRock Investment Management (UK) Limited website blackrock.co.uk/brsc

# Contents

# Overview

## Performance record

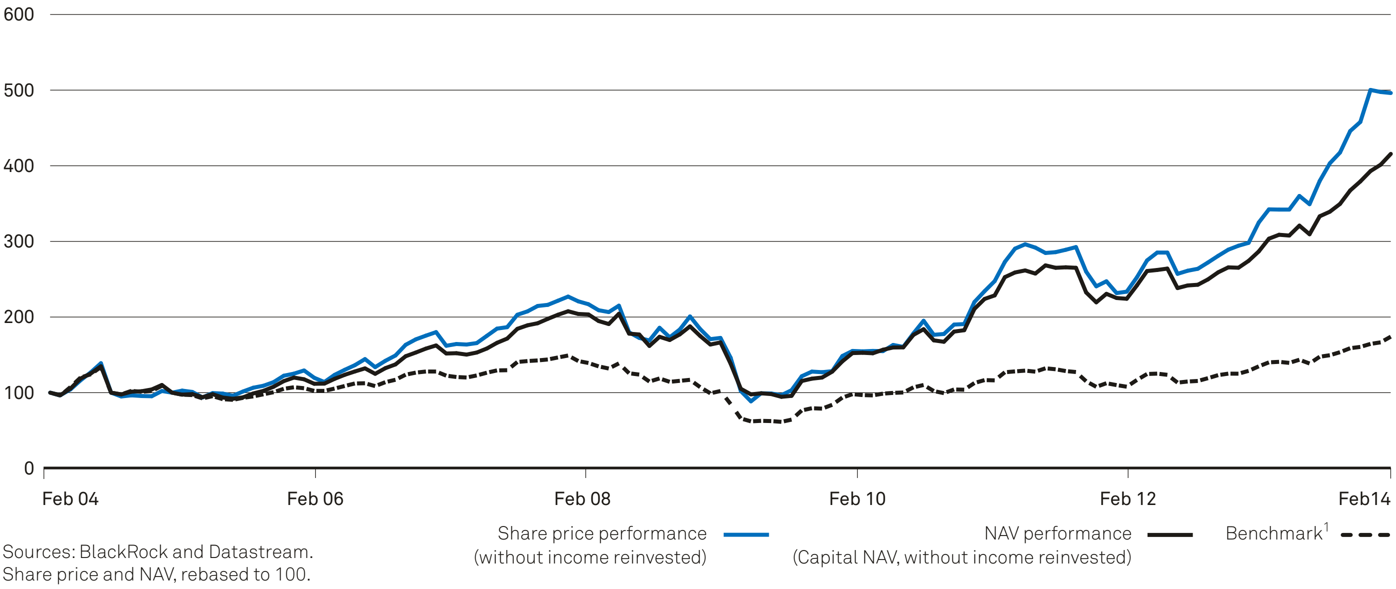
### FINANCIAL HIGHLIGHTS

| | Year ended 28 February 2014 | Year ended 28 February 2013 | % change |
|---|---|---|---|
| **Performance** | | | |
| Net asset value per share (debenture at par value) | 985.47p | 720.42p | +36.8 |
| Net asset value per share (debenture at par value, capital only) | 975.48p | 712.39p | +36.9 |
| Net asset value per share (debenture at fair value) | 978.01p | 715.37p | +36.7 |
| Numis Smaller Companies plus AIM (ex Investment Companies) Index[1] | 5,003.30 | 4,026.91 | +24.2 |
| Share price | 908.00p | 626.50p | +44.9 |
| Revenue return per share | 14.59p | 11.53p | +26.5 |
| Interim dividend per share | 4.60p | 3.50p | +31.4 |
| Proposed final dividend per share | 7.40p | 6.50p | +13.8 |
| Total dividends paid and payable in respect of the year ended | 12.00p | 10.00p | +20.0 |
| Total assets less current liabilities (£'000) | 511,720 | 374,797 | +36.5 |
| Equity shareholders' funds (£'000) | 471,843 | 344,934 | +36.8 |
| Ongoing charges ratio[2] | 0.7% | 0.6% | |
| Ongoing charges ratio (including performance fees) | 1.0% | 1.0% | |
| Dividend yield | 1.3% | 1.6% | |
| Gearing | 8.2% | 9.2% | |

1. Excludes income reinvested.
2. Ongoing charges ratio calculated as a percentage of average shareholders' funds and using expenses, excluding finance costs, performance fees and taxation in accordance with AIC guidelines.

Source: BlackRock.

### PERFORMANCE FROM 1 MARCH 2004 TO 28 FEBRUARY 2014




Sources: BlackRock and Datastream.
Share price and NAV, rebased to 100.

1. FTSE SmallCap Index (excluding Investment Companies) prior to 31 August 2007 and Numis Smaller Companies plus AIM (excluding Investment Companies) Index from 1 September 2007, rebased to 100. Excludes income reinvestment.

# Overview

## Chairman's statement

Over the last ten years Net Asset Value per share has increased by 388% and Dividends per share by 171%. Your Company continues to be an outstanding long term investment.

Nicholas Fry

**PERFORMANCE**

I am pleased to report excellent results for your Company for the year ended 28 February 2014. During the year the net asset value ("NAV") increased by 36.8% to 985.5p per share, substantially outperforming the Company's benchmark, the Numis Smaller Companies plus AIM (excluding Investment Companies) Index[1], which increased by 24.2% in the year. Your Company's share price rose by 44.9% to 908.0p per share[1].

Relative outperformance was driven by good stock selection, and assisted by sector allocation and gearing. Details of the various contributors to performance can be found in the Investment Manager's Report on pages 7 to 9.

Small and midcap stocks have performed well during the year with the FTSE 250 Index[1] rising by 22.1% compared with an increase of 7.1% for the FTSE 100 Index[1]. The FTSE AIM All Share Index[1] improved significantly on its poor performance at the last year end, up by 20.5%.

Since the financial year end, the Company's NAV has decreased by 3.2%, against a decrease in the benchmark of 4.4%, and the share price has fallen by 6.0%.

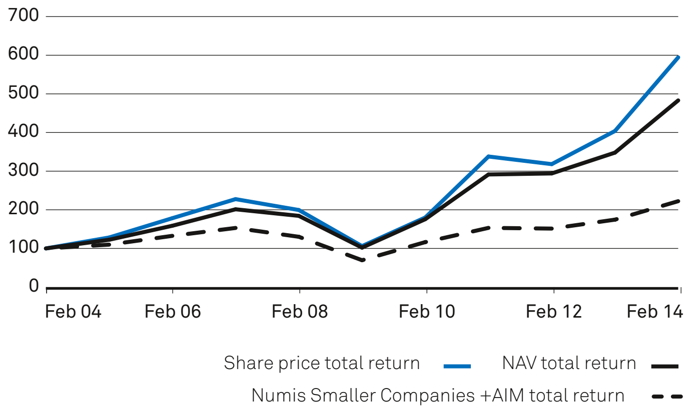
Over the longer term the Company's performance has substantially exceeded its benchmark, as shown in the table opposite.

| Performance to 28 February 2014 | 1 Year | 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|
| Net asset value per share | +36.8% | +58.8% | +333.4% | +319.9% |
| Benchmark[1] | +24.2% | +34.8% | +183.4% | +74.1% |
| Net Asset Value per share (with income reinvested) | +38.7% | +65.6% | +367.1% | +387.9% |
| Benchmark (with income reinvested)[1] | +27.4% | +45.1% | +219.9% | +122.3% |
| Share price (with income reinvested) | +47.2% | +75.9% | +460.8% | +494.0% |

1. Benchmark – Numis Smaller Companies plus AIM (excluding Investment Companies) Index from 1 September 2007; FTSE SmallCap Index excluding Investment Companies prior to that date.

The progression of the Company's total return performance (with income reinvested) over the last ten years is shown in the chart below.

**SHARE PRICE AND NAV TOTAL RETURN VS BENCHMARK (WITH INCOME REINVESTED)**




Sources: BlackRock and Datastream.

1. All percentages in sterling terms without income reinvested.

## EARNINGS AND DIVIDENDS

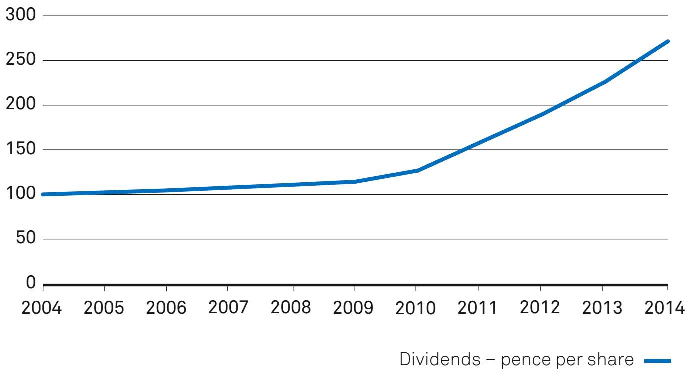
The Company's revenue return per share for the year ended 28 February 2014 amounted to 14.59p compared with 11.53p for the previous year.

In October 2013 the Board declared an interim dividend of 4.60p per share (2013: 3.50p per share). The Directors are now pleased to recommend the payment of a final dividend of 7.40p per share (2013: 6.50p per share), making a total for the year of 12.00p, an increase of 20.0% over the total dividend of 10.00p paid in the previous year.

Subject to shareholder approval, the final dividend will be paid on 17 June 2014 to shareholders on the register on 16 May 2014; the ex-dividend date is 14 May 2014.

As a result of continued growth in earnings, in each of the last ten years your Company has increased its annual dividends per share, which have risen by 171% over the decade. The profile of dividend growth over the last ten years is shown in the graph below.

### TEN YEAR DIVIDEND GROWTH




Sources: BlackRock and Datastream.

## GEARING

During the financial year the Board negotiated an increase in the three year revolving loan facility with Scotia Bank (Ireland) Limited from £15 million to £25 million in order to be less dependent on short term borrowings and to enable the Company to benefit from the perceived improvement in prospects for the smaller companies sector. This facility is in addition to the Company's existing £15 million debenture and an uncommitted bank overdraft facility of £20 million.

It is the Board's intention that gearing will not exceed 15% of the net assets of the Company at the time of the drawdown of the relevant borrowings. Under normal operating conditions it is envisaged that gearing will be within a range of 0%-15% of net assets.

Gearing levels and sources of funding are reviewed regularly and the Board continues to believe that moderate gearing is in the long term interests of shareholders; for the year under review, gearing contributed approximately 3.0% to performance. At the year end, the Company's gearing was 8.2% of net assets.

## DISCOUNT

The discount to net assets at which the share price stood averaged 8.8% over the year under review, ranging from a premium of 0.1% to a discount of 15.6%, and ended the year at 7.2% (all measured against NAV with debt at fair value). The Company's discount has since widened to 9.8% as at the date of this report.

## SHARE OWNERSHIP

The Board continued to focus on broadening the awareness of the Company's attractions, particularly to wealth managers and to the wider retail shareholder market. Over the last three years the number of shares in the Company held by retail shareholders has increased from 20% to over 46% and we aim for this trend to continue.

## ALTERNATIVE INVESTMENT FUND MANAGERS' DIRECTIVE

The Alternative Investment Fund Managers' Directive issued by the European Commission (the 'Directive') seeks to reduce systemic risk by regulating alternative investment fund managers ('AIFMs'). AIFMs are responsible for managing investment products that fall within the category of Alternative Investment Funds ('AIFs') and investment trusts are included in this. The Directive was implemented on 22 July 2013 although the Financial Conduct Authority has permitted a transitional period of one year after that during which UK AIFMs must seek authorisation. The Board has taken, and will continue to take, independent advice on the consequences for the Company and has decided in principle that BlackRock Fund Managers Limited will be appointed as its AIFM in advance of the end of the transitional period on 22 July 2014.

## ANNUAL GENERAL MEETING & ARTICLES OF ASSOCIATION

At the forthcoming Annual General Meeting, shareholders will be asked to approve new Articles of Association in substitution for the current Articles of Association. The Board is proposing to make these amendments to the Articles of Association in response to the Alternative Investment Fund Managers' Directive. Details of the principal changes are given on page 23 of the Directors' Report. In addition, the Board is proposing an amendment to the aggregate limit on Directors' remuneration. At present the Company's Articles of Association set an aggregate limit of £150,000 per annum for Directors' fees. The Board is proposing as an ordinary resolution that the aggregate limit on Directors' fees be increased to £200,000. This will provide for the possibility of an overlap of Directors upon retirement and replacement in accordance with the Company's succession plan. The increase in the aggregate limit would also facilitate any future increase in Directors' fees to reflect market trends and to ensure that the remuneration of the Directors is sufficient to attract and retain Directors with suitable knowledge and experience. Full details of the fees paid to

## Chairman's statement continued

Directors are set out in the Directors' Remuneration Report on pages 25 to 28.

The Board also proposes to increase the limit of the number of shares that may be issued with pre-emption rights dis-applied from 5% to 10% when this authority is renewed at the forthcoming Annual General Meeting ("AGM") in June 2014. Details are set out in the Directors' Report on page 22 and in the Notice of AGM on page 64 of this Annual Report and Financial Statements.

The AGM of the Company will be held at the offices of BlackRock at 12 Throgmorton Avenue, London EC2N 2DL on 10 June 2014 at 11.30 a.m. Mike Prentis, the Portfolio Manager, will be making a presentation to shareholders on the Company's performance and the outlook for equity markets. The Directors and representatives of the Investment Manager look forward to meeting shareholders informally after the meeting and I hope that as many shareholders as possible will choose to attend.

### OUTLOOK

Recent upgrades to forecasts for the UK economy are encouraging. The holdings in the Company's portfolio are well placed to make the most of these positive economic conditions, with strong management and exposure to the better performing sectors of the economy. On a more cautionary note, the strength of sterling may hamper growth for companies with international exposure and valuations are beginning to look full for more companies. Nevertheless, we anticipate good earnings growth from your Company's holdings, and this should feed through into positive returns for the Company's shareholders in the medium term.

**NICHOLAS FRY**
Chairman
25 April 2014

# Performance

## Investment manager's report

Your Company continues to outperform its benchmark, and we expect good earnings growth in portfolio holdings to feed through to share prices.

Mike Prentis

### MARKET REVIEW AND OVERALL INVESTMENT PERFORMANCE

During the financial year stockmarkets in the developed world have generally moved steadily ahead. Economic data from the UK has been rather better than expected and GDP growth looks to be accelerating. In the US the data from the private sector has also been supportive and economic momentum looks to be building slowly. The economies in Continental Europe appear to be stabilising, especially in Germany. Data from Asia and Emerging Markets have been mixed and overall sentiment seems to be steady. We have experienced periods of uncertainty mainly caused by the tapering of quantitative easing in the US and also by events in the Ukraine, but so far these have not prevented markets edging higher after setbacks.

Over the year the Company's NAV per share rose by 36.8% to 985.47p; the benchmark[1] rose by 24.2%, whilst the FTSE100 Index[1] rose by only 11.0%, all percentages in sterling terms without income reinvested.

### PERFORMANCE REVIEW

Relative outperformance was driven by good stock selection, assisted by sector allocation and gearing. Gearing was maintained in the range of 8%-10% throughout the year.

Looking at stock selection, the most significant positive contributors to relative performance were our holdings in Optimal Payments, Xaar, Workspace Group, Howden Joinery Group, Polar Capital Holdings and Walker Greenbank. Good contributions were also made by other core holdings Ashtead Group, Restaurant Group, Bellway and Booker Group.

Optimal Payments, a leading online payments provider, announced interim results showing sharply higher profits and good cash generation, followed by a full year trading update which indicated that profits would be ahead of market expectations. Management remains very confident of medium term prospects and the company's share price trebled over the financial year.

Xaar, the leading manufacturer of print heads used in inkjet printers, issued a positive year end trading update indicating full year organic revenue growth of 55% and expected operating margins of 30%. This performance is largely attributable to Xaar's huge success with the sales of its Platform 3 inkjet heads, which are mainly being sold to enable the decoration of ceramic tiles. Xaar has taken significant market share. The company remains well positioned and is looking at other vertical markets for its printheads. We have held Xaar shares for many years, including through some difficult trading periods, therefore it was particularly pleasing to see management delivering such outstanding performance. Against this improving background, the company's share price more than trebled during the year.

Workspace Group's share price performed strongly on the back of a good NAV growth forecast released by the company. Its property is generally located on the fringes of Central London where rents are growing fastest. Workspace's passing rents are relatively modest with good scope to increase gradually. Yet its portfolio is valued off a relatively high yield with scope for some yield compression. At the same time, the company has been very successful in gaining approval to add extra space or to change the use of space, in both cases offering the prospect of further increases in rents or capital profits.

Howden Joinery Group has continued to gain market share in the supply of good quality kitchens to the UK market, focusing on local builders. Polar Capital Holdings announced assets under management had grown strongly on the back of consistently good investment performance and successful new fund launches. Walker Greenbank, the leading interior furnishings company has benefited from increasing consumer confidence and the pick-up in the UK housing market. The company has also seen better trading in overseas markets. The shares had been very cheap and the market has begun to appreciate the company's qualities.

On the negative side the largest detractors from relative performance were Ocado, Oxford Instruments, AZ Electronic Materials and Anite. Ocado was a constituent of our benchmark index for most of the financial year and its share price performed very strongly over the year. We did not own shares in Ocado.

1. All percentages in sterling terms, without income reinvested.

Oxford Instruments has had a more difficult year, driven partly by pressure on government funded research budgets, the ending of one high margin contract, the strength of sterling impacting the translation of overseas profits and weakness in some overseas markets. The company did complete the purchase of Andor Technology which should be beneficial over the medium term, and continues to innovate; we expect the fortunes of the company to improve in due course.

AZ Electronic Materials announced that it had a weaker start to the year and expected this trend to continue into the second quarter; and not for the first time, earnings were downgraded. We were impatient in selling our holding prior to a bid by Merck at a good premium.

Anite provides testing for telecoms handsets and networks. The company's revenues can be quite lumpy and it has seen some delays in new contracts. The company is however very well placed to benefit from the introduction of the latest generation of handsets.

Sector allocation benefited from our overweight sector positions in housebuilders and food and drug retailers, where we hold Booker Group, and our underweight positions in the oil & gas sector.

### ACTIVITY

Our general approach is to slowly recycle from our largest capitalisation stocks into smaller companies which we hope will also fare well. For example, during December we sold our remaining holding in Ashtead Group following its promotion to the FTSE 100 Index. We bought the holding in 2010 when the share price was about 100p. The company is very well managed and has taken full advantage of improving conditions in the US market. We believe Ashtead Group looks well set but our usual practice is to sell holdings when they get into the FTSE 100 Index, as we did with our holding in Hargreaves Lansdown a few years ago. We also took profit in a number of other holdings, selling out of some completely and using the proceeds to invest in smaller companies.

We participated in a number of IPOs and placings during the year, including Foxtons Group, the London focused estate agent, DX Services, a mail, parcels and logistics business, Judges Scientific, a designer of precision instruments, Incadea, a leading supplier of software to the global automotive retail and wholesale market, Parkmead, the North Sea focused oil & gas company set up by Tom Cross, former CEO of Dana Petroleum; and Tarsus, the exhibitions group which is quite heavily focused on emerging markets. In these and other new investments we have identified strong and ambitious management teams running businesses with considerable medium term potential. These companies have the potential to be larger holdings if they can deliver on their initial promise.

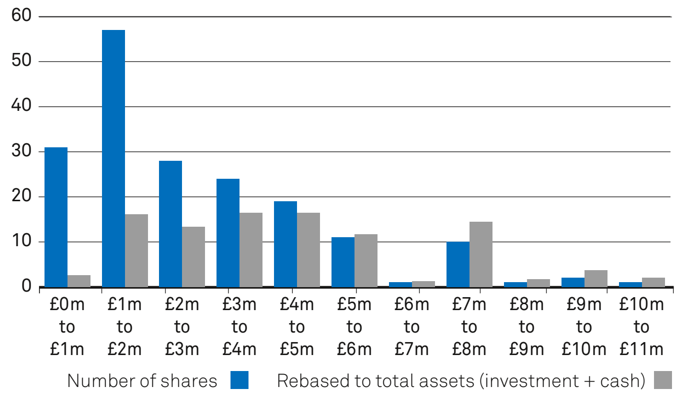
### PORTFOLIO POSITIONING

We have sought to maintain good exposure to themes we expect to remain strong, notably the strengthening UK and US housing markets; improving UK consumer confidence; the strength of the London economy; increasing flows into equities; leading technologies; and the increasing use of advanced, often online payments. We have also more recently sought to gain additional exposure to Continental Europe in anticipation of gradual recovery.

We have maintained an underweight position in companies too heavily exposed to government spending both in the UK and US, and food producers and similar companies with limited pricing power.

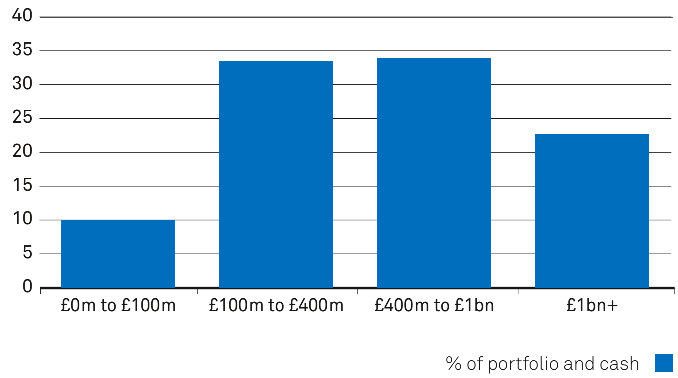
The portfolio remains well diversified with more than 150 holdings, the largest of which is about 2.1% of total portfolio investments. All of our larger holdings are well established companies. Positions in very small companies are taken where we believe the upside is potentially very attractive, but position sizing is small recognising the greater risk of disappointment.

INVESTMENT SIZE AS AT 28 FEBRUARY 2014




Source: BlackRock.

MARKET CAPITALISATION AS AT 28 FEBRUARY 2014




Source: BlackRock.

## OUTLOOK

Newsflow from our holdings largely exposed to the UK economy has generally continued to be good; this includes housebuilders such as Bellway and other UK consumer exposed companies such as Restaurant Group and Howden Joinery Group. We expect these and similar companies to continue to trade well. Many of the industrial companies and some software and media companies are very international, and can expect demand levels to vary quite markedly around the world, although this situation is no worse in 2014 than 2013. However, the strength of sterling presents an additional headwind in 2014.

We think share prices will be driven more by earnings growth in 2014 and further earnings multiple expansion looks unlikely for many companies. However, we expect good earnings growth from our holdings and this should feed through to share prices, although a repeat of 2013 performance is highly unlikely.

**MIKE PRENTIS**
BlackRock Investment Management (UK) Limited
25 April 2014

# Performance

## Summary of ten largest investments 28 February 2014

Set out below is a brief description by the Investment Manager of the Company's ten largest investments

**Optimal Payments** – 2.1% (2013: 1.0%) is a global provider of online and mobile payment processing services. The company operates under two brands: NETBANX which offers straight through processing services; and NETELLER which operates online e-wallets for use by consumers. Optimal Payments has grown revenues significantly in recent years benefiting from the increase in e-commerce, with excellent profit growth as the company has leveraged its relatively fixed cost base. The company has a long track record of successfully operating in the payments industry, and as a result is well positioned to capitalise on the regulation of online gaming in the USA.

**Bellway** – 1.9% (2013: 2.3%) is one of the largest housebuilders in the United Kingdom with operations across the country. Management is very experienced and has run the company in good and bad housing market conditions. Bellway has bought land steadily over the last few years; operating margins are increasing further as more recently acquired land is built on. Bellway has the scope to increase volumes of sales over the next few years and average selling prices are also likely to increase. Bellway shares still trade at a slight premium to net tangible assets and look good value in absolute terms and relative to the sector.

**Workspace Group** – 1.8% (2013: 1.8%) is a provider of premises tailored to the needs of new and growing businesses across London. It owns more than 100 properties in London providing 5.4 million square feet of space which is home to some 4,000 businesses employing more than 30,000 people. Workspace provides the right properties to attract and retain customers giving them the flexibility to adjust the space they need to help them grow. Occupancy levels have continued to increase as have rents per square foot. Workspace has also supplemented core operational income and capital values by redeveloping certain property assets. This has enabled the company's net asset value to grow steadily and we expect this to continue as London thrives and creates more jobs.

**Senior** – 1.7% (2013: 2.4%) is an international manufacturing group providing engineered products for demanding operating environments. The group's strategy is to focus on sectors where it is positioned to benefit from both global market growth and increasingly stringent emission control legislation. Senior operates through two Divisions: Aerospace, which serves both the commercial aerospace and defence markets and Flexonics, which serves automotive and other industrial markets. The company is particularly closely aligned to the growth of the commercial aerospace sector and especially to wide bodied aircraft production. Senior's designed in products and high order book give it excellent revenue visibility. Growth in earnings in recent years has been strong and the shares remain modestly rated.

**Xaar** – 1.5% (2013: 0.8%) is the leading global independent supplier of digital inkjet print heads. The company is well positioned to capitalise on the growing use of digital printing in industrial applications, particularly the printing of decoration onto ceramic tiles where the conversion of production from analogue to digital printers is only partially complete. Strong revenue and profit growth in recent years has enabled the company to significantly increase its investments in research & development of new products and interesting new technologies, which in turn will drive growth in the future.

**Elementis** – 1.5% (2013: 1.0%) is a global specialty chemicals company which operates in three divisions: Specialty Products, Surfactants, and Chromium Chemicals. The largest business Specialty Products develops and supplies rheology additives for use in paints and coatings, cosmetics and oilfield drilling fluids. This business has been the key driver of revenue and profit growth, as the company has benefited from growth in its end markets and the introduction of new products to gain market share. Surfactants and Chromium Chemicals benefit from strong market positions and are highly cash generative, providing the funds to invest in growing the higher margin specialty products business. The company is highly cash generative with a strong balance sheet and a track record of returning excess cash to shareholders via special dividends.

**Restaurant Group** – 1.5% (2013: 1.5%) operates 440 branded restaurants, pub restaurants and airport concessions across the UK. The group occupies market leading positions in edge of town, out of town, rural and airport locations and its principle brands are Frankie & Benny's, Chiquito, Coast to Coast and Garfunkels. Restaurant Group has an excellent track record of delivering consistent year on year growth in cash flow and profits combined with high returns on investment which funds both new restaurant openings and a progressive dividend policy. The strong offer combined with excellent operational performance means that Restaurant Group is both popular with consumers and an attractive tenant for landlords, and as a result the group has a strong pipeline of new restaurants to be opened in coming years.

**Polar Capital Holdings** – 1.5% (2013: 1.1%) is an investment management company which offers a range of geographical and sector funds, both long only and absolute return, to professional and institutional investors. The company benefits from strong management who seek to maintain an entrepreneurial culture focused on delivering superior performance, combined with robust operational processes which ensure the interests of their investment managers and clients are aligned. The company has seen significant growth in its assets under management and now manages US$13 billion split across 22 funds and 5 managed accounts. Its strong product offering means Polar Capital Holdings is well positioned to continue to grow its assets under management and its net cash balance sheet provides reassurance in tougher market conditions.

**Dunelm Group** – 1.5% (2013: 1.6%) is a specialist out of town homewares retailer operating 131 superstores in the UK with an average sales area of 30,000 square feet plus an online store. The company's 'Simply Value for Money' proposition focuses on offering consumers market leading choice of high quality and good value products, supported by strong customer service. Dunelm's store network still has limited coverage across some parts of the UK and management target a mature store portfolio of 200 stores. Looking forward, adding new stores as well as developing newer retail channels such as online provides considerable opportunity for future growth. The business is highly profitable and cash generative and has a track record of periodically returning excess capital to shareholders through special dividends which is expected to continue.

**Avon Rubber** – 1.4% (2013: 1.0%) is an engineering company which has been successfully transformed from a diverse conglomerate to a more focused business over recent years, and now specialises in two core markets, Protection & Defence and Dairy. Protection & Defence is the global leader in advanced Chemical, Biological, Radiological and Nuclear respiratory protection solutions for use by the military, national security and emergency services. The company's principle products are a range of respirator masks and replacement filters, with scope to grow considerably in its core US market as well as overseas. The dairy business manufactures and supplies dairy liners and tubing both to OEM manufacturers of milking parlour systems and directly to farms through its market leading Milkrite brand.

All percentages reflect the value of the holding as a percentage of total investments. Percentages in brackets represent the value of the holding as at 28 February 2013. Together, the ten largest investments represents 16.4% of the Company's portfolio (ten largest investments as at 28 February 2013: 14.5%).

# Performance

## Fifty largest investments

| Company | Market value £'000 | % of total portfolio | Business activity |
|---|---|---|---|
| Optimal Payments | 10,620 | 2.1 | Provision of online payments solutions |
| Bellway | 9,726 | 1.9 | Housebuilding |
| Workspace Group | 9,110 | 1.8 | Supply of flexible workspace to businesses in London |
| Senior | 8,596 | 1.7 | Manufacture and supply of components for the aerospace and automotive sector |
| Xaar | 7,932 | 1.5 | Design and manufacture of industrial printheads used in inkjet printers |
| Elementis | 7,929 | 1.5 | Manufacture of additives that enhance the feel, flow and finish of everyday products |
| Restaurant Group | 7,712 | 1.5 | Operation of branded restaurants |
| Polar Capital Holdings | 7,649 | 1.5 | Investment management |
| Dunelm Group | 7,473 | 1.5 | Supply of home furnishings |
| Avon Rubber | 7,204 | 1.4 | Production of safety masks and dairy related products |
| Headlam Group | 7,178 | 1.4 | Distribution of carpets and other floor coverings |
| Howden Joinery Group | 7,152 | 1.4 | Design and manufacture of kitchens sold to local builders |
| Paragon | 7,123 | 1.4 | Provision of loans mainly to buy to let landlords |
| ITE Group | 7,112 | 1.4 | Organisation of trade exhibitions in Russia and other former Soviet Union countries |
| Bovis Homes Group | 6,438 | 1.3 | Housebuilding |
| Oxford Instruments | 5,995 | 1.2 | Design and manufacture of tools and systems to analyse and manipulate matter at the atomic level |
| LSL Property Services | 5,659 | 1.1 | Provision of residential property services |
| Galliford Try | 5,627 | 1.1 | Housebuilding and construction |
| St Modwen Properties | 5,597 | 1.1 | Property investment and development |
| Clarkson | 5,548 | 1.1 | Shipbroking and related activities |
| Paypoint | 5,488 | 1.1 | Provision of payment solutions |
| Big Yellow Group | 5,458 | 1.1 | Self-storage and related services |
| Brewin Dolphin Holdings | 5,367 | 1.0 | Private client fund management |
| Lookers | 5,242 | 1.0 | Supply of cars and after market parts and services |
| Ted Baker | 5,205 | 1.0 | Design and sale of fashion clothing |
| UTV Media | 5,050 | 1.0 | Television and radio broadcasting |
| Rathbone Brothers | 4,929 | 1.0 | Private client fund management |
| Walker Greenbank | 4,909 | 1.0 | Design, manufacture and distribution of wallcoverings and furnishing fabrics |
| Gooch & Housego | 4,816 | 0.9 | Design and manufacture of precision optical components, subsystems and instruments used to transmit and measure light |
| Hyder Consulting | 4,766 | 0.9 | Provision of engineering design services |
| Dechra Pharmaceuticals | 4,754 | 0.9 | Development and supply of pharmaceutical and other products focused on the veterinary market |
| Victrex | 4,730 | 0.9 | Manufacture and supply of PEEK thermoplastic products |
| Consort Medical | 4,665 | 0.9 | Manufacture of drug delivery services |
| Tyman | 4,643 | 0.9 | Manufacture and supply of window and door components |
| Telit Communications | 4,612 | 0.9 | Design and sale of cellular communication products |
| Telecom Plus | 4,482 | 0.9 | Supply of telecom, gas, electricity and other utility services |
| Grainger | 4,472 | 0.9 | Ownership and rental of residential property |
| Fidessa Group | 4,454 | 0.9 | Development and marketing of financial trading and connectivity software |
| Topps Tiles | 4,411 | 0.9 | Sourcing and retail of ceramic tiles |
| SIG | 4,332 | 0.8 | Supply of insulation, roofing and interior fit out materials |
| James Fisher & Sons | 4,107 | 0.8 | Provision of marine services |
| Abcam | 4,083 | 0.8 | Production and distribution of research grade antibodies and associated products |

| Company | Market value | % of total portfolio | Business activity |
|---|---|---|---|
| | £’000 | | |
| Hutchinson China Meditech | 4,075 | 0.8 | Development and supply of traditional Chinese medicines to the Chinese market |
| Foxtons Group | 4,011 | 0.8 | Provision of property services |
| Booker Group | 3,994 | 0.8 | Wholesale of grocery products |
| Savills | 3,943 | 0.8 | Provision of property services |
| Ithaca Energy | 3,925 | 0.8 | Development and production of oil in the North Sea |
| Quintain Estates & Development | 3,863 | 0.8 | Property investment and development with a current focus on Wembley |
| 4Imprint | 3,757 | 0.7 | Supply of promotional merchandise in the US |
| Blinkx | 3,753 | 0.7 | Supply of video technology and an online catalogue to enable video clips to be viewed |
| 50 largest investments | 283,676 | 55.6 | |
| Remaining Investments | 226,951 | 44.4 | |
| **TOTAL** | **510,627** | **100.0** | |

A complete listing of all of the Company’s portfolio holdings as at 28 February 2014 is given on the Company’s website at the following link: www.blackrock.co.uk/literature/fund-update/brsct-portfolio-disclosure.pdf. At 28 February 2014, the Company did not hold any equity interests comprising more than 3% of any company’s share capital other than as disclosed in the table below:

| Company | % owned |
|---|---|
| Richland Resources Ltd | 4.6 |
| Air Partner plc | 4.5 |
| Walker Greenbank plc | 4.5 |
| Brainjuicer Group plc | 4.2 |
| Avon Rubber plc | 3.7 |
| City of London Investment Group plc | 3.4 |
| Source Bioscience plc | 3.4 |
| Hayward Tyler Group plc | 3.4 |
| Kalibrate Technologies plc | 3.1 |

## COMPARATIVES FOR TEN LARGEST INVESTMENTS

| Company | 2014 Market value | 2014 % total portfolio | 2013 Market value | 2013 % total portfolio |
|---|---|---|---|---|
| | £’000 | | £’000 | |
| Optimal Payments | 10,620 | 2.1 | 3,846 | 1.0 |
| Bellway | 9,726 | 1.9 | 8,607 | 2.3 |
| Workspace Group | 9,110 | 1.8 | 7,018 | 1.8 |
| Senior | 8,596 | 1.7 | 9,042 | 2.4 |
| Xaar | 7,932 | 1.5 | 2,925 | 0.8 |
| Elementis | 7,929 | 1.5 | 3,701 | 1.0 |
| Restaurant Group | 7,712 | 1.5 | 5,602 | 1.5 |
| Polar Capital Holdings | 7,649 | 1.5 | 4,083 | 1.1 |
| Dunelm Group | 7,473 | 1.5 | 6,103 | 1.6 |
| Avon Rubber | 7,204 | 1.4 | 3,662 | 1.0 |
| | **83,951** | **16.4** | **54,589** | **14.5** |

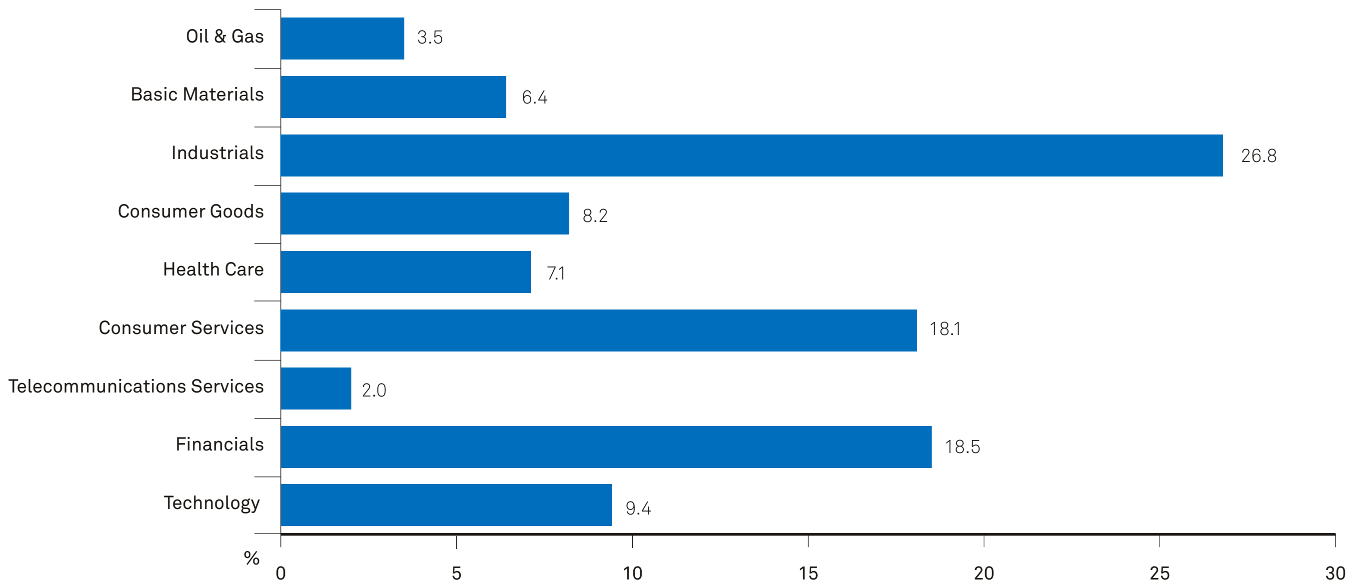
# Performance

## Distribution of investments

| Sector | % of portfolio |
|---|---|
| Oil & Gas Producers | 3.5 |
| **Oil & Gas** | **3.5** |
| Industrial Metals & Mining | 0.7 |
| Mining | 2.7 |
| Chemicals | 3.0 |
| **Basic Materials** | **6.4** |
| Support Services | 11.3 |
| Electronic & Electrical Equipment | 4.5 |
| Industrial Engineering | 1.2 |
| Aerospace & Defence | 3.5 |
| Industrial Transport | 2.8 |
| Construction & Materials | 3.5 |
| **Industrials** | **26.8** |
| Food Producers | 0.1 |
| Beverages | 0.3 |
| Personal Goods | 1.0 |
| Household Goods & Home Construction | 6.8 |
| **Consumer Goods** | **8.2** |
| Health Care Equipment & Services | 2.5 |
| Pharmaceuticals & Biotechnology | 4.6 |
| **Health Care** | **7.1** |

| Sector | % of portfolio |
|---|---|
| Food & Drug Retailers | 1.1 |
| Travel & Leisure | 5.3 |
| Media | 5.7 |
| General Retailers | 6.0 |
| **Consumer Services** | **18.1** |
| Fixed-Line Telecommunications Services | 2.0 |
| **Telecommunications Services** | **2.0** |
| Equity Investment Instruments | 0.2 |
| Retail Real Estate Investment Trust | 2.9 |
| Real Estate Investments Services | 6.6 |
| Financial Services | 8.8 |
| **Financials** | **18.5** |
| Technology Hardware & Equipment | 1.7 |
| Software & Computer Services | 7.7 |
| **Technology** | **9.4** |

ANALYSIS OF PORTFOLIO VALUE BY SECTOR




Source: BlackRock.

# Performance

## Strategic report

The Directors present the Strategic Report of the Company for the year ended 28 February 2014.

The aim of the Strategic Report is to provide shareholders with the ability to assess how the Directors have performed their duty to promote the success of the Company for shareholders' collective benefit.

### OBJECTIVE

The Company's prime objective is to achieve long term capital growth for shareholders through investment mainly in smaller UK quoted companies. No material change will be made to this objective without shareholder approval.

### STRATEGY, BUSINESS MODEL AND INVESTMENT POLICY

The Company is an investment trust which invests in accordance with the objective given above. It has no employees and outsources its management function to the Investment Manager, BlackRock Investment Management (UK) Limited.

To achieve its investment objective the Company may invest in securities which are listed overseas but have a secondary UK quotation. The Company may also trade on the Alternative Investment Market ("AIM") and the Board's current intention is that the value of AIM listed stocks as a percentage of the Company's portfolio should not exceed 40%. The Manager's approach in determining the optimal exposure to AIM investments subject to the parameters set by the Board is to focus on the merits of the underlying company and to seek value rather than to focus on the exchange on which the holding is listed, and consequently the level of exposure to AIM investments will vary from time to time. Although investments are primarily in companies listed on recognised stock exchanges, the Investment Manager may also invest in unquoted securities with the prior approval of the Board.

Performance is measured against an appropriate benchmark, the Numis Smaller Companies plus AIM (excluding Investment Companies) Index.

The Investment Manager has adopted a consistent investment process, focusing on good quality growth companies that are trading well; stock selection is the primary focus but consideration is also given to sector weightings and underlying themes. Whilst there are no set limits on individual sector exposures against the Company's benchmark, a schedule of sector weightings is presented at each Board meeting for review.

In applying the investment objective, the Investment Manager expects the Company to be fully invested and to borrow as and when appropriate. The Company seeks to achieve an appropriate spread of investment risk by investing in a number of holdings across a range of sectors.

The Company may not hold more than 5% of the share capital of any company in which it has an investment. In addition, while the Company may hold shares in other listed investment companies (including investment trusts) the Board has agreed that the Company will not invest more than 15% of its total assets in other UK listed investment companies.

The Investment Manager will not deal in derivatives without the prior approval of the Board and derivative instruments, such as options and futures contracts, have not been used during the year.

### GEARING POLICY

The Investment Manager believes that gearing can add value over the long term. The Company currently has £15 million of debenture stock in issue, a £25 million multi-currency revolving loan facility with Scotia Bank (Ireland) Limited and a bank overdraft facility of £20 million with Bank of New York Mellon ("BNYM").

The benefits of gearing are discussed and the effective level agreed with the Board regularly. It is intended that gearing will not exceed 15% of the net assets of the Company at the time of the drawdown of the relevant borrowings and at the balance sheet date stood at 8.2% of net assets. Under normal operating circumstances, it is envisaged that gearing will fall in a range between 0%-15% of net assets.

### PORTFOLIO ANALYSIS

A detailed analysis of the portfolio has been provided on pages 12 to 14.

### PERFORMANCE

In the year to 28 February 2014, the Company's NAV increased by 36.8% compared with a rise of 24.2% in the benchmark (the Numis Smaller Companies plus AIM (excluding Investment Companies) Index). The Company's ordinary share price rose by 44.9% (all percentages calculated in sterling terms and without income reinvested).

The Investment Manager's Report on pages 7 to 9 includes a review of the main developments during the year, together with information on investment activity within the Company's portfolio.

### Results and dividends

The results for the Company are set out in the Income Statement on page 39. The total profit for the year, after taxation, was £132,223,000 (2013: £52,740,000) which was comprised of revenue return of £6,987,000 (2013: £5,520,000), and a capital return of £125,236,000 (2013: £47,220,000).

The Company's revenue return amounted to 14.59p per share (2013: 11.53p).

The Directors recommend the payment of a final dividend of 7.40p per share (2013: 6.50p per share) which, together with the interim dividend of 4.60p per share (2013: 3.50p per share), makes a total of 12.00p per share in respect of the year ended 28 February 2014 (2013: 10.00p per share). The dividend will be paid on 17 June 2014 to shareholders on the register of members at the close of business on 16 May 2014. The cost of the final dividend amounts to £3,543,000 (2013: £3,112,000).

### Key performance indicators

At each Board meeting, the Directors consider a number of performance measures to assess the Company's success in achieving its objectives. Amongst others, the key performance indicators ("KPIs") used to measure the progress and performance of the Company over time and which are comparable to those reported by other investment trusts are set out below.

| | 2014 | 2013 |
|---|---|---|
| Net asset value (debenture at par) | 985.47p | 720.42p |
| Net asset value (debenture at fair value) | 978.01p | 715.37p |
| Net asset value (debenture at par value, capital only) | 975.48p | 712.39p |
| Share price | 908.00p | 626.50p |
| Total return performance | 38.7% | 18.1% |
| Discount to NAV with debenture at fair value | 7.2% | 12.4% |
| Revenue return per share | 14.59p | 11.53p |
| Ongoing charges[1] | 0.7% | 0.6% |
| Ongoing charges (including performance fees) | 1.0% | 1.0% |

1. Calculated as a percentage of average shareholders' funds and using expenses, excluding finance costs, performance fees and taxation in accordance with AIC guidelines.

Sources: BlackRock and Datastream.

Additionally, the Board regularly reviews a number of indices and ratios to understand the impact on the Company's relative performance of the various components such as asset allocation and stock selection. The Board also reviews the performance and ongoing charges of the Company against a peer group of UK smaller companies trusts and open ended funds.

The Directors recognise that it is in the long term interests of shareholders that shares do not trade at a significant discount to their prevailing net asset value. During the year the shares traded between a premium of 0.1% and a discount of 15.6%, ending the year at 7.2% (based on NAV with debt at fair value).

Your Board believes that the best way of addressing the discount over the long term is to create demand for the shares in the secondary market. To this end your Investment Manager is devoting considerable effort to broadening the awareness of the Company's outstanding attractions particularly to wealth managers and to the wider retail shareholder market. Over the last three years, the number of shares held by retail shareholders has increased from 20% to nearly 46%.

### PRINCIPAL RISKS

The key risks faced by the Company are set out below. The Board regularly reviews and agrees policies for managing each risk, as summarised below.

- Performance risk – The Board is responsible for deciding the investment strategy to fulfil the Company's objectives and monitoring the performance of the Investment Manager. An inappropriate strategy may lead to underperformance against the benchmark index. To manage this risk the Investment Manager provides an explanation of significant stock selection decisions and the rationale for the composition of the investment portfolio. The Board monitors and mandates an adequate spread of investments, in order to minimise the risks associated with factors specific to particular sectors and based on the diversification requirements inherent in the Company's investment policy. The Board also receives reports showing an analysis of the Company's performance against the benchmark. Past performance is not necessarily a guide to future performance and the value of your investment in the Company and the income from it can fluctuate as the value of the underlying investments fluctuate.

- Market risk – Market risk arises from volatility in the prices of the Company's investments. It represents the potential loss the Company might suffer through holding investments in the face of negative market movements. The Board considers asset allocation, stock selection and levels of gearing on a regular basis and has set investment restrictions and guidelines which are monitored and reported on by the Investment Manager. The Board monitors the implementation and results of the investment process with the Investment Manager.

- Income/dividend risk – The amount of dividends and future dividend growth will depend on the Company's underlying portfolio. Any change in the tax treatment of the dividends or interest received by the Company may reduce the level of dividends received by shareholders. The Board monitors this risk through the receipt of detailed income forecasts and considers the level of income at each meeting.

- Regulatory risk – The Company operates as an investment trust in accordance with Chapter 4 of Part 24 of the Corporation Tax Act 2010. As such, the Company is exempt from capital gains tax on the profits realised from the sale of its investments. The Investment Manager monitors investment movements, the level and type of forecast income and expenditure and the amount of proposed dividends to ensure that the provisions of Chapter 4 of Part 24 of the Corporation Tax Act 2010 are not breached and the results are reported to the Board.

  The Company must also comply with the provisions of the Companies Act 2006 and, as its shares are admitted to the Official List, the UKLA Listing Rules, the Disclosure and Transparency Rules and the Prospectus Rules. A breach of the Companies Act 2006 could result in the Company and/or the Directors being fined or the subject of criminal proceedings. A breach of the UKLA Listing Rules could result in the Company's shares being suspended from listing, which in turn would breach the requirements of Chapter 4 of Part 24 of the Corporation Tax Act 2010. The Board relies on the services of its professional advisers and its corporate Company Secretary to ensure compliance with all relevant regulations. The Company Secretary has stringent compliance procedures in place and monitors regulatory developments and changes.

- Operational risk – In common with most other investment trust companies, the Company has no employees. The Company therefore relies upon the services provided by third parties and is dependent on the control systems of the Investment Manager and the Company's other service providers. The security, for example, of the Company's assets, dealing procedures, accounting records and maintenance of regulatory and legal requirements, depend on the effective operation of these systems. These are regularly tested and monitored and an internal control report, which includes an assessment of risks together with procedures to mitigate such risks, is prepared by the Investment Manager and reviewed by the Audit Committee twice a year. The custodian (The Bank of New York Mellon (International) Ltd ("BNYM"), a subsidiary of The Bank of New York Mellon) and the Investment Manager also produce regular Service Organisation Reports (SOC 01) or AAF 01/06 Reports which are reviewed by their respective auditors and give assurance regarding the effective operation of controls and are also reviewed by the Audit Committee.

- Financial risks – The Company's investment activities expose it to a variety of financial risks that include market price risk, currency risk, interest rate risk, liquidity risk and credit risk. Further details are disclosed in note 18 on pages 52 to 56, together with a summary of the policies for managing these risks.

## FUTURE PROSPECTS

The Board's main focus is to achieve long term capital growth. The future performance of the Company is dependent upon the success of the investment strategy and, to a large extent, on the performance of financial markets. The outlook for the Company in the next twelve months is discussed in the Chairman's Statement on page 6 and the Investment Manager's Report on page 9.

## SOCIAL, COMMUNITY AND HUMAN RIGHTS ISSUES

As an investment trust, the Company has no direct social or community responsibilities. However, the Directors believe that it is in shareholders' interests to consider human rights issues, environmental, social and governance factors when selecting and retaining investments. Details of the Company's policy on socially responsible investment are set out on page 32.

## DIRECTORS AND EMPLOYEES AND GENDER REPRESENTATION

The Directors of the Company on 28 February 2014, all of whom held office throughout the year, are set out in the Directors' biographies on page 18. The Board consists of 3 male Directors and 2 female Directors.

The Company does not have any employees.

The information set out on pages 7 to 17 including the Investment Manager's Report, forms part of the Strategic Report.

The Strategic Report was approved by the Board at its meeting on 25 April 2014.

## BY ORDER OF THE BOARD

**BLACKROCK INVESTMENT MANAGEMENT (UK) LIMITED**
Company Secretary
25 April 2014

# Governance

## Directors

Nicholas Fry (Chairman) was appointed to the Board in January 2005 and became Chairman of the Company in June 2012. He is a non-executive director of Pochin's PLC and Chairman of Pembroke Heritage Fund Limited. After qualification as a chartered accountant, he spent much of his career in investment banking, for many years with S.G. Warburg & Co. Limited (now part of UBS AG). He was a partner in KPMG between 1998 and 2002 and senior adviser to KPMG Corporate Finance until March 2005. He brings to the Board a wide experience of City matters, with particular emphasis on banking and professional services, and experience as a non-executive director of listed and unlisted smaller companies since 2005.

Caroline Burton was appointed to the Board in July 2011. She is a non-executive director of TR Property Investment Trust plc and Liverpool Victoria and a member of the appointments committee of the Hermes Property Unit Trust. She has almost forty years of investment experience across a wide range of asset classes and geographies acting with a variety of different types of investor. She has been involved with investment trusts for many years, as well as with insurance companies, wealth managers and pension funds.

Gillian Nott (Senior Independent Director) was appointed to the Board in January 2005. She is chairman of Witan Pacific Investment Trust plc and a non-executive director of Martin Currie Global Portfolio Investment Trust plc, JP Morgan Russian Securities plc and Baronsmead VCT 2, VCT 3 and VCT 5 plc. After a career working and investing in predominantly smaller companies, albeit within large corporations, she moved to run ProShare, an organisation committed to lobbying on behalf of private investors and educating the public about personal finance. She was previously on the Board of the FSA and was until December 2013 a Deputy Chairman of the Association of Investment Companies. She thus brings to the Board an understanding of the Trust's investment universe as well as a strong background in regulatory matters and the retail investment market.

Michael Peacock (Chairman of the Audit Committee) was appointed to the Board in July 2012. He is a non-executive director and chairman of the audit committee of Regenersis plc. A qualified chartered accountant, he has over 19 years' experience in a number of senior roles in industry, most recently as group finance director of Victrex plc until his retirement in 2010. He also spent a number of years in corporate finance, first at Hill Samuel & Co Limited and between 1987 and 1990 at Barclays De Zoete Wedd Limited.

Robert Robertson was appointed to the Board in April 2008. He is a director of Lowland Investment Company plc and a number of private companies. He was previously chairman of West China Cement Limited and chief executive of Tarmac Group Limited and Anglo American's Industrial Minerals division. His early career was in finance, working in London, Paris, Johannesburg, New York and Rio de Janeiro. He brings almost forty years' experience in industry, a considerable amount of which being with smaller companies.

All of the Directors are independent of the management company and are members of the Audit Committee, the Nomination Committee and the Management Engagement Committee.

# Directors' report

The Directors present the Annual Report and Financial Statements of the Company for the year ended 28 February 2014.

## STATUS OF THE COMPANY

In the opinion of the Directors, the Company has conducted its affairs during the year under review, and subsequently, so as to qualify as an investment trust for the purposes of Chapter 4 of Part 24 of the Corporation Tax Act 2010. The Company has received approval from HM Revenue & Customs ("HMRC") on the basis of an application under Regulation 5 of the Investment Trust (Approved Company) (Tax) Regulations 2011 for investment trust status for accounting periods starting on or after 1 January 2012. This is subject to the Company continuing to meet the eligibility conditions in section 1158 of the Corporation Tax Act 2010 and the ongoing requirements for approved companies in Chapter 3 of Part 2 of the Investment Trust (Approved Company) (Tax) Regulations 2011.

The Company was incorporated in Scotland on 2 May 1906 under the registered number 006176 and is domiciled in the United Kingdom. The Company is registered as an investment company as defined in section 833 of the Companies Act 2006 and operates as such. The Company is not a close company within the meaning of the provisions of the Corporation Tax Act 2010.

The Company's shares are eligible for inclusion in the stocks and shares component of an Individual Savings Account.

## FACILITATING RETAIL INVESTMENTS

The Company currently conducts its affairs so that, as an investment trust, the shares issued by the Company can be recommended by independent financial advisers to ordinary retail investors in accordance with the FCA's rules in relation to non-mainstream investment products and intends to continue to do so for the foreseeable future.

In the context of the implementation of RDR and the growing popularity of investment trusts on platforms, it is worth noting that the Company's shares are designed for private investors in the UK including retail investors, professionally-advised private clients and institutional investors who seek long term capital growth and an attractive total return from quoted securities through investing in smaller UK quoted companies and who understand and are willing to accept the risks of exposure to equities. When assessing the suitability of the shares, private investors should also consider consulting an independent financial adviser who specialises in advising on the acquisition of shares and other securities before acquiring shares. Naturally, investors should also be capable of evaluating the risks and merits of an investment in the Company and should always have sufficient resources to bear any loss that may result.

## FUTURE PROSPECTS

Commentary on future prospects for the Company is set out in both the Chairman's Statement on page 6 and the Investment Manager's Report on page 9.

## DIVIDENDS

Details of the dividends payable in respect of the year are set out in the Strategic Report on pages 15 and 16.

## INVESTMENT MANAGEMENT AND ADMINISTRATION

BlackRock Investment Management (UK) Limited ("BIM UK") provides management and administration services to the Company under a contract terminable on six months' notice. BlackRock receives an annual fee of 0.65% in respect of the first £50 million of the Company's total assets less current liabilities, reducing to 0.5% thereafter. A performance fee is payable at the rate of 10% of the annualised excess performance relative to the benchmark in the two previous financial years, applied to the average of the total assets less current liabilities of the Company. The fee is payable annually in April and is capped at 0.25% of the average of the total assets less current liabilities.

No penalty on termination of the investment management contract would be payable by the Company in the event that six months' written notice is given to BIM UK. There are no provisions relating to payment of fees in lieu of notice.

The Company contributes to a sales and marketing initiative operated by BlackRock on behalf of the investment trusts under its management, which commenced on 1 November 2013. The Company's contribution represents 0.03% (excluding VAT) per annum of its net assets of £416m as at 31 October 2013 (approximately £150,000 including VAT). The contribution in the year ended 28 February 2014 amounted to £50,000 (including VAT).

BIM UK also acts as the Secretary of the Company.

With effect from 22 July 2014, the Company is required under AIFMD to appoint an authorised AIFM to manage the Company's portfolio. The AIFM is responsible for ensuring that the requirements of the Directive are met in respect of the Alternative Investment Funds (AIFs) that it manages, including appropriate mitigation and monitoring of risk and liquidity, implementation of robust risk management systems and reporting to regulatory authorities. The Company has decided in principle that BlackRock Fund Managers Limited ("BFM") will be appointed as AIFM with effect from 22 July 2014 and at this point it is envisaged that the investment management and administration services will transfer from BIM UK to BFM. The Board is confident that this will not have any material impact on the commercial terms of the management agreement or the level of professional indemnity provided or result in any significant change to the day to day administration of the Company's management and administration services.

Both BIM UK and BFM are subsidiaries of BlackRock, Inc. which is a publicly traded corporation on the New York Stock Exchange operating as an independent firm. The PNC Financial Services Group, Inc. has a significant economic interest in BlackRock, Inc. PNC Financial Services Group, Inc. is a US public company.

BNYM is the custodian of the Company's assets. The BNYM fee is payable at rates depending on the number of trades effected and location of securities held. The custodian agreement is subject to 30 days' notice of termination by either party.

Under AIFMD, the Company will also be required to appoint a Depositary. The Company intends to appoint BNYM in this role with effect from 1 July 2014. The role of the Depositary under AIFMD is to act as a central custodian with additional duties to monitor the operations of the Company, including monitoring cash flows and ensuring that the Company's assets are valued appropriately in accordance with the relevant regulations and guidance.

### APPOINTMENT OF THE INVESTMENT MANAGER

The Board considers the arrangements for the provision of investment management services to the Company on an ongoing basis and a formal review is conducted annually. The Board believes that the continuing appointment of the Investment Manager, on the terms as previously disclosed, is in the interests of shareholders as a whole.

As part of the annual review the Board considered the quality and continuity of the personnel assigned to handle the Company's affairs, the investment process and the results achieved to date. In the Board's view, the investment remit is best served by the BlackRock UK Smaller Companies Team, as manager of some of the best performing UK equity funds specialising in small and mid cap investments.

### CHANGE OF CONTROL

There are no agreements which the Company is party to that might be affected by a change of control of the Company.

### EXERCISE OF VOTING RIGHTS IN INVESTEE COMPANIES

The exercise of voting rights attached to the Company's portfolio has been delegated to the Investment Manager, whose voting policy is set out below.

BlackRock's approach to voting at shareholder meetings, engagement with companies and corporate governance is framed within an investment context.  BlackRock believes that sound corporate governance practices by companies contribute to their long term financial performance and thus to better risk-adjusted returns.  BlackRock's proxy voting process is led by our Corporate Governance and Responsible Investment team, located in five offices around the world. In addition to its own professional staff, the Corporate Governance and Responsible Investment team draws upon the expertise of BlackRock's portfolio managers, researchers and other internal and external resources globally.

BlackRock's global corporate governance and engagement principles are published on the website blackrock.com/corporate/en-gb/about-us/responsible-investment/responsible-investment-reports. The principles set out BlackRock's views on the overarching features of corporate governance that apply in all markets.  For each region, BlackRock also publish market-specific policies, which are updated every year to ensure they remain relevant.

The voting guidelines are principles-based and not prescriptive because BlackRock believes that each voting situation needs to be assessed on its merits. Voting decisions are taken to support the outcome that BlackRock believes its professional judgment will best protect the economic interests of its clients.

During the year under review, the Investment Manager voted on 2,058 proposals at 181 general meetings on behalf of the Company. At these meetings the Investment Manager voted in favour of most resolutions, as should be expected when investing in well run companies, but voted against 25 management resolutions and abstained from voting on 22 resolutions. Most of the votes against were in respect of resolutions to approve a poorly structured remuneration package or on capital raising requests which would have significantly diluted existing shareholders.

### PRINCIPAL RISKS

The key risks faced by the Company are set out In the Strategic Report on pages 15 to 17.

### GOING CONCERN

The Directors, having considered the nature and liquidity of the portfolio, the Company's investment objective and the Company's projected income and expenditure, are satisfied that the Company has adequate resources to continue in operational existence for the foreseeable future and is financially sound. For this reason, they continue to adopt the going concern basis in preparing the financial statements. The Company is able to meet all of its liabilities from its assets and income generated from these assets and the ongoing expenses (excluding performance fees, finance costs and taxation) are approximately 0.7% of net assets. Ongoing expenses with performance fees included were 1.0% of net assets for the year end 28 February 2014, and as the performance fee is capped at 0.25% of total assets less current liabilities, ongoing charges calculated on this basis are not likely to significantly exceed this going forward.

### DIRECTORS

Biographies of the Directors are detailed on page 18. The Directors of the Company as at 28 February 2014 are set out in the Directors' Remuneration Report on pages 25 to 28 together with their interests in the ordinary shares of the Company. All of the Directors held office throughout the year under review.

The Company's Articles of Association provide that one third of Directors retire by rotation each year and that each Director shall retire and offer himself/herself for re-election at intervals of no more than three years.

Mr Robertson will retire by rotation in accordance with the Company's Articles of Association. Mr Fry and Mrs Nott, who have served on the Board for more than nine years, will also retire at the forthcoming Annual General Meeting and seek re-election. The Board has considered the position of the Directors, as part of the evaluation process, and believes that it would be in the Company's best interests for them to be proposed for re-election, given their material level of contribution.

There were no contracts subsisting during or at the end of the year in which a Director of the Company is or was materially interested and which is or was significant in relation to the Company's business.

## DIRECTORS' INDEMNITY

In addition to Directors' and Officers' liability insurance cover, the Company's Articles of Association provide, subject to the provisions of applicable UK legislation, an indemnity for Directors in respect of costs incurred in the defence of any proceedings brought against them by third parties arising out of their positions as Directors, in which they are acquitted or judgement is given in their favour. The Company has entered into Deeds of Indemnity with Directors individually which are available for inspection at the registered office of the Company and will be available at the Annual General Meeting.

## CONFLICTS OF INTEREST

The Company's Articles of Association reflect the codification of certain directors' duties arising from the Companies Act 2006 and in particular the duty of Directors to avoid conflicts of interests.

The Board has put in place a framework for Directors to report conflicts of interest or potential conflicts of interest which it believes has worked effectively during the year. All Directors notified the Company Secretary of any situations where they considered that they had a direct or indirect interest, or duty that conflicted or possibly conflicted, with the interests of the Company. All such situations were reviewed by the Board and duly authorised. Directors were also made aware that there remains a continuing obligation to notify the Company Secretary of any new situation that may arise, or any change to a situation previously notified. It is the Board's intention to continue to review all notified situations on an annual basis.

## GLOBAL GREENHOUSE GAS EMISSIONS FOR THE PERIOD 1 MARCH 2013 TO 28 FEBRUARY 2014

The Company has no greenhouse gas emissions to report from its operations, nor does it have responsibility for any other emissions producing sources under the Companies Act 2006 (Strategic Report and Directors' Reports) Regulations 2013.

## DIRECTORS' REMUNERATION REPORT

The Directors' Remuneration Report is set out on pages 25 to 28. Ordinary resolutions to approve this report and to approve the remuneration policy as set out in the future policy table on page 26 will be put to shareholders at the forthcoming Annual General Meeting. Further details are given on pages 22 to 24.

## SUBSTANTIAL SHARE INTERESTS

As at 28 February 2014, the Company had received notification of the following interests in 3% or more of the voting rights attaching to the Company's issued share capital.

| | Holding | % |
|---|---|---|
| BlackRock, Inc.* | 7,644,318 | 16.0 |
| Derbyshire County Council | 2,385,000 | 5.0 |
| Lloyds Banking Group plc | 2,376,286 | 5.0 |
| East Riding of Yorkshire Council | 2,177,000 | 4.5 |
| Royal London Asset Management Limited | 2,114,724 | 4.4 |
| Investec Wealth & Investment Ltd | 2,053,115 | 4.3 |

* Including 2,445,795 shares held by BlackRock Institutional Funds (The Dynamic Diversified Growth Fund) representing 5.1% of the Company's issued share capital. The remainder of BlackRock Inc.'s holding represents shareholdings of investment vehicles managed by members of the BlackRock Group and discretionary managed money, none of which exceed 3% of the Company's issued share capital on an individual fund basis.

The Board is also aware that 0.9% of the Company's share capital is held through the BlackRock Investment Trusts Savings Plan and ISA.

As at 22 April 2014, the Company had received notification of the following interests in 3% or more of the voting rights attaching to the Company's issued share capital.

## Directors' report continued

| | Holding | % |
|---|---|---|
| BlackRock, Inc.* | 7,644,318 | 16.0 |
| Derbyshire County Council | 2,385,000 | 5.0 |
| East Riding of Yorkshire Council | 2,177,000 | 4.5 |
| Royal London Asset Management Limited | 2,114,724 | 4.4 |
| Investec Wealth & Investment Ltd | 2,053,115 | 4.3 |

* Including 2,445,795 shares held by BlackRock Institutional Funds (The Dynamic Diversified Growth Fund) representing 5.1% of the Company's issued share capital. The remainder of BlackRock Inc.'s holding represents shareholdings of investment vehicles managed by members of the BlackRock Group and discretionary managed money, none of which exceed 3% of the Company's issued share capital on an individual fund basis.

The Board is also aware that 0.9% of the Company's share capital is held through the BlackRock Investment Trusts Savings Plan and ISA.

### SHARE CAPITAL AND SHARE REPURCHASES

Full details of the Company's share capital are given in note 15 on page 51. Details of the voting rights in the Company's shares as at the date of this report are given in note 17 to the Notice of Annual General Meeting on page 67. There are no restrictions on the voting rights of the shares or on the transfer of shares, and there are no shares that carry specific rights with regard to the control of the Company.

No shares were purchased during the year. At 28 February 2014, the Company's issued share capital was 47,879,792 ordinary shares, excluding 2,113,731 shares held in treasury. The latest authority to repurchase ordinary shares was granted to Directors on 26 June 2013 and expires on 10 June 2014. The Directors are proposing that their authority to buy back shares be renewed at the forthcoming Annual General Meeting.

### TREASURY SHARES

The Board has determined that up to 10% of the Company's issued shares may be held in treasury and may be subsequently cancelled or sold for cash in the market. This would give the Company the ability to reissue shares quickly and cost efficiently, thereby improving liquidity and providing the Company with additional flexibility in the management of its capital base.

The Board currently intends only to authorise the sale of shares from treasury at or above the prevailing net asset value per share (plus costs of the relevant sale). This should result in a positive overall effect on shareholders if shares are bought back at a discount and then sold at a price at or above the net asset value per share (less costs of the relevant sale).

In the interests of all shareholders, the Board will continue to keep the matter of treasury shares under review.

### ANNUAL GENERAL MEETING

**The following information to be discussed at the forthcoming Annual General Meeting is important and requires your immediate attention. If you are in any doubt about the action you should take, you should seek advice from your stockbroker, bank manager, solicitor, accountant or other financial adviser authorised under the Financial Services and Markets Act 2000 (as amended).**

**If you have sold or transferred all of your ordinary shares in the Company, you should pass this document, together with any other accompanying documents, including the form of proxy, at once to the purchaser or transferee, or to the stockbroker, bank or other agent through whom the sale or transfer was effected, for onward transmission to the purchaser or transferee.**

Following the publication of final remuneration disclosure regulations effective from 1 October 2013 and in accordance with the Enterprise & Regulatory Reform Act, the Company's remuneration policy will be subject to a triennial binding shareholder vote. The rest of the Directors' remuneration report will continue to be subject to an annual advisory vote. These resolutions are included as items of ordinary business and are included as Resolution 2 and Resolution 3 in the Notice of Annual General Meeting on pages 64 to 67 of the Annual Report and Financial Statements.

Resolutions relating to the following items of special business will be proposed at the forthcoming Annual General Meeting.

#### Resolution 10 Directors' Remuneration:

At present, Article 35(1) which deals with Directors' remuneration, sets an aggregate limit of £150,000 per annum on Directors' fees. The Board is proposing as an ordinary resolution that the aggregate limit on Directors' fees be increased to £200,000 per annum. This will provide for an overlap of Directors upon retirement and replacement in accordance with the Company's succession plan. The increase in the aggregate limit would also facilitate any future increase in Directors' fees to reflect market trends and to ensure that the remuneration of the Directors is sufficient to attract and retain Directors with suitable knowledge and experience. Full details of the fees paid to Directors are set out in the Directors' Remuneration Report on pages 25 to 28.

#### Resolution 11 Authority to allot shares

The Directors may only allot shares for cash if authorised to do so by shareholders in general meeting. This resolution seeks authority for the Directors to allot shares for cash up to an aggregate nominal amount of £1,196,994 which is equivalent to 4,787,976 ordinary shares of 25p each and represents 10% of the current issued share capital excluding treasury shares. The Directors will use this authority when it is in the best interests of the Company to issue shares for cash. This authority will expire at the conclusion of next year's Annual General Meeting, unless renewed prior to that date at an earlier general meeting.

### Resolution 12 Authority to disapply pre-emption rights

By law, directors require specific authority from shareholders before allotting new shares or selling shares out of treasury for cash without first offering them to existing shareholders in proportion to their holdings.

Resolution 12 empowers the Directors to allot new shares for cash or to sell shares which are held by the Company in treasury, otherwise than to existing shareholders on a pro rata basis, up to an aggregate nominal amount of £1,196,994 which is equivalent to 4,787,976 ordinary shares of 25p each and 10% of the Company's issued ordinary share capital excluding treasury shares. Unless renewed at a general meeting prior to such time, this authority will expire at the conclusion of the Annual General Meeting of the Company to be held in 2015.

### Resolution 13 Authority to buy back shares

The resolution to be proposed will seek to renew the authority granted to Directors enabling the Company to purchase its own shares. The Directors will only consider repurchasing shares in the market if they believe it to be in shareholders' interests and as a means of correcting any imbalance between supply and demand for the Company's shares.

Under the Listing Rules of the FCA, the maximum price which can be paid is the higher of (i) 5% above the average market value of the ordinary shares for the five business days immediately preceding the date on which the purchase is made and (ii) the higher of the price quoted for (a) the last independent trade of, and (b) the highest current independent bid for, any number of ordinary shares on the trading venue where the purchase is carried out. In making purchases, the Company will deal only with member firms of the London Stock Exchange. The Directors are seeking authority to purchase up to 7,177,180 ordinary shares (being 14.99% of the issued share capital excluding treasury shares). This authority, unless renewed at an earlier general meeting, will expire at the conclusion of next year's Annual General Meeting in 2015.

### Resolution 14 Amendment to the Articles of Association

Regulations implementing the Alternative Investment Fund Managers Directive ("AIFMD Regulations") came into force in the UK on 22 July 2013. The Board is proposing to make amendments to the Articles of Association in response to the AIFMD Regulations coming into force.

The principal changes proposed to be introduced in the Articles of Association, and their effect, are set out below.

- The Articles of Association will now provide that the net asset value of the Company shall be calculated at least annually and be disclosed to shareholders from time to time in such manner as may be determined by the Board. The amendment will have no bearing on current practice and simply articulates the minimum requirements of the AIFMD Regulations.

- The Articles of Association will now provide that the Company's Annual Report and Financial Statements may be prepared either in accordance with generally acceptable accounting principles of the UK or such other international accounting standards as may be permitted under the law of the UK. The amendment will have no bearing on current practice and simply articulates the minimum requirements of the AIFMD Regulations.

- The AIFMD Regulations require that prior to any new or existing investor making an investment in the Company certain prescribed information is to be made available to them. Therefore, the Articles of Association will include language with the effect that such information shall be made available to prospective and existing shareholders from time to time in such manner as may be determined by the Board (including, in certain cases, on the Company's website or by electronic notice).

- The AIFMD Regulations require that the Company has a depositary. Under the AIFMD Regulations, the depositary has strict liability for the loss of the Company's financial assets in respect of which it has safe-keeping duties. This rule applies even where the depositary has delegated the actual custody of an asset to another entity. The Company may wish to hold assets in a country where the depositary is required by local law to use a local sub-custodian to hold the relevant asset. The depositary may not wish the Company to acquire or retain such an asset, unless it can discharge its strict liability to the local sub-custodian. A discharge of strict liability in these circumstances will only be possible if the Company's rules or instruments of incorporation (for example, the Articles of Association) permit such a discharge. The Board is cognisant that situations may arise where allowing the depositary to discharge its strict liability will be commercially necessary. An amendment to the Articles of Association is therefore proposed with the effect of enabling the Board, should the need arise and subject to applicable laws, to allow a depositary to discharge its strict liability for loss of certain of the Company's assets. This proposed amendment provides the Company with commercial flexibility and the Board will exercise its discretion in the usual way in determining whether or not to provide such a discharge.

In line with early guidance from the FCA, the Articles of Association will now provide that appropriate procedures shall be put in place for the valuation of the Company's assets in accordance with applicable laws. The full terms of the proposed amendments to the Articles of Association will be available for inspection from the date of this report until the close of the forthcoming Annual General Meeting at 12 Throgmorton Avenue, London EC2N 2DL. The full terms of the proposed amendments to the Articles of Association will also be available for inspection at the place of the forthcoming AGM for at least 15 minutes before and during that AGM.

# Directors' report continued

## RECOMMENDATION

As each of the Directors has an interest in resolution 10, the Board does not believe it is appropriate to make a recommendation to shareholders in relation to voting in respect of that resolution. The Board considers that each of the other resolutions is likely to promote the success of the Company and is in the best interests of the Company and its shareholders as a whole. The Directors unanimously recommend that you vote in favour of the resolutions as they intend to do in respect of their own beneficial holdings.

## CORPORATE GOVERNANCE

Full details are given in the Corporate Governance Statement on pages 29 to 32. The Corporate Governance Statement forms part of this Directors' Report.

## AUDIT INFORMATION

As required by section 418 of the Companies Act 2006 the Directors who held office at the date of this report each confirm that, so far as they are aware, there is no relevant audit information of which the Company's auditor is unaware and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

## INDEPENDENT AUDITOR

The auditor, Scott-Moncrieff, has indicated their willingness to continue in office and resolutions proposing their reappointment and authorising the Directors to determine their remuneration for the ensuing year will be submitted at the Annual General Meeting.

The Directors' Report was approved by the Board at its meeting on 25 April 2014.

## BY ORDER OF THE BOARD

**BLACKROCK INVESTMENT MANAGEMENT (UK) LIMITED**
Company Secretary
25 April 2014

# Governance

## Directors' remuneration report

The Board presents the Directors' Remuneration Report for the year ended 28 February 2014 which has been prepared in accordance with the requirements of sections 420-422 of the Companies Act 2006. In addition, following the publication by the Department for Business, Innovation and Skills ("BIS") of final remuneration disclosure regulations effective from 1 October 2013, the report now comprises a policy report, which is subject to a triennial binding shareholder vote, and a remuneration policy implementation report, which will be subject to an annual advisory vote. The future remuneration policy which is subject to a binding vote is set out in the future policy table on page 26.

The law requires the Company's independent auditor to audit certain parts of the disclosures provided. Where disclosures have been audited, they are indicated as such. The auditor's opinion is included in their report on pages 37 and 38.

### STATEMENT BY THE CHAIRMAN

The Board's policy on remuneration is set out in the future policy table on page 26. A key element is that fees payable to Directors should be sufficient to attract and retain individuals with suitable knowledge and experience.

Following a review on 18 March 2014 and with effect from 1 March 2014, the remuneration of the Chairman was increased to £36,000, the Chairman of the Audit Committee increased to £27,000 and the other Directors increased to £24,000. Prior to this increase, the remuneration was last increased on 1 March 2013. The basis for determining the level of increase in Directors' remuneration is set out in the policy report below.

### REMUNERATION COMMITTEE

The Board as a whole fulfils the function of the Remuneration Committee and considers any change in the Directors' remuneration policy. The Board is of the opinion that a Remuneration Committee is not appropriate for a Company of this size and nature and a separate Committee has therefore not been established. The Company's Directors are all non-executive and are independent of the Investment Manager.

No advice or services were provided by any external agencies or third parties.

### POLICY REPORT

In determining Directors' fees, a number of factors are considered, including the time commitment required, the level of skills and appropriate experience required, and the need for Directors to maintain on an on-going basis an appropriate level of knowledge of regulatory and compliance requirements in an industry environment of increasing complexity. The Board also considers the average rate of inflation during the period since the last fee increase, and reviews the level of remuneration in comparison with other investment trusts of a similar size and/or mandate as well as taking account of any data published by the Association of Investment Companies to ensure that fees are in line with industry practice. This comparison, together with consideration of any alteration in non-executive Directors' responsibilities, is used to review whether any change in remuneration is necessary. The review is performed on an annual basis.

The Company has no employees and consequently no consideration is required to be given to employment conditions elsewhere in setting Directors' fees.

No element of the Directors' remuneration is performance related. The Company has not awarded any share options or long term performance incentives to any of the Directors. None of the Directors has a service contract with the Company or receives any non cash benefits or pension entitlements. The terms of their appointment are detailed in a letter sent to them when they join the Board. These letters are available for inspection at BlackRock's offices at, 12 Throgmorton Avenue, London EC2N 2DL and will be available at the AGM.

### FUTURE POLICY TABLE

| | | |
|---|---|---|
| | Purpose and link to strategy | Fees payable to Directors should be sufficient to attract and retain individuals of high calibre with suitable knowledge and experience. Those chairing the Board and key Committees should be paid higher fees than other Directors in recognition of their more demanding roles. Fees should reflect the time spent by Directors on the Company's affairs and the level of complexity of responsibilities borne by the Directors. |
| | Description | Current levels of fixed annual fee:<br>Chairman – £36,000<br>Audit Committee Chairman – £27,000<br>Directors – £24,000<br>All reasonable expenses to be reimbursed. |
| | Maximum levels | Remuneration consists of a fixed fee each year, set in accordance with the stated policies and any increase granted must be in line with the stated policies.<br>The Company's Articles of Association set a limit of £150,000 per annum in respect of the fees that may be paid to Directors in any financial year. The Directors are proposing an amendment to the Company's Articles of Association to increase this to £200,000 with effect from 10 June 2014. In addition, the Directors propose a limit of £50,000 per annum in relation to the maximum that may be paid in respect of taxable benefits. These ceilings have been set at a level to provide flexibility in respect of the recruitment of additional Board members and inflation. |
| Operation | Fixed fee element | The Board reviews the quantum of Directors' fees each year to ensure that this is appropriate in view of the time commitment required, the level of skills and appropriate experience required, and the need for Directors to maintain on an on-going basis an appropriate level of knowledge of regulatory and compliance requirements in an industry environment of increasing complexity. The average rate of inflation during the period since the last fee increase will also be considered as well as the level of remuneration in comparison with other investment trusts of a similar size and/or mandate. This comparison, together with consideration of any alteration in non-executive level of Directors' remuneration for other investment trusts of a similar size. There is no compensation for loss of office. |
| | Taxable benefits | Taxable benefits comprise travel and subsistence expenses incurred by the Directors in the course of travel to attend Board and Committee meetings which are held at BlackRock's offices in London, and which are reimbursed by the Company and therefore treated as a benefit in kind and are subject to tax and national insurance. The Company's policy in respect of this element of remuneration is that all reasonable costs of this nature will be reimbursed as they are incurred. |

### CONSIDERATION OF SHAREHOLDERS' VIEWS

An ordinary resolution to approve the remuneration report is put to members at each AGM, and shareholders have the opportunity to express their views and raise any queries in respect of remuneration policy at this meeting. To date, no shareholders have commented in respect of the remuneration policy.

In accordance with recent changes to the Companies Act 2006, the Company is required to seek shareholder approval for its remuneration policy. Consequently, an ordinary resolution for the approval of the remuneration policy as set out above in the future policy table will be put to shareholders at the forthcoming AGM. It is the intention of the Board that the above policy on remuneration will take effect from the date of the AGM and will continue to apply for the next three financial years.

This will be the first year that a binding vote is put to shareholders in respect of the Company's remuneration policy. In previous years, the remuneration report has been subject to an advisory vote by shareholders. At the Company's previous AGM, held on 26 June 2013, 99.58% of votes cast were in favour of the resolution to approve the Directors' remuneration report in respect of the year ended 28 February 2014.

## REMUNERATION IMPLEMENTATION REPORT

A single figure for the total remuneration of each Director is set out in the table below for the years ended 28 February 2014 and 28 February 2013:

| | 2014 Fees £ | 2013 Fees £ | 2014 Taxable benefits £ | 2013 Taxable benefits £ | 2014 Total £ | 2013 Total £ |
|---|---|---|---|---|---|---|
| Nicholas Fry (Chairman) | 32,250 | 28,773 | 1,521 | – | 33,771 | 28,773 |
| Richard Brewster[1] | n/a | 10,400 | n/a | 178 | n/a | 10,578 |
| Caroline Burton | 21,500 | 20,800 | – | – | 21,500 | 20,800 |
| Gillian Nott[2] | 21,500 | 20,800 | – | – | 21,500 | 20,800 |
| Michael Peacock[3] | 24,750 | 15,947 | 2,034 | 772 | 26,784 | 16,719 |
| Robert Robertson | 21,500 | 20,800 | 637 | – | 22,137 | 20,800 |
| Total | 121,500 | 117,520 | 4,192 | 950 | 125,692 | 118,470 |

1. Retired on 27 June 2012.
2. Senior Independent Director.
3. Audit Committee Chairman. Appointed on 1 July 2012.

The information in the above table has been audited. The amounts paid by the Company to the Directors were for services as non-executive Directors.

As at 28 February 2014, there were no amounts outstanding to Directors in respect of their annual fees (28 February 2013: nil).

As the Company has no employees, the table above also comprises the total remuneration costs and benefits paid by the Company. To enable shareholders to assess the relative importance of spend on pay, this has been shown in the table below compared with the Company's total revenue, total operating expenses and dividend distributions.

## RELATIVE IMPORTANCE OF SPEND ON DIRECTORS' REMUNERATION

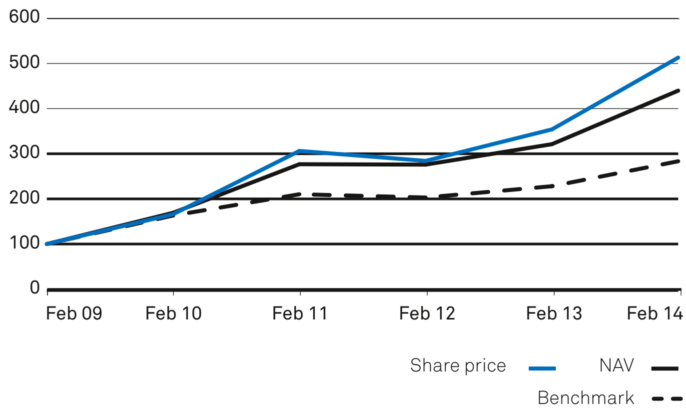
| | 2014 £'000 | 2013 £'000 | Change £'000 |
|---|---|---|---|
| Directors' total remuneration | 126 | 118 | +8 |
| Dividends paid and payable | 5,626 | 4,788 | +838 |
| Total revenue | 8,460 | 6,705 | +1,755 |
| Operating expenses (including management and performance fees) | 3,900 | 2,929 | +971 |

No payments were made in the period to any past Directors (2013: nil).

## PERFORMANCE

The line graph which follows compares the Company's net asset value (with income reinvested) and share price total return with the total return on an equivalent investment in the Numis Smaller Companies plus AIM (excluding Investment Companies) Index (formerly the Hoare Govett Smaller Companies plus AIM (excluding Investment Companies) Index) from 1 September 2007. This composite index was selected for comparison purposes, as it was the Company's benchmark used for investment performance measurement purposes.

### TOTAL SHAREHOLDER RETURN FROM 1 MARCH 2009 TO 28 FEBRUARY 2014




Sources: BlackRock and Datastream.

# Directors' remuneration report continued

## SHAREHOLDINGS

The Board has not adopted a policy that Directors are required to own shares in the Company.

The interests of the Directors in the ordinary shares of the Company are set out in the tables below. The Company does not have a share option scheme therefore none of the Directors has an interest in share options. All of the Directors held office throughout the year under review.

| | Ordinary shares | |
|---|---|---|
| | 28 February 2014 | 28 February 2013 |
| Caroline Burton | 3,000 | 3,000 |
| Nicholas Fry | 40,000 | 40,000 |
| Gillian Nott | 11,500 | 11,500 |
| Michael Peacock | 1,000 | – |
| Robert Robertson | 80,062 | 83,571 |

All of the holdings of the Directors are beneficial. No changes to these holdings had been notified up to the date of this report.

The information in the above tables has been audited.

## RETIREMENT OF DIRECTORS

All of the Company's Directors are subject to retirement by rotation in accordance with the Company's Articles of Association. Directors are appointed for an initial term covering the period from the date of their appointment until the first AGM thereafter, at which time they are required to stand for election in accordance with the Articles of Association. Subsequently, Directors retire by rotation at least every three years. Any Director who is not considered to be independent of the Investment Manager or who has served on the Board for more than nine years will be subject to annual re-election.

## BY ORDER OF THE BOARD

**BLACKROCK INVESTMENT MANAGEMENT (UK) LIMITED**
Company Secretary
25 April 2014

# Governance

## Corporate governance statement

### CHAIRMAN'S INTRODUCTION

Corporate Governance is the process by which the Board seeks to look after shareholders' interests and protect and enhance shareholder value. Shareholders hold the Directors responsible for the stewardship of the Company, delegating authority and responsibility to the Directors to manage the Company on their behalf and holding them accountable for its performance.

The Board is ultimately responsible for framing and executing the Company's strategy and for closely monitoring risks. We aim to run our Company in a manner which is responsible and consistent with our belief in honesty, transparency and accountability. In our view, good governance means managing our business well and engaging effectively with investors. We consider the practice of good governance to be an integral part of the way we manage the Company and we are committed to maintaining high standards of financial reporting, transparency and business integrity.

As a UK-listed investment trust company our principal reporting obligation is driven by the UK Corporate Governance Code (the "UK Code") issued by the Financial Reporting Council ("FRC") in September 2012. However, as listed investment trust companies differ in many ways from other listed companies, the Association of Investment Companies has drawn up its own set of guidelines, the AIC Code of Corporate Governance (the "AIC Code") issued in February 2013, which addresses the governance issues relevant to investment companies and has been approved by the FRC.

The UK Code is available from the Financial Reporting Council's website at frc.org.uk. The AIC Code is available from the Association of Investment Companies at theaic.co.uk.

This report, which forms part of the Directors' Report, explains how the Board deals with its responsibility in respect of Corporate Governance.

### CORPORATE GOVERNANCE COMPLIANCE STATEMENT

The Board has made the appropriate disclosures in this report to ensure the Company meets its continuing obligations. It should be noted that as an investment trust, most of the Company's day-to-day responsibilities are delegated to third parties, the Company has no employees and the Directors are non-executive. Thus, not all of the provisions of the UK Code are directly applicable to the Company.

The Board considers that the Company has complied with the recommendations of the AIC Code and the provisions contained within the UK Code that are relevant to the Company throughout this accounting period, and this statement describes how the principles of governance are applied to the Company.

### THE BOARD

#### Board composition

The Board currently consists of five non-executive Directors, all of whom are independent of the Company's Investment Manager. The provision of the UK Code which relates to the combination of the roles of the chairman and the chief executive does not apply as the Company does not have a chief executive. The Directors' biographies, set out on page 18, demonstrate a breadth of investment, commercial and professional experience which enables them to provide effective strategic leadership and proper governance of the Company. Mrs Nott is the Senior Independent Director.

#### Board independence and tenure

The Board's individual independence, including that of the Chairman, has been considered, and this independence allows all of the Directors to sit on the Company's various Committees. The Board is of the view that length of service will not necessarily 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. It is considered that all the Company's Directors continued to be independent in both character and judgement and that there are no relationships or circumstances likely to affect the judgement of any Director.

The Company does not have a chief executive as day-to-day management of the Company's affairs is delegated to the Investment Manager. None of the Directors has a service contract with the Company. The terms of their appointment are detailed in a letter sent to them when they join the Board. These letters are available for inspection at the offices of BlackRock Investment Management (UK) Limited, 12 Throgmorton Avenue, London EC2N 2DL and will be available at the AGM.

#### Directors' appointment, retirement and rotation

The Directors retire by rotation at every third Annual General Meeting and any Directors appointed to the Board since the previous Annual General Meeting also retire and stand for election. Any Director who is not considered by the Board to be independent of the Investment Manager or who has served on the Board for more than nine years will be subject to annual re-election. The Directors support a planned and progressive renewing of the Board.

#### Directors' training and induction

When a new Director is appointed to the Board, he or she is provided with all relevant information regarding the Company and their duties and responsibilities as a Director. In addition, a new Director will also spend some time with representatives of the Investment Manager whereby he or she will become familiar with the various processes which the Investment Manager considers necessary for the performance of its duties and responsibilities to the Company. The Company's policy is to encourage Directors to keep up to date and attend training courses on matters which are directly relevant to their involvement with the Company. The Directors also receive regular briefings from, amongst others, the auditor and the Company Secretary regarding any proposed developments or changes in laws or regulations that could affect the Company and/or the Directors.

### Directors' liability insurance

The Company has maintained appropriate Directors' Liability Insurance cover throughout the year.

## BOARD'S RESPONSIBILITIES

The Board meets at least five times each year and may have additional dedicated meetings to consider strategy and other issues. Between these meetings there is regular contact with the Investment Manager.

The Board is responsible to shareholders for the overall management of the Company. It decides upon matters relating to the Company's investment objective, policy and strategy and monitors the Company's performance towards achieving that objective through its agreed policy and strategy. The Board has also adopted a schedule of matters reserved for its decision.

The Board is supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. Strategic issues and all operational matters of a material nature are determined by the Board.

The Directors also have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are followed and that it complies with applicable rules and regulations. Where necessary, in the furtherance of their duties, the Directors may seek independent professional advice at the expense of the Company.

The Board has responsibility for ensuring that the Company keeps adequate accounting records which disclose with reasonable accuracy at any time the financial position of the Company and which enable it to ensure that the financial statements comply with the Companies Act 2006. It is the Board's responsibility to present a balanced and understandable assessment, which extends to interim and other price-sensitive public reports.

The Board is also responsible for safeguarding the assets of the Company and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## PERFORMANCE EVALUATION

The Board formally reviews its performance on an annual basis, together with that of its Committees. This encompasses both quantitative and qualitative measures of performance in respect of the Board and its Committees. This year, the review was carried out at the end of 2013/beginning of 2014 by way of the completion of an evaluation survey and a subsequent review of the findings. The appraisal of the Chairman follows the same process and is carried out by the Board as a whole under the leadership of the Senior Independent Director in the absence of the Chairman.

The appraisal process is considered by the Board to be constructive in terms of identifying areas for improving the functioning and performance of the Board and the Committees and the contribution of individual Directors, as well as building on and developing individual and collective strengths. There were no significant actions arising from the evaluation process.

Following the formal evaluation the Chairman is pleased to confirm that each of the Directors continues to be effective and to demonstrate commitment to the role (including time for Board and Committee meetings and any other duties).

Mrs Nott, as Senior Independent Director, is pleased to confirm that, following the formal evaluation, the Chairman also continues to be effective and to demonstrate commitment to the role (including time for Board and Committee meetings and any other duties).

## DELEGATION OF RESPONSIBILITIES

The Board has delegated the following areas of responsibility:

### Management and administration

The management of the investment portfolio and the administration of the Company have been delegated to the Investment Manager. The Investment Manager, operating under guidelines determined by the Board, has direct responsibility for decisions relating to the day to day running of the Company and is accountable to the Board for the investment, financial and operating performance of the Company. Custody and settlement services are provided by BNYM, a subsidiary of The Bank of New York Mellon.

The Board has delegated the exercise of voting rights attaching to the securities held in the portfolio to the Investment Manager. Details of the Investment Manager's voting policy are set out on page 20.

### Committees of the Board

#### Nomination Committee

As the Board is small, and all the Directors are non-executive, it fulfils the function of the Nomination Committee and meets when necessary to select and propose suitable candidates for appointment. The Committee deals with all matters relating to appointments to, and retirements from, the Board of Directors. In this context it applies a process whereby the optimum size, balance and profile of the Board is determined and potential candidates are identified, appraised and appointed.

Appointments of new Directors will be made on a formalised basis, with the Committee agreeing the selection criteria and the method of selection, recruitment and appointment. The services of an external search consultant may be used to identify potential candidates.

The Board's policy on diversity, including gender, is to take this factor into account during the recruitment process. However, the Board is committed to appointing the most appropriate candidates, regardless of gender or other forms of diversity. Therefore, no target has been set against which to report.

### Audit Committee

The Audit Committee, which is chaired by Mr Peacock, consists of all the Directors of the Company. Further details are provided in the Report of the Audit Committee on pages 33 to 35.

### Remuneration Committee

Remuneration of the Chairman and Directors is determined by the Board. It is not considered necessary to have a separate Remuneration Committee, as the Directors are not employed by and are not former employees of the Investment Manager.

### Management Engagement Committee

There is a Management Engagement Committee, comprising all the Directors of the Company which is chaired by Mr Fry. The Committee meets at least once a year to consider the remuneration of the Investment Manager and to review the terms of the investment management and administration contracts.

## ATTENDANCE AT BOARD AND COMMITTEE MEETINGS

The number of full scheduled Board meetings and Committee meetings attended by each Director during the year was as follows:

| | Board | Audit Committee | Nomination Committee | Management Engagement Committee |
|---|---|---|---|---|
| Number of Meetings held | 6 | 3 | 1 | 1 |
| Number of Meetings attended: | | | | |
| Nicholas Fry | 6 | 3 | 1 | 1 |
| Caroline Burton | 6 | 3 | 1 | 1 |
| Gillian Nott | 5 | 2 | 1 | 1 |
| Michael Peacock | 6 | 3 | 1 | 1 |
| Robert Robertson | 6 | 3 | 1 | 1 |

## INTERNAL CONTROLS

The Board is responsible for establishing and maintaining the Company's control systems and for reviewing their effectiveness, for ensuring that financial information published or used within the business is reliable, and for regularly monitoring compliance with regulations governing the operation of investment trusts. The Board reviews the effectiveness of the internal control systems on an ongoing basis to identify, evaluate and manage the Company's significant risks. As part of that process, there are procedures designed to capture and evaluate any failings or weaknesses. Should a case be categorised by the Board as significant, procedures exist to ensure that necessary action is taken to remedy the failings. The Board is not aware of any significant failings or weaknesses in the year.

Control of the risks identified, covering financial, operational, compliance and risk management, is embedded in the operations of the Investment Manager and BNYM. There is a monitoring and reporting process to review these controls, which has been in place throughout the year under review and up to the date of this report, carried out by the Investment Manager's corporate audit department. This accords with the FRC's "Internal Control: Revised Guidance for Directors on the UK Corporate Governance Code".

The Investment Manager reports to the Company on its review of internal controls, formally on a semi-annual basis and verbally at each Board and Audit Committee meeting, and provides an annual report from the Investment Manager's reporting accountants on the control policies and procedures in operation. The Audit Committee also receives semi-annual reports from BNYM on the internal controls of its custodial operations, together with the opinion of the reporting accountants.

The Board recognises that these control systems can only be designed to manage rather than eliminate the risk of failure to achieve business objectives, and to provide reasonable, but not absolute, assurance against material misstatement or loss, and relies on the operating controls established by the Investment Manager and BNYM.

The Investment Manager prepares revenue forecasts and management accounts which allow the Board to assess the Company's activities and review its performance.

The Board and the Investment Manager have agreed clearly defined investment criteria, specified levels of authority and exposure limits. Reports on these issues, including performance statistics and investment valuations, are submitted to the Board at each meeting.

The Company does not have its own internal audit function, as all the administration is delegated to the Investment Manager. The Board monitors the controls in place through the Investment Manager's internal audit department and feels that there is currently no need for the Company to have its own internal audit function although this matter is kept under review.

## FINANCIAL REPORTING

The Statement of Directors' Responsibilities in respect of the Financial Statements is set out on page 36, the Independent Auditor's Report on pages 37 and 38, and the statement of going concern on page 20.

### SOCIALLY RESPONSIBLE INVESTMENT

The Company invests mainly in smaller UK quoted companies. The Board aims to be a socially responsible investor and believes that it is important to invest in companies whose boards act responsibly in respect of environmental, ethical and social issues. BlackRock's evaluation procedure and financial analysis of the companies within the portfolio includes research and appraisal of such matters, and also takes into account environmental policies and other business issues.

BlackRock's policies on socially responsible investment and Corporate Governance are detailed on the website blackrock.com/corporate/en-gb/about-us. The Investment Manager is supportive of the UK Stewardship Code, which is voluntary and operates on a "comply or explain basis".

### BRIBERY PREVENTION POLICY

The provision of bribes of any nature to third parties in order to gain a commercial advantage is prohibited and is a criminal offence. The Board has a zero tolerance policy towards bribery and a commitment to carry out business fairly, honestly and openly. The Board takes its responsibility to prevent bribery by the Company's Investment Manager on its behalf very seriously and BlackRock has anti-bribery policies and procedures in place which are high level, proportionate and risk based. The Company's service providers have been contacted in respect of their anti-bribery policies and, where necessary, contractual changes are made to existing agreements in respect of anti-bribery provisions.

### COMMUNICATION WITH SHAREHOLDERS

All shareholders have the opportunity to attend and vote at the Annual General Meeting. The Notice of Annual General Meeting which is sent out 20 working days in advance of the meeting sets out the business of the meeting and any item not of an entirely routine nature is explained in the Directors' Report on pages 22 and 23. Separate resolutions are proposed for substantive issues.

Shareholders are updated on performance through the publication of the interim and annual reports and the Investment Manager reviews the Company's activities at the Annual General Meeting, where the Chairman of the Board and the Chairman of the Audit Committee and representatives of the Investment Manager are available to answer shareholders' queries. Proxy voting figures are announced to shareholders at the Annual General Meeting and will be made available on the Investment Manager's website shortly after the meeting.

The Company's willingness to enter into discussions with institutional shareholders is also demonstrated by the programmes of institutional presentations made by the Investment Manager, following the release of each set of Company results. The Board discusses with the Investment Manager at each Board meeting any feedback from meetings with shareholders, and it also receives reports from its corporate broker.

There is a section within this Annual Report and Financial Statements entitled "Shareholder Information", on pages 60 to 62, which provides an overview of useful information available to shareholders.

The Company's accounts, regular factsheets and other information are also published on blackrock.co.uk/brsc which is the website maintained by the Company's Investment Manager, BlackRock Investment Management (UK) Limited. The work undertaken by the auditor does not involve consideration of the maintenance and integrity of the website and, accordingly, the auditor accepts no responsibility for any changes that have occurred to the accounts 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 accounts may differ from legislation in their jurisdiction.

### DISCLOSURE AND TRANSPARENCY RULES

Other information required to be disclosed pursuant to the Disclosure and Transparency Rules has been placed in the Directors' Report on pages 19 to 24 because it is information which refers to events that have taken place during the course of the year. The disclosures in respect of DTR 7.2.5 in respect of internal controls are set out on page 31.

### FOR AND ON BEHALF OF THE BOARD

**NICHOLAS FRY**
Chairman
25 April 2014

# Governance

## Report of the audit committee

### ROLE AND RESPONSIBILITIES

The Company has a separately chaired Audit Committee whose duties include considering and recommending to the Board for approval the contents of the half yearly and annual financial statements, and providing an opinion as to whether the Annual Report and Financial Statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy. The Committee also reviews the external auditor's report on the annual financial statements and is responsible for reviewing and forming an opinion on the effectiveness of the external audit process and audit quality. Other duties include reviewing the appropriateness of the Company's accounting policies and ensuring the adequacy of the internal control systems and standards. The Audit Committee operates within written terms of reference detailing its scope and duties and these are available on the website at blackrock.co.uk/brsc.

The Audit Committee meets at least three times a year. Two of the planned meetings are held prior to the Board meetings to approve the half yearly and annual results. The third meeting focuses on the audit plan, internal controls and assessment of fraud. The Audit Committee receives information from the Investment Manger's internal audit and compliance departments on a regular basis.

### COMPOSITION

The Audit Committee comprises all the Directors including the Chairman of the Company; all of whom, including the Chairman of the Committee, have recent and relevant financial experience from their senior management roles. The biographies of the Directors may be found on page 18.

### RESPONSIBILITIES AND REVIEW OF THE EXTERNAL AUDIT

During the year the principal activities of the Audit Committee included:

- considering and recommending to the Board for approval the contents of the half yearly and annual financial statements and reviewing the external auditor's report thereon;
- reviewing the scope, execution, results, cost effectiveness, independence and objectivity of the external auditor;
- reviewing and recommending to the Board for approval the audit and non-audit fees payable to the external auditor and the terms of their engagement;
- reviewing and approving the external auditor's plan for the financial year, with a focus on the identification of areas of audit risk, and consideration of the appropriateness of the level of audit materiality adopted;
- reviewing the role of the Board, the Investment Manager and third party service providers in an effective audit process;
- reviewing the efficiency of the external audit process and the quality of the audit engagement partner and the audit team, and making a recommendation to the Board with respect to the reappointment of the auditor;
- considering the quality of the formal audit report to shareholders;
- reviewing the appropriateness of the Company's accounting policies; and
- ensuring the adequacy of the internal control systems and standards.

The fees paid to the external auditor are set out in note 5 on page 46.

The Committee has also reviewed and accepted the 'whistleblowing' policy that has been put in place by the Investment Manager under which its staff, in confidence, can raise concerns about possible improprieties in matters of financial reporting or other matters, in so far as they affect the Company.

### SIGNIFICANT ISSUES CONSIDERED REGARDING THE ANNUAL REPORT AND FINANCIAL STATEMENTS

During the year, the Audit Committee considered the significant issues and areas of key audit risk in respect of the Annual Report and Financial Statements. The Audit Committee reviewed the external audit plan at an early stage and concluded that the appropriate areas of audit risk relevant to the Company had been identified and that suitable audit procedures had been put in place to obtain reasonable assurance that the financial statements as a whole would be free of material misstatements. The table on page 34 sets out the key areas of risk identified and also explains how these were addressed.

| Significant issue | How the issue was addressed |
|---|---|
| The accuracy of the valuation of the investment portfolio | Listed investments are valued using stock exchange prices provided by third party pricing vendors, Unquoted or illiquid investments, if any, are valued by the Directors based on recommendations from BlackRock's Pricing Committee. The Board reviews detailed portfolio valuations at each of its Board meetings and receives confirmation from the Investment Manager that the pricing basis is appropriate, in line with relevant accounting standards as adopted by the Company and that the carrying values are materially correct. The Board also relies on the Investment Manager's and Fund Accountant's controls which are documented in a semi-annual internal controls report which is reviewed by the Audit Committee. |
| The risk of misappropriation of assets and unsecured ownership of investments | The Audit Committee reviews reports from its service providers on key controls over the assets of the Company. Any significant issues are reported by the Investment Manager to the Audit Committee. The Investment Manager has put in place procedures to ensure that investments can only be made to the extent that the appropriate contractual and legal arrangements are in place to protect the Company's assets. |
| The accuracy of the calculation of the management fee and performance fee | The management and performance fees are calculated in accordance with the contractual terms in the investment management agreement by the administrator and are reviewed in detail by the Investment Manager and are also subject to an analytical review by the Board. The audit also includes checks on the calculation of the management fee and performance fee to ensure that they are correctly calculated. |
| The risk that income is overstated, incomplete or inaccurate through failure to recognise proper income entitlements or to apply the appropriate accounting treatment for recognition of income | The Board reviews income forecasts, including special dividends, and receives explanations from the Investment Manager for any variations or significant movements from previous forecasts and prior year figures. |

As the provision of portfolio valuation, fund accounting and administration services is delegated to the Company's Investment Manager, BlackRock, who sub-delegate fund accounting to a third party service provider and the provision of custody services is contracted to BNYM, the Audit Committee has also reviewed the Service Organisation Control Reports (SOC 01) and Audit and Assurance Faculty (AAF) reports prepared by the Investment Manager, Custodian and Fund Accountants to ensure that the relevant control procedures are in place to cover these areas of risk as identified above and are adequate and appropriate and have been designated as operating effectively by the reporting accountants.

### AUDITOR AND AUDIT TENURE

The Company's current auditor, Scott-Moncrieff has acted in this role for more than twenty years. As the Company is not in the FTSE 350 there is no requirement for the contract to be put out to tender on a ten year basis; however the Audit Committee review the performance of the auditor on a regular basis, taking into consideration the services and advice provided to the Company and the fees charged for these services. The last formal tender for audit services was conducted in 2008, and following presentations and interviews with a number of audit firms, it was agreed that Scott-Moncrieff as the incumbent should continue as the Company's auditor. The audit partner changes at least every five years. On the basis of the auditor's performance the Audit Committee has recommended their continuing appointment to the Board. EU Audit Reform proposals are currently under consideration. If these proposals are approved it is expected that the Committee will need to adhere to mandatory rotation of the Auditor. The Audit Committee also considers the risks associated with audit firms withdrawing from the market and the relationship with the Company's auditor.

There are no contractual obligations that restrict the Company's choice of auditor. The Audit Committee monitors the level of non-audit work carried out by the auditor and seeks assurances from the auditor that they maintain suitable policies and processes ensuring independence and monitors compliance with the relevant regulatory requirements on an annual basis. The Company operates on the basis whereby the provision of non-audit services by the auditor is permissible where no conflict of interest arises, where the independence of the auditor is not likely to be impinged by undertaking the work and the quality and objectivity of both the non-audit work and audit work will not be compromised. The only non-audit work carried out during the year was the review of the half-yearly financial statements and also the auditors review of the debenture certificate. Fees paid in respect of these services were £5,125 (excluding VAT) (2013: £5,125).

The auditor has indicated their willingness to continue in office and resolutions proposing their reappointment and authorising the Directors to determine their remuneration for the ensuing year will be proposed at the AGM.

### ASSESSMENT OF THE EFFICACY OF THE EXTERNAL AUDIT PROCESS

To assess the effectiveness of the external audit, members of the Audit Committee work closely with BlackRock to obtain a good understanding of the progress and efficiency of the audit. The Audit Committee has adopted a framework in its review of the effectiveness of the external audit process and audit quality. This includes a review of the following areas:

- The quality of the audit engagement partner and the audit team;
- The expertise of the audit firm and the resources available to it;

- Identification of areas of audit risk;
- Planning, scope and execution of the audit;
- Consideration of the appropriateness of the level of audit materiality adopted;
- The role of the Board, the Investment Manager and third party service providers in an effective audit process;
- Communications by the auditor with the Audit Committee;
- How the auditor supports the work of the Audit Committee and how the audit contributes added value;
- A review of independence and objectivity of the audit firm; and
- The quality of the formal audit report to shareholders.

Feedback in relation to the audit process and the efficacy of the Investment Manager in performing their role is also sought from relevant involved parties, notably the audit partner and team. The external auditor is invited to attend the Audit Committee meetings at which semi-annual and annual financial statements are considered and at which they have the opportunity to meet with the Audit Committee without representatives of the Investment Manager being present.

The effectiveness of the Board and the Investment Manager in the external audit process is assessed principally in relation to the timely identification and resolution of any process errors or control breaches that might impact the Company's NAVs and accounting records. It is also assessed by reference to how successfully any issues in respect of areas of accounting judgement are identified and resolved, the quality and timeliness of papers analysing these judgements, the Board and the Investment Manager's approach to the value of independent audit and the booking of any audit adjustments arising and the timely provision of draft public documents for review by the auditor and the Audit Committee.

To form a conclusion with regard to the independence of the external auditor, the Audit Committee considers whether the skills and experience of the auditor make them a suitable supplier of any non audit services and whether there are safeguards in place to ensure that there is no threat to their objectivity and independence in the conduct of the audit resulting from the provision of any such services. On an annual basis, Scott-Moncrieff review the independence of their relationship with the Company and report to the Audit Committee, providing details of any other relationship with the Investment Manager. As part of this review, the Audit Committee also receives information about policies and processes for maintaining independence and monitoring compliance with relevant requirements from the Company's auditor, including information on the rotation of audit partners and staff, the level of fees that the Company pays in proportion to the overall fee income of the firm, and the level of related fees, details of any relationships between the audit firm and its staff and the Company as well as an overall confirmation from the auditor of their independence and objectivity. As a result of their review, the Audit Committee has concluded that Scott-Moncrieff is independent of the Company and the Investment Manager.

## CONCLUSIONS IN RESPECT OF THE ANNUAL REPORT AND FINANCIAL STATEMENTS

The production and the audit of the Company's Annual Report and Financial Statements is a comprehensive process requiring input from a number of different contributors. One of the key governance requirements of the Company's Annual Report and Financial Statements is that they are fair, balanced and understandable. The Board has requested that the Audit Committee advise on whether it considers that the Annual Report and Financial Statements fulfils these requirements, and that the Audit Committee has given consideration to the following:

- The comprehensive documentation that is in place setting out the controls over the production of the Annual Report and Financial Statements, including the verification processes in place to deal with the factual content;
- The comprehensive reviews that are undertaken at different levels in the production process of the Annual Report and Financial Statements, by the Investment Manager, the third party service providers responsible for accounting services and the Audit Committee that aim to ensure consistency and overall balance;
- The controls that are in place at the Investment Manager and third party service providers to ensure the completeness and accuracy of the Company's financial records and the security of the Company's assets;
- The existence of satisfactory control reports that have been reviewed and reported on by external auditors to verify the effectiveness of the internal controls of the Investment Manager and the Company's third party service providers (Service Organisation Control (SOC 01) reports and Audit and Assurance Faculty (AAF) reports).

As a result of the work performed, the Committee has concluded that the Annual Report and Financial Statements for the year ended 28 February 2014, taken as a whole, are fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy and has reported on these findings to the Board. The Board's conclusions in this respect are set out in the Statement of Directors' Responsibilities on page 36.

**MICHAEL PEACOCK**
Chairman
Audit Committee
25 April 2014

# Governance

## Statement of directors' responsibilities

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the net return or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

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

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

The Directors have delegated responsibility to the Investment Manager for the maintenance and integrity of the Company's corporate and financial information included on the Investment Manager's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors consider that the Annual Report and Financial Statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

Each of the Directors, whose names and functions are listed on page 18 confirm that, to the best of their knowledge:

- the financial statements, which have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), give a true and fair view of the assets, liabilities, financial position and net return of the Company; and
- the Strategic Report contained in the Annual Report and Financial Statements includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that it faces.

**FOR AND ON BEHALF OF THE BOARD OF DIRECTORS**
**NICHOLAS FRY**
Chairman
25 April 2014

# Financial statements

## Independent auditor's report to the members of BlackRock Smaller Companies Trust plc

We have audited the financial statements of BlackRock Smaller Companies Trust plc for the year ended 28 February 2014, which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement the Reconciliation of Movements in Shareholders' Funds and the related notes. 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 Company's members as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an 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 Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITOR

As explained more fully in the Statement of Directors' Responsibilities on page 36, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit 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

A description of the scope of an audit of financial statements is provided at the Financial Reporting Council's website at frc.org.uk/apb/scope/private.cfm.

### OPINION ON FINANCIAL STATEMENTS

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 28 February 2014 and of its return for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepting Accounting Practice; and
- have been prepared in accordance with the Companies Act 2006.

### OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

We identified the following risks that we believe have the greatest impact on the audit strategy:

- Investment portfolio valuation;
- Accuracy of fees;
- Revenue recognition; and
- Misappropriation of Company assets.

### OUR APPLICATION OF MATERIALITY

We apply the concept of materiality in planning and performing our audit, and in evaluating the effect of misstatements on our audit and on the financial statements. For the purposes of determining whether the financial statements are free from material misstatement we define materiality as the level of error that would change the opinion of the reader of the financial statements

When establishing our overall audit strategy, we determined the level of uncorrected misstatement that would be material for the financial statements as a whole to be £4,700,000, which is 1% of net assets (net assets being a key performance indicator for investors in the Company).

Materiality for revenue transactions was determined to be £47,000, as we believe readers of the financial statements will be more sensitive to variances in the revenue account.

We agreed with the Audit Committee that we would report to them individual and extrapolated errors in excess of a threshold of £20,000, as well as differences below that threshold that we believe warranted reporting on qualitative grounds.

### AN OVERVIEW OF THE SCOPE OF OUR AUDIT

The way in which we scoped our audit in order to address the assessed risks of material misstatement was as follows:

#### Investment portfolio valuation

The holdings and valuations of all investments were reconciled to the custodian report. A sample of year end valuations were agreed to appropriate external sources.

#### Accuracy of fees

The management fee and performance fee were recalculated, to ensure that they were accurate and is calculated in accordance with the terms of the investment management agreement.

#### Revenue recognition

The income recorded for a sample of securities was checked to appropriate external sources. We paid particular attention to any special dividends and their accounting treatment.

# Financial statements

## Independent auditor's report continued

A sample of investment disposals was agreed to contract notes to ensure these were correctly recorded.

### Misappropriation of Company assets

We reviewed the accounting records for any significant transactions that were outside the normal course of business.

The Audit Committee's consideration of these risks is set out on pages 33 and 34.

### OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the Strategic Report and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the Corporate Governance Statement in compliance with rules 7.2.5 and 7.2.6 in the Disclosure and Transparency rules sourcebook issued by the Financial Conduct Authority (information about internal control and risk management systems in relation to financial reporting processes and share capital structure) is consistent with the financial statements.

### MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following:

Under the International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Company acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the Annual Report and Financial Statements is fair, balanced and understandable and whether the Annual Report and Financial Statements appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

Under the Listing Rules we are required to review:

- the Directors' statement on page 20 in relation to going concern; and
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the Corporate Governance Code specified for our review; and
- certain elements of the report to the shareholders by the Board on Directors' remuneration.

**Gareth Magee (Senior Statutory Auditor)**
For and on behalf of Scott-Moncrieff,
Statutory Auditor
Exchange Place 3
Semple Street
Edinburgh
EH3 8BL
25 April 2014

# Financial statements

## Income statement for the year ended 28 February 2014

| | Notes | Revenue 2014 | Revenue 2013 | Capital 2014 | Capital 2013 | Total 2014 | Total 2013 |
|---|---|---|---|---|---|---|---|
| | | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Gains on investments held at fair value through profit or loss | 10 | – | – | 129,276 | 50,439 | 129,276 | 50,439 |
| Exchange losses | | – | – | 1 | (1) | 1 | (1) |
| Income from investments held at fair value through profit or loss | 3 | 8,460 | 6,697 | – | – | 8,460 | 6,697 |
| Other income | 3 | – | 8 | – | – | – | 8 |
| Investment management and performance fees | 4 | (574) | (418) | (2,837) | (2,114) | (3,411) | (2,532) |
| Other operating expenses | 5(a) | (492) | (397) | – | – | (492) | (397) |
| **Net return before finance costs and taxation** | | 7,394 | 5,890 | 126,440 | 48,324 | 133,834 | 54,214 |
| Finance costs | 6 | (402) | (368) | (1,204) | (1,104) | (1,606) | (1,472) |
| **Net return on ordinary activities before taxation** | | 6,992 | 5,522 | 125,236 | 47,220 | 132,228 | 52,742 |
| Taxation on ordinary activities | 7 | (5) | (2) | – | – | (5) | (2) |
| **Net return on ordinary activities after taxation** | 9 | 6,987 | 5,520 | 125,236 | 47,220 | 132,223 | 52,740 |
| **Return per ordinary share** | 9 | 14.59p | 11.53p | 261.56p | 98.62p | 276.15p | 110.15p |

The total column of this statement represents the Profit and Loss Account of the Company.

The supplementary revenue and capital columns are both prepared under guidance published by the Association of Investment Companies ("AIC"). The Company had no recognised gains or losses other than those disclosed in the Income Statement. All items in the above statement derive from continuing operations. All income is attributable to the equity holders of BlackRock Smaller Companies Trust plc.

The notes on pages 43 to 56 form part of these financial statements.

# Financial statements

## Reconciliation of movements in shareholders' funds for the year ended 28 February 2014

| | Note | Called-up share capital | Share premium account | Capital redemption reserve | Capital reserves | Revenue reserve | Total |
|---|---|---|---|---|---|---|---|
| | | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| For the year ended 28 February 2013 | | | | | | | |
| At 29 February 2012 | | 12,498 | 38,952 | 1,982 | 233,770 | 9,531 | 296,733 |
| Return for the year | | – | – | – | 47,220 | 5,520 | 52,740 |
| Dividends paid (see (a) below) | 8 | – | – | – | – | (4,539) | (4,539) |
| At 28 February 2013 | | 12,498 | 38,952 | 1,982 | 280,990 | 10,512 | 344,934 |
| For the year ended 28 February 2014 | | | | | | | |
| At 28 February 2013 | | 12,498 | 38,952 | 1,982 | 280,990 | 10,512 | 344,934 |
| Return for the year | | – | – | – | 125,236 | 6,987 | 132,223 |
| Dividends paid (see (b) below) | 8 | – | – | – | – | (5,314) | (5,314) |
| At 28 February 2014 | | 12,498 | 38,952 | 1,982 | 406,226 | 12,185 | 471,843 |

(a) Final dividend of 5.98p per share for the year ended 29 February 2012, declared on 26 April 2012 and paid on 4 July 2012 and interim dividend of 3.50p per share for the six months ended 31 August 2012, declared on 26 October 2012 and paid on 7 December 2012.
(b) Final dividend of 6.50p per share for the year ended 28 February 2013, declared on 26 April 2013 and paid on 3 July 2013 and interim dividend of 4.60p per share for the six months ended 31 August 2013, declared on 24 October 2013 and paid on 29 November 2013.

The notes on pages 43 to 56 form part of these financial statements.

# Financial statements

## Balance sheet as at 28 February 2014

| | Notes | 2014 | 2013 |
|---|---|---|---|
| | | £'000 | £'000 |
| **Fixed assets** | | | |
| Investments held at fair value through profit or loss | 10 | 510,627 | 379,655 |
| **Current assets** | | | |
| Debtors | 11 | 2,169 | 184 |
| Cash | | 4,187 | – |
| | | 6,356 | 184 |
| **Creditors – amounts falling due within one year** | 13 | (5,263) | (5,042) |
| **Net current assets/(liabilities)** | | 1,093 | (4,858) |
| **Total assets less current liabilities** | | 511,720 | 374,797 |
| **Creditors – amounts falling due after more than one year** | 14 | (39,877) | (29,863) |
| **Net assets** | | 471,843 | 344,934 |
| **Capital and reserves** | | | |
| Called-up share capital | 15 | 12,498 | 12,498 |
| Share premium account | 16 | 38,952 | 38,952 |
| Capital redemption reserve | 16 | 1,982 | 1,982 |
| Capital reserves | 16 | 406,226 | 280,990 |
| Revenue reserve | 16 | 12,185 | 10,512 |
| **Total equity shareholders' funds** | | 471,843 | 344,934 |
| **Net asset value per ordinary share (debenture at par value)** | 17 | 985.47p | 720.42p |
| **Net asset value per ordinary share (debenture at fair value)** | 17 | 978.01p | 715.37p |

The financial statements on pages 39 to 56 were approved and authorised for issue by the Board of Directors on 25 April 2014 and signed on its behalf by Nicholas Fry, Chairman, and Michael Peacock, Director and Audit Committee Chairman.

BlackRock Smaller Companies Trust plc.

Registered in Scotland, No. 6176.

The notes on pages 43 to 56 form part of these financial statements.

# Financial statements

## Cash flow statement for the year ended 28 February 2014

| | Notes | 2014 | 2013 |
|---|---|---|---|
| | | £'000 | £'000 |
| **Net cash inflow from operating activities** | 5(b) | 5,004 | 4,097 |
| **Servicing of finance** | | (1,597) | (1,431) |
| **Taxation** | | | |
| Income tax received | | – | 20 |
| Overseas withholding tax (paid)/received | | (1) | 5 |
| **Total taxation** | | (1) | 25 |
| **Capital expenditure and financial investment** | | | |
| Purchase of investments | | (182,342) | (137,299) |
| Proceeds from sale of investments | | 180,173 | 130,345 |
| **Net cash outflow from capital expenditure and financial investment** | | (2,169) | (6,954) |
| **Financing activities** | | | |
| Equity dividends paid | 8 | (5,314) | (4,539) |
| Inflow from drawdown of revolving loan | | 10,000 | 15,000 |
| **Net cash inflow from financing** | | 4,686 | 10,461 |
| **Increase in cash in the year** | 12(a) | 5,923 | 6,198 |

The notes on pages 43 to 56 form part of these financial statements.

# Notes to the financial statements

## 1. PRINCIPAL ACTIVITY

The principal activity of the Company is that of an investment trust company within the meaning of section 1158 of the Corporation Tax Act 2010.

## 2. ACCOUNTING POLICIES

### (a) Basis of preparation

The Company's financial statements have been prepared on the historical cost basis of accounting, except for investments which are managed and evaluated on a fair value basis, in accordance with the Companies Act 2006, United Kingdom Generally Accepted Accounting Practice ("UK GAAP") and with the Statement of Recommended Practice ("SORP") for investment trusts and venture capital trusts issued by the Association of Investment Companies ("AIC"), revised in January 2009. The principal accounting policies adopted by the Company are set out below. The policies have been applied consistently throughout the year and are consistent with those applied in the preceding year. All of the Company's operations are of a continuing nature.

The Company's financial statements are presented in sterling, which is the currency of the primary economic environment in which the Company operates. All values are rounded to the nearest thousand pounds (£'000) except where otherwise stated.

### (b) Presentation of Income Statement

In order to better reflect the activities of an investment trust company and in accordance with guidance issued by the AIC, supplementary information which analyses the Income Statement between items of a revenue and capital nature has been presented alongside the Income Statement.

### (c) Investments designated as held at fair value through profit or loss

The Company's investments are classified as held at fair value through profit or loss in accordance with FRS 26 – 'Financial instruments: Recognition and Measurement' and are managed and evaluated on a fair value basis in accordance with its investment strategy.

All investments are designated upon initial recognition as held at fair value through profit or loss. The sales of assets are recognised at the trade date of the disposal. Proceeds will be measured at fair value, which will be regarded as the proceeds of sale less any transaction costs.

The fair value of the financial instruments is based on their quoted bid price or last traded price at the balance sheet date on the exchange on which the investment is quoted, without deduction for estimated future selling costs. Unquoted investments are valued by the Directors at fair value using International Private Equity and Venture Capital Valuation Guidelines. This policy applies to all current and non current asset investments of the Company.

Changes in the value of investments held at fair value through profit or loss and gains and losses on disposal are recognised in the Income Statement as "Gains or losses on investments held at fair value through profit or loss". Also included within this heading are transaction costs in relation to the purchase or sale of investments.

In order to improve the disclosure of how companies measure the fair value of their financial investments, the disclosure requirements in FRS 29 have been extended to include a fair value hierarchy. The fair value hierarchy consists of the following three levels:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset or liability

Level 3 – inputs for the asset or liability that are not based on observable market data

This policy applies to non current asset investments held by the Company.

### (d) Segmental reporting

The Directors are of the opinion that the Company is engaged in a single segment of business being investment business.

# Notes to the financial statements continued

## 2. ACCOUNTING POLICIES continued

### (e) Income

Dividends receivable on equity shares are treated as revenue for the year on an ex-dividend basis. Where no ex-dividend date is available, dividends receivable on or before the year end are treated as revenue for the year. Provision is made for any dividends not expected to be received. Fixed returns on non equity securities are recognised on a time apportionment basis. Interest income is accounted for on an accruals basis.

Special dividends are treated as a capital receipt or revenue receipt depending on the facts or circumstances of each particular case.

Dividends are accounted for in accordance with FRS 16 – 'Current Taxation' on the basis of income actually receivable, without adjustment for the tax credit attaching to the dividends. Dividends from overseas companies continue to be shown gross of withholding tax.

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 in the capital column of the Income Statement.

### (f) Expenses

All expenses are accounted for on an accruals basis. Expenses have been treated as revenue except as follows:

- expenses including finance costs which are incidental to the acquisition or disposal of investments are included within the cost of the investments. Details of transaction costs on the purchases and sales of investments are disclosed in note 10 on page 49;
- the investment management fee has been allocated 75% to the capital column and 25% to the revenue column of the Income Statement in line with the Board's expected long term split of returns, in the form of capital gains and income respectively, from the investment portfolio; and
- performance fees have been allocated 100% to the capital column of the Income Statement, as performance has been predominantly generated through capital returns of the investment portfolio.

### (g) Long term borrowings and finance costs

Long term borrowings are carried in the Balance Sheet at amortised cost, representing the cumulative amount of net proceeds on issue plus accrued finance costs. Finance costs are accounted for on an accruals basis. Finance costs are allocated, insofar as they relate to the financing of the Company's investments, 75% to the capital column and 25% to the revenue column of the Income Statement, in line with the Board's expected long term split of returns, in the form of capital gains and income respectively, from the investment portfolio.

### (h) Taxation

Deferred tax is recognised in respect of all temporary differences at the balance sheet date, where transactions or events that result in an obligation to pay more tax in the future or right to pay less tax in the future have occurred at the balance sheet date. Deferred tax is measured on a non-discounted basis, at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. This is subject to deferred tax assets only being recognised if it is considered more likely than not that there will be suitable profits from which the future reversal of the temporary differences can be deducted.

Where expenses are allocated between capital and revenue, any tax relief in respect of the expenses is allocated between capital and revenue returns on the marginal basis using the Company's effective rate of corporation tax for the accounting period.

### (i) Debtors

Debtors are sales for future settlement, other debtors, prepayments and accrued income in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets. Debtors are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

### (j) Creditors
Creditors are purchases for future settlements, interest payable, share buyback costs and accruals in the ordinary course of business. Creditors are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities. Creditors are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

### (k) Dividends payable
Under FRS 21 final dividends should not be accrued in the financial statements unless they have been approved by shareholders before the balance sheet date. Interim and special dividends should not be accrued in the financial statements unless they have been paid.

Dividends payable to equity shareholders are recognised in the Reconciliation of Movements in Shareholders' Funds when they have been approved by shareholders in the case of a final dividend, or paid in the case of an interim dividend, and have become a liability of the Company.

### (l) Cash and cash equivalents
Cash comprises cash in hand and demand deposits. Cash equivalents are short term, highly liquid investments, that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value.

### (m) Going concern
The Directors are satisfied that the Company has adequate resources to continue in operational existence for the foreseeable future and therefore consider the going concern assumption to be appropriate.

## 3. INCOME

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **Investment income:** | | |
| UK listed dividends | 7,115 | 5,955 |
| UK listed dividends – special | 936 | 400 |
| Property income dividends | 145 | 133 |
| Overseas listed dividends | 264 | 209 |
| | 8,460 | 6,697 |
| **Other income:** | | |
| Underwriting commission | – | 8 |
| | – | 8 |
| Total | 8,460 | 6,705 |
| **Total income comprises:** | | |
| Dividends | 8,460 | 6,697 |
| Other income | – | 8 |
| | 8,460 | 6,705 |

## 4. INVESTMENT MANAGEMENT AND PERFORMANCE FEES

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Revenue £'000 | Capital £'000 | Total £'000 | Revenue £'000 | Capital £'000 | Total £'000 |
| Investment management fee | 574 | 1,726 | 2,300 | 418 | 1,254 | 1,672 |
| Performance fee | – | 1,111 | 1,111 | – | 860 | 860 |
| Total | 574 | 2,837 | 3,411 | 418 | 2,114 | 2,532 |

## Notes to the financial statements continued

### 4. INVESTMENT MANAGEMENT AND PERFORMANCE FEES continued

The investment management fee is calculated based on 0.65% in respect of the first £50 million of the Company's total assets less current liabilities, reducing to 0.50% thereafter. A performance fee is payable at the rate of 10% of the annualised excess performance over the benchmark in the two previous financial years, applied to the average of the total assets less current liabilities of the Company. The fee is payable annually in April and is capped at 0.25% of the average of the total assets less current liabilities of the Company.

8.4% outperformance was generated against the Company's benchmark for the performance period ended 28 February 2014 (2013: 3.3%). The fee was restricted by the 0.25% cap and £1,111,000 has been accrued for the year ended 28 February 2014 (2013: £860,000).

Performance fees have been wholly allocated to capital reserves as the performance has been predominantly generated through capital returns of the investment portfolio.

### 5. OPERATING ACTIVITIES

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| (a) Other operating expenses | | |
| Auditor's remuneration: | | |
| – audit services | 19 | 18 |
| – non audit services* | 6 | 6 |
| Registrar's fee | 28 | 25 |
| Directors' remuneration (excluding expenses) | 122 | 118 |
| Other administrative costs | 317 | 230 |
| | 492 | 397 |
| The Company's ongoing charges – calculated as a percentage of average shareholders' funds and using operating expenses, excluding performance fees, finance costs and taxation were: | 0.7% | 0.6% |
| The Company's ongoing charges – calculated as a percentage of average shareholders' funds and using operating expenses, including performance fees, and taxation and excluding finance costs were: | 1.0% | 1.0% |

* Non audit services relate to the review of the half yearly financial statements and debenture certificate.

| | £'000 | £'000 |
|---|---|---|
| **(b) Reconciliation of net return before finance costs and taxation to net cash flow from operating activities** | | |
| Total return before finance costs and taxation | 133,834 | 54,214 |
| Gains on investments held at fair value through profit and loss | (129,276) | (50,439) |
| Exchange losses of a capital nature | (1) | 1 |
| Increase in accrued income | (40) | (12) |
| Increase in creditors | 487 | 333 |
| Net cash inflow from operating activities | 5,004 | 4,097 |

### 6. FINANCE COSTS

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Revenue £'000 | Capital £'000 | Total £'000 | Revenue £'000 | Capital £'000 | Total £'000 |
| 7.75% debenture stock interest | 291 | 872 | 1,163 | 289 | 869 | 1,158 |
| Loan and overdraft interest | 108 | 321 | 429 | 76 | 224 | 300 |
| Amortised debenture stock issue expenses | 3 | 11 | 14 | 3 | 11 | 14 |
| | 402 | 1,204 | 1,606 | 368 | 1,104 | 1,472 |

The allocation of finance costs between revenue and capital reflects the level of funds on deposit during the year. It takes into account the fact that such funds on deposit are only capable of earning a revenue return. The remaining finance costs have been allocated in the ratio 75:25 between capital and revenue in line with the Directors' expected long term split of returns from the investment portfolio.

## 7. TAXATION

### (a) Analysis of charge in the year

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Revenue £'000 | Capital £'000 | Total £'000 | Revenue £'000 | Capital £'000 | Total £'000 |
| Current tax: | | | | | | |
| Overseas tax (note 7(b)) | 5 | – | 5 | 2 | – | 2 |
| Total taxation | 5 | – | 5 | 2 | – | 2 |

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

The tax assessed for the year is lower than the standard rate of corporation tax in the UK for a large company of 23.08% (2013: 24.17%). The differences are explained below:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Revenue £'000 | Capital £'000 | Total £'000 | Revenue £'000 | Capital £'000 | Total £'000 |
| Return on ordinary activities before taxation | 6,992 | 125,236 | 132,228 | 5,522 | 47,220 | 52,742 |
| Return on ordinary activities multiplied by standard rate of corporation tax of 23.08% (2013: 24.17%) | 1,614 | 28,904 | 30,518 | 1,335 | 11,413 | 12,748 |
| Effects of: | | | | | | |
| Income not subject to corporation tax | (1,919) | – | (1,919) | (1,587) | – | (1,587) |
| Non taxable gains on investments held at fair value through profit or loss | – | (29,836) | (29,836) | – | (12,190) | (12,190) |
| Excess management expenses not utilised | 305 | 932 | 1,237 | 252 | 777 | 1,029 |
| Overseas tax charge | 5 | – | 5 | 2 | – | 2 |
| Current corporation tax charge (note 7(a)) | 5 | – | 5 | 2 | – | 2 |

Investment trusts are exempt from corporation tax on capital gains provided the Company obtains agreement from HMRC that the tests in section 1158 of the Corporation Tax Act 2010 have been met.

The standard rate of corporation tax in the UK changed from 24% to 23% with effect from 1 April 2013.

(c) At 28 February 2014, the Company had net surplus management expenses of £30,513,000 (2013: £26,757,000) and a non-trade loan relationship deficit of £17,728,000 (2013: £16,122,000). A deferred tax asset has not been recognised in respect of these losses as the Company is not expected to generate taxable income in the future in excess of the deductible expenses of that future period and, accordingly, it is unlikely that the Company will be able to reduce future tax liabilities through the use of existing excess expenses and loan relationship deficits.

## Notes to the financial statements continued

### 8. DIVIDENDS

| Dividends paid on equity shares: | Record date | Payment date | 2014 £'000 | 2013 £'000 |
|---|---|---|---|---|
| 2012 final of 5.98p | 1 June 2012 | 4 July 2012 | – | 2,863 |
| 2013 interim of 3.50p | 9 November 2012 | 7 December 2012 | – | 1,676 |
| 2013 final of 6.50p | 31 May 2013 | 3 July 2013 | 3,112 | – |
| 2014 interim of 4.60p | 1 November 2013 | 29 November 2013 | 2,202 | – |
| | | | 5,314 | 4,539 |

The Directors have proposed a final dividend of 7.40p per share in respect of the year ended 28 February 2014. The proposed final dividend will be paid, subject to shareholders' approval, on 17 June 2014 to shareholders on the Company's register on 16 May 2014. The final dividend has not been included as a liability in these financial statements as final dividends are only recognised in the financial statements when they have been approved by shareholders, or in the case of special dividends, recognised when paid to shareholders.

The total dividends payable in respect of the year which form the basis of determining retained income for the purposes of section 1158 of the Corporation Tax Act 2010 and section 833 of the Companies Act 2006, and the amounts proposed, meet the relevant requirements as set out in this legislation.

| Dividends paid or proposed on equity shares: | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Interim paid of 4.60p per share (2013: 3.50p) | 2,202 | 1,676 |
| Final proposed of 7.40p* per share (2013: 6.50p) | 3,543 | 3,112 |
| | 5,745 | 4,788 |

* Based upon 47,879,792 ordinary shares (excluding treasury shares) in issue on 25 April 2014.

### 9. RETURN PER ORDINARY SHARE

Revenue and capital returns per share are shown below and have been calculated using the following:

| | 2014 | 2013 |
|---|---|---|
| Net revenue return attributable to ordinary shareholders (£'000) | 6,987 | 5,520 |
| Net capital return attributable to ordinary shareholders (£'000) | 125,236 | 47,220 |
| Total return (£'000) | 132,223 | 52,740 |
| Total equity shareholders' funds (£'000) | 471,843 | 344,934 |
| The weighted average number of ordinary shares in issue during each year on which the return per ordinary share was calculated, was: | 47,879,792 | 47,879,792 |
| The actual number of ordinary shares in issue at the end of each year on which the net asset value was calculated, was: | 47,879,792 | 47,879,792 |

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Revenue p | Capital p | Total p | Revenue p | Capital p | Total p |
| **Return per share** | | | | | | |
| Calculated on weighted average number of shares | 14.59 | 261.56 | 276.15 | 11.53 | 98.62 | 110.15 |
| Calculated on actual number of shares | 14.59 | 261.56 | 276.15 | 11.53 | 98.62 | 110.15 |
| **Net asset value per share (debenture at par value)** | – | – | 985.47 | – | – | 720.42 |
| **Net asset value per share (debenture at fair value)** | – | – | 978.01 | – | – | 715.37 |

## 10. INVESTMENTS HELD AT FAIR VALUE THROUGH PROFIT OR LOSS

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| UK equity listed investments held at fair value | 352,350 | 268,361 |
| UK equity quoted AIM investments held at fair value | 158,277 | 111,294 |
| | 510,627 | 379,655 |
| Valuation brought forward | 379,655 | 321,270 |
| Investment holding gains | (98,948) | (71,353) |
| Opening cost of equity investments | 280,707 | 249,917 |
| Additions at cost | 183,818 | 136,307 |
| Disposals | (140,263) | (105,517) |
| Cost carried forward | 324,262 | 280,707 |
| Closing investment holding gains | 186,365 | 98,948 |
| Closing valuation of equity investments | 510,627 | 379,655 |

During the year, the Company incurred purchase transaction costs of £952,000 (2013: £718,000) and sale transaction costs of £241,000 (2013: £174,000).

### Gains on investments held at fair value through profit or loss

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Realised gains on sales | 41,859 | 22,844 |
| Movement in investment holding gains | 87,417 | 27,595 |
| | 129,276 | 50,439 |

## 11. DEBTORS

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Sales for future settlement | 1,988 | 39 |
| Taxation recoverable | 12 | 16 |
| Prepayments and accrued income | 169 | 129 |
| | 2,169 | 184 |

## 12. MOVEMENT IN NET DEBT

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **(a) Reconciliation of net cash flow to movement in net debt** | | |
| Increase in cash in the year | 5,923 | 6,198 |
| Drawdown of revolving facility | (10,000) | (15,000) |
| Exchange movements | 1 | (1) |
| Amortised debenture stock issue expenses | (14) | (14) |
| Change in net debt | (4,090) | (8,817) |
| Net debt at the beginning of the year | (31,600) | (22,783) |
| Net debt at the end of the year | (35,690) | (31,600) |

| | At 1 March 2013 £'000 | Cash flows £'000 | Exchange movements £'000 | Amortised issue expenses £'000 | At 28 February 2014 £'000 |
|---|---|---|---|---|---|
| **(b) Analysis of change in net debt** | | | | | |
| Cash, overdraft, short term deposits and money market funds | (1,737) | 5,923 | 1 | – | 4,187 |
| Debt due after more than one year | (29,863) | (10,000) | – | (14) | (39,877) |
| Net debt at the end of the year | (31,600) | (4,077) | 1 | (14) | (35,690) |

## 13. CREDITORS – AMOUNTS FALLING DUE WITHIN ONE YEAR

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Purchases for future settlement | 2,567 | 1,091 |
| Bank overdraft | – | 1,736 |
| Other creditors | 2,696 | 2,215 |
| | 5,263 | 5,042 |

## 14. CREDITORS – AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| 7.75% debenture stock 2022* | 15,000 | 15,000 |
| Unamortised debenture stock issue expenses | (123) | (137) |
| | 14,877 | 14,863 |
| Scotia Bank loan | 25,000 | 15,000 |
| | 39,877 | 29,863 |

* The fair value of the 7.75% debenture stock using the last available quoted offer price from the London Stock Exchange as at 28 February 2014 was 123.00p per debenture, a total of £18,450,000. (At 28 February 2013: 115.20p, a total of £17,280,000.)

The £15 million debenture stock was issued on 8 July 1997. Interest on the stock is payable in equal half yearly instalments on 31 July and 31 January in each year. The stock is secured by a first floating charge over the whole of the assets of the Company and is redeemable at par on 31 July 2022.

The three year multi-currency revolving loan facility with Scotia Bank (Ireland) Limited was increased to £25 million during June 2013, at 28 February 2014 the facility was fully utilised (2013: £15 million facility, fully utilised). Under the amended agreement the termination date of this facility is the third anniversary of the effective date being June 2013. Interest on this facility is reset every three months and is currently charged at the rate of 1.821250% (2013: 1.911250%).

## 15. CALLED-UP SHARE CAPITAL

| | Ordinary shares (nominal) | Treasury shares (nominal) | Total shares in issue | Nominal value £'000 |
|---|---|---|---|---|
| Allotted, called up and fully paid share capital comprised: | | | | |
| Ordinary shares of 25p each | | | | |
| At 1 March 2013 | 47,879,792 | 2,113,731 | 49,993,523 | 12,498 |
| **At 28 February 2014** | 47,879,792 | 2,113,731 | 49,993,523 | 12,498 |

During the year no ordinary shares were purchased for cancellation or placed in treasury (2013: nil). The number of ordinary shares in issue at the year end, excluding treasury shares, was 47,879,792 (2013: 47,879,792).

The ordinary shares (excluding any shares held in treasury) carry the right to receive any dividends and have one voting right per ordinary share. There are no restrictions on the voting rights of the shares or the transfer of the shares.

## 16. SHARE PREMIUM ACCOUNT AND RESERVES

| | Share premium account £'000 | Capital redemption reserve £'000 | Capital reserve (arising on investments sold) £'000 | Capital reserve (arising on revaluation of investments held) £'000 | Revenue reserve £'000 |
|---|---|---|---|---|---|
| At 1 March 2013 | 38,952 | 1,982 | 182,042 | 98,948 | 10,512 |
| Movement during the year: | | | | | |
| Revenue return for the year | – | – | – | – | 6,987 |
| Gains on realisation of investments | – | – | 41,859 | – | – |
| Exchange movements | – | – | (2) | – | – |
| Change in investment holding gains | – | – | – | 87,417 | – |
| Finance costs, investment management and performance fees charged to capital after taxation | – | – | (4,038) | – | – |
| Dividends paid during the year | – | – | – | – | (5,314) |
| **At 28 February 2014** | 38,952 | 1,982 | 219,861 | 186,365 | 12,185 |

## 17. NET ASSET VALUE PER ORDINARY SHARE

| | 2014 | 2013 |
|---|---|---|
| Net assets attributable to ordinary shareholders (£'000) | 471,843 | 344,934 |
| The actual number of ordinary shares in issue at the end of each year on which the net asset value per ordinary share was calculated, was: | 47,879,792 | 47,879,792 |
| Net asset value per ordinary share (with debenture at par value) | 985.47p | 720.42p |
| Net asset value per ordinary share (with debenture at par, capital only) | 975.48p | 712.39p |
| Net asset value per ordinary share (with debenture at fair value)* | 978.01p | 715.37p |
| Ordinary share price | 908.00p | 626.50p |

* The fair value of the 7.75% debenture stock using the last available quoted offer price from the London Stock Exchange as at 28 February 2014 was 123.00p per debenture, a total of £18,450,000. (At 28 February 2013: 115.20p, a total of £17,280,000.)

### 18. RISK MANAGEMENT POLICIES AND PROCEDURES

As an investment trust, the Company invests in equities and other investments for the long term so as to achieve its investment objective as stated on page 15. In pursuing its investment objective, the Company is exposed to a variety of financial risks that could result in either a reduction in the Company's net assets or a reduction in the profits available for distribution by way of dividends.

These financial risks include: market risk (comprising currency risk, interest rate risk and market price risk), liquidity risk and credit risk. The Directors' approach to the management of them, are set out below. The Investment Manager, in close co-operation with the Board of Directors, coordinates the Company's risk management.

The objectives, policies and processes for managing the risks are set out below and have not changed from the previous accounting period.

#### (i) Market risk

The fair value or future cash flows of a financial instrument held by the Company may fluctuate due to the changes in market prices. This market risk comprises currency risk (see note 18 (ii)), interest rate risk (see note 18 (iii)) and market price risk (see note 18 (iv)). The Board of Directors reviews and agrees policies for managing these risks, for which policies have remained substantially unchanged from those applying in the year ended 28 February 2013. The Investment Manager assesses the exposure to market risk when making each investment decision and monitors the overall level of market risk on the whole of the investment portfolio on an ongoing basis.

#### (ii) Currency risk

As the Company's objective is to achieve long term capital growth for shareholders through investment mainly in smaller UK quoted companies, the majority of the Company's assets are sterling denominated. From time to time the Company may hold an overseas line of stock to the extent that the underlying investment has exposure to the UK market and consequently at any time a very small proportion of the Company's assets, liabilities and income may be denominated in currencies other than sterling (the Company's functional currency and that in which it reports its results). It is the opinion of the Board of Directors that due to the de minimis level of these holdings, any movements in exchange rates will not materially affect the value of the portfolio cash, investment purchases, investment sales and income.

As at 28 February 2014, there was 1 non-sterling denominated investment (2013: 2).

#### (iii) Interest rate risk

Interest rate movements may affect the interest payable on the Company's variable rate borrowings and the level of income receivable on cash deposits.

Interest rate changes may also impact on the market value of the Company's investments other than fixed rate securities. The effect of interest rate changes on the earnings of companies held within the portfolio may have a significant impact on the valuation of the Company's equity.

#### Management of the risk

The possible effects on fair value and cash flows that could arise as a result of changes in interest rates are taken into account when making investment decisions and borrowing. The Company, generally, does not hold significant cash balances, with short term borrowings being used when required. The Company finances part of its activities through borrowings at levels approved and monitored by the Board of Directors. The debenture stock also provides finance and was issued as part of the Company's planned gearing.

#### Interest rate exposure

The Company is exposed to interest rate risk through its overdraft facility and cash deposits with BNYM. Borrowing varied throughout the year as part of a Board endorsed policy. The Company had a net overdraft of £nil as well as a multi-currency revolving loan facility of £25,000,000 which was fully utilised at the year end (2013: overdraft £1,737,000 and loan facility of £15,000,000). If variable interest borrowings were maintained at this level for a year, a 1% change in base rates (up or down) would decrease or increase the total return by £250,000 or 0.52p per share (2013: £167,000 or 0.35p per share).

The Company's debenture stock accrues interest at a fixed rate of 7.75% per annum. The Company expects to hold this stock to maturity, therefore it is not exposed to variations in interest rates.

The Company's exposure to interest rates at 28 February was:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Within one year £'000 | More than one year £'000 | Total £'000 | Within one year £'000 | More than one year £'000 | Total £'000 |
| Exposure to floating interest rates: | | | | | | |
| Bank overdraft | – | – | – | (1,737) | – | (1,737) |
| Bank Loan | – | (25,000) | (25,000) | – | (15,000) | (15,000) |
| Exposure to fixed interest rates: | | | | | | |
| 7.75% debenture stock 2022 | – | (14,877) | (14,877) | – | (14,863) | (14,863) |
| Total exposure to interest rates | – | (39,877) | (39,877) | (1,737) | (29,863) | (31,600) |

The above year end amounts are not representative of the exposure to interest rates during the year, as the level of exposure changes as investments are made, borrowings are drawn down and repaid, and the mix of borrowings between floating and fixed interest rates change.

Interest received on cash balances, or paid on the bank overdraft respectively, was on average 0.15% and 1.47% per annum (2013: 0.15% and 1.75%). Interest payable on the £15 million debenture stock is accrued at a fixed rate of 7.75% per annum. Interest payable on the £25 million multi-currency revolving loan facility is payable at a rate of 1.821250% (2013: £15 million payable at a rate of 1.911250%).

### (iv) Market price risk

Market price risks (i.e. changes in market prices other than those arising from interest rate risk or currency risk) may affect the value of the quoted and unquoted investments. The Company's investments are susceptible to market price risk arising from uncertainties about future prices of the investments.

### Management of the risk

The Board manages the risks inherent in the investment portfolio by ensuring full and timely access to relevant information from the Investment Manager. The Board meets regularly and at each meeting reviews investment performance. The Board monitors the Investment Manager's compliance with the Company's objectives and is directly responsible for investment strategy.

The Company's exposure to changes in market prices at the end of the year on its quoted equity investments was as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Investments held at fair value through profit or loss | 510,627 | 379,655 |

### Concentration of exposure to market price risks

An analysis of the Company's fifty largest investments and sector analysis are shown on pages 12 to 14. At 28 February 2014, this shows the majority of the investments' value is in UK companies. Accordingly, there is a concentration of exposure to the UK, though it is recognised that an investment's country of domicile or of listing does not necessarily equate to its exposure to the economic conditions in that country.

### 18. RISK MANAGEMENT POLICIES AND PROCEDURES continued

#### Market price risk sensitivity

The sensitivity of the return after taxation for the year and the equity to an increase or decrease of 25% in the fair values of the Company's net assets is given below. This level of change is considered to be reasonably possible based on observation of current market conditions. The sensitivity analysis is based on the Company's equities and equity exposure through options at each balance sheet date, with all other variables held constant.

The impact of a 25% increase in the value of investments on the revenue return as at 28 February 2014, is a decrease of £160,000 (2013: £119,000) and on the capital return is an increase of £127,178,000 (2013: £94,558,000).

The impact of a 25% decrease in the value of investments on the revenue return as at 28 February 2014, is an increase of £160,000 (2013: £119,000) and on the capital return is a decrease of £127,178,000 (2013: £94,558,000).

#### (v) Liquidity risk

This is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities.

#### Management of the risk

Liquidity risk is not significant as the majority of the Company's assets are investments in quoted equities and other quoted securities that are readily realisable. The Company has an overdraft facility of £20 million and a three year multi-currency revolving loan facility of £25 million (2013: overdraft £15 million) and debenture stock which is secured by a floating charge over the whole of its assets and which is redeemable at par on 31 July 2022.

The Board of Directors gives guidance to the Investment Manager as to the maximum amount of the Company's resources that should be invested in any one Company. The policy is that the Company should remain fully invested in normal market conditions and that short term borrowings be used to manage short term cash requirements.

#### Liquidity risk exposure

The table below analyses the Company's contractual liabilities.

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Within 1 year £'000 | Between 1 and 5 years £'000 | More than 5 years £'000 | Within 1 year £'000 | Between 1 and 5 years £'000 | More than 5 years £'000 |
| Debenture stock | 1,163 | 4,650 | 18,970 | 1,163 | 4,650 | 20,133 |
| Bank overdraft | – | – | – | 1,737 | – | – |
| Bank loan | – | 25,000 | – | – | 15,000 | – |
| Other creditors and accruals | 2,696 | – | – | 3,305 | – | – |
| | 3,859 | 29,650 | 18,970 | 6,205 | 19,650 | 20,133 |

#### (vi) Credit risk

The failure of the counterparty to a transaction to discharge its obligations under that transaction could result in the Company suffering a loss.

#### Management of the risk

The risk is not significant, and is managed as follows:

- investment transactions are carried out with a large number of brokers, whose credit standing is reviewed periodically by the Investment Manager, and limits are set on the amount that may be due from any one broker
- cash at bank is held only with reputable banks with high quality external credit ratings

In summary, compared to the amounts included in the Balance Sheet, the maximum exposure to credit risk at 28 February 2014 was:

| | 2014 Balance Sheet £'000 | 2013 Balance Sheet £'000 |
|---|---|---|
| Sales for future settlement | 1,988 | 39 |
| Accrued income | 169 | 129 |
| | 2,157 | 168 |

### (vii) Capital management policies and procedures

The Company's capital management objectives are:

- to ensure that it will be able to continue as a going concern; and
- to secure long term capital growth primarily through investing in quoted securities in the UK

This is to be achieved through an appropriate balance of equity capital and gearing. The policy is that gearing should not exceed 15% of net assets.

The Company's total capital at 28 February 2014 was £511,720,000 (2013: £376,534,000) comprising £nil (2013: £1,737,000) of bank overdraft, £25,000,000 (2013: £15,000,000) of bank loan, £14,877,000 (2013: £14,863,000) of debenture stock at par value and £471,843,000 (2013: £344,934,000) of equity share capital and other reserves.

### (viii) Fair values of financial assets and financial liabilities

Investments are held at fair value through profit or loss. All liabilities are held in the Balance Sheet at a reasonable approximation of fair value. Debenture stock is carried in the Balance Sheet at amortised cost.

Financial assets and financial liabilities are either carried in the Balance Sheet at their fair value (investment and derivatives) or the balance sheet amount is a reasonable approximation of fair value (due from brokers, dividends and interest receivable, due to brokers, accruals, cash at bank, bank overdraft and amounts due under the multi-currency revolving loan facility).

### Fair value hierarchy disclosures

The table below sets out fair value measurements using the FRS 29 fair value hierarchy.

| Financial assets and financial liabilities at fair value through profit or loss at 28 February 2014 | Level 1 £'000 | Level 2 £'000 | Level 3 £'000 | Total £'000 |
|---|---|---|---|---|
| Equity investments | 510,627 | – | – | 510,627 |
| Total | 510,627 | – | – | 510,627 |

| Financial assets and financial liabilities at fair value through profit or loss at 28 February 2013 | Level 1 £'000 | Level 2 £'000 | Level 3 £'000 | Total £'000 |
|---|---|---|---|---|
| Equity investments | 379,655 | – | – | 379,655 |
| Total | 379,655 | – | – | 379,655 |

## Notes to the financial statements continued

### 18. RISK MANAGEMENT POLICIES AND PROCEDURES continued

Categorisation within the hierarchy has been determined on the basis of the lowest level input that is significant to the fair value measurement of the relevant asset as follows:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset or liability

Level 3 – inputs for the asset or liability that are not based on observable market data

The valuation techniques used by the Company are explained in the accounting policies in note 2.

### 19. TRANSACTIONS WITH THE INVESTMENT MANAGER

The related party transactions between the Company and BlackRock Investment Management (UK) Limited are set out in the Directors' Report on pages 19 to 24 and in note 4 on pages 45 and 46. The investment management and performance fees for the year were £3,411,000 (2013: £2,532,000).

At the year end, the following amounts were outstanding in respect of investment management and performance fees: £1,755,000 (2013: £1,762,000).

In addition to the above services, with effect from 1 November 2013, BlackRock has provided the Company with marketing services. The total fees paid or payable for these services for the year ended 28 February 2014 amounted to £50,000 including VAT (2013: £nil) of which £50,000 including VAT (2013: £nil) was outstanding at 28 February 2014.

### 20. RELATED PARTIES DISCLOSURES

Disclosures of the Directors' interests in the ordinary shares of the Company and fees and expenses payable to the Directors are given in the Directors' Remuneration Report on pages 27 and 28.

### 21. CONTINGENT LIABILITIES

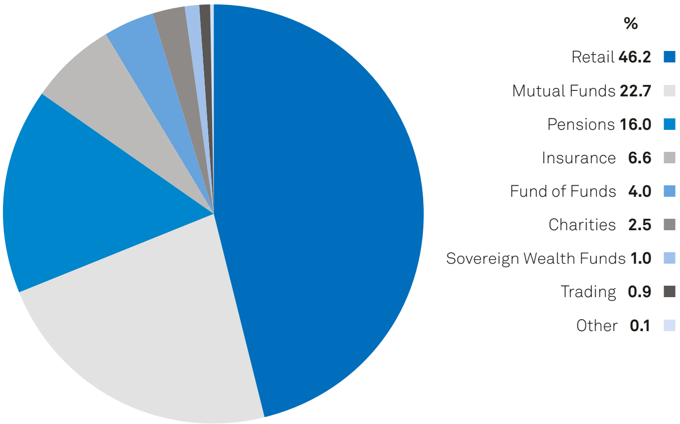
There were no contingent liabilities at 28 February 2014 (2013: nil).

# Additional information

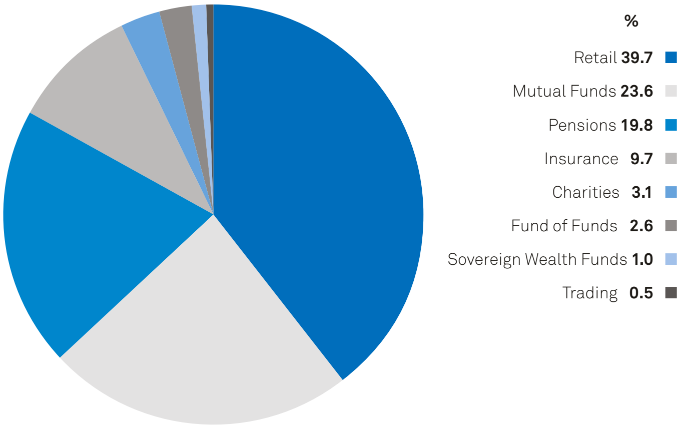
## Analysis of ordinary shareholders as at 28 February 2014 (unaudited)

### BY TYPE OF HOLDER

As at 28 February 2014




As at 28 February 2013




### BY SIZE OF HOLDING

| | Number of shares | % of total 2014 | % of total 2013 | Number of holders | % of total 2014 | % of total 2013 |
|---|---|---|---|---|---|---|
| 1-10,000 | 2,466,102 | 5.1 | 4.8 | 1,270 | 85.6 | 84.3 |
| 10,001-100,000 | 5,378,030 | 11.2 | 9.8 | 146 | 9.8 | 10.5 |
| 100,001-1,000,000 | 19,730,466 | 41.2 | 38.4 | 57 | 3.8 | 4.3 |
| 1,000,001-5,000,000 | 20,305,194 | 42.5 | 33.0 | 11 | 0.8 | 0.8 |
| Over 5,000,000 | – | – | 14.0 | – | – | 0.1 |
| | 47,879,792 | 100.0 | 100.0 | 1,484 | 100.0 | 100.0 |

# Additional information

## Historical performance record (unaudited)

| Year ended February | Total assets less current liabilities £'000 | Shareholders' funds £'000 | Net asset value per share p[3] | Share price p | Revenue available for dividends £'000 | Revenue earnings per share p | Dividends per share p |
|---|---|---|---|---|---|---|---|
| 2004 | 140,623 | 125,891 | 234.7 | 183.0 | 2,397 | 4.32 | 4.42 |
| 2005 | 160,331 | 145,500 | 284.4 | 229.0 | 2,365 | 4.59 | 4.52 |
| 2006 | 197,382 | 182,621 | 361.2 | 312.0 | 2,258 | 4.46 | 4.62 |
| 2007 | 241,636 | 226,860 | 453.8 | 392.8 | 2,824 | 5.61 | 4.76 |
| 2008 | 215,843 | 201,052 | 414.5 | 340.0 | 3,540 | 7.16 | 4.90[1] |
| 2009 | 125,071 | 110,265 | 227.4 | 177.0 | 3,499 | 7.21 | 5.05[2] |
| 2010 | 197,087 | 182,267 | 380.7 | 293.8 | 3,572 | 7.41 | 5.60 |
| 2011 | 312,036 | 297,202 | 620.7 | 542.0 | 4,095 | 8.55 | 7.00 |
| 2012 | 311,582 | 296,733 | 619.8 | 503.0 | 4,865 | 10.16 | 8.40 |
| 2013 | 374,797 | 344,934 | 720.4 | 626.5 | 5,520 | 11.53 | 10.00 |
| 2014 | 511,720 | 471,843 | 985.5 | 908.0 | 6,987 | 14.59 | 12.00 |

1. Excluding a special dividend of 1.25p.
2. Excluding a special dividend of 0.70p.
3. Debenture at par value.

# Additional information

## Management & administration

### REGISTERED OFFICE
(Registered in Scotland, No. 006176)
Exchange Place 1
1 Semple Street
Edinburgh EH3 8BL

### INVESTMENT MANAGER
BlackRock Investment Management (UK) Limited*
12 Throgmorton Avenue
London EC2N 2DL

### SECRETARY AND ADMINISTRATOR
BlackRock Investment Management (UK) Limited*
12 Throgmorton Avenue
London EC2N 2DL

### REGISTRAR
Computershare Investor Services PLC*
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
Telephone: 0870 707 1649

### SAVINGS PLAN AND ISA ADMINISTRATOR
Freepost RLTZ-KHUH-KZSB
BlackRock Investment Management (UK) Limited*
PO Box 9036
Chelmsford CM99 2XD
Telephone: 0800 44 55 22

### STOCKBROKERS
Canaccord Genuity Limited*
88 Wood Street
London EC2V 7QR

### SOLICITORS
Dundas & Wilson CS LLP
Saltire Court
20 Castle Terrace
Edinburgh EH1 2EN

### CUSTODIAN AND BANKER
The Bank of New York Mellon (International) Limited*
One Canada Square
London E14 5AL

### AUDITOR
Scott-Moncrieff
Chartered Accountants
Exchange Place 3
Semple Street
Edinburgh EH3 8BL

* Authorised and regulated by the Financial Conduct Authority.

# Additional information

## Shareholder information

### FINANCIAL CALENDAR

The timing of the announcement and publication of the Company's results may normally be expected in the months shown below:

**April**
Annual results and final dividend for year announced.

**May**
Annual Report and Financial Statements published.

**June**
Annual General Meeting.

**June/July**
Final dividend paid.

**October**
Half yearly figures to 31 August announced and half yearly financial report published.

**November**
Interim dividend paid.

### DIVIDEND – 2014

The proposed final dividend in respect of the year ended 28 February 2014 is 7.40p per share.

| | |
|---|---|
| Ex-dividend date (shares transferred without the dividend) | 14 May 2014 |
| Record date (last date for registering transfers to receive the dividend) | 16 May 2014 |
| Last date for registering DRIP instructions | 27 May 2014 |
| Dividend payment date | 17 June 2014 |

### PAYMENT OF DIVIDENDS

Cash dividends will be sent by cheque to the first-named shareholder at their registered address. Dividends may also be paid direct into a shareholder's bank account via BACSTEL-IP (Bankers' Automated Clearing Service – Telecom Internet Protocol). This may be arranged by contacting the Company's registrar, Computershare Investor Services PLC, through their secure website investorcentre.co.uk, or by telephone on 0870 707 1649, or by completing the Mandate Instructions section on the reverse of your dividend counterfoil. Tax vouchers will be sent to shareholders at their registered address, unless other instructions have been given, to arrive on the payment date.

### DIVIDEND REINVESTMENT SCHEME ("DRIP")

Shareholders may request that their dividends be used to purchase further shares in the Company. Dividend reinvestment forms may be obtained from Computershare Investor Services PLC through their secure website investorcentre.co.uk, or on 0870 707 1649. Shareholders who have already opted to have their dividends reinvested do not need to reapply. The last date for registering for this service for the forthcoming dividend is 27 May 2014.

### SHARE PRICE

The Company's mid-market ordinary share price is quoted daily in The Financial Times under "Investment Companies" and in The Daily Telegraph and The Times under "Investment Trusts". The share price is also available on the BlackRock Investment Management (UK) Limited ("BlackRock") website at blackrock.co.uk/brsc.

### ISIN/SEDOL NUMBERS

The ISIN/SEDOL numbers and mnemonic codes for the Company's shares are:

| | Ordinary Shares |
|---|---|
| ISIN | GB0006436108 |
| SEDOL | 0643610 |
| Reuters code | BRSC |
| Bloomberg code | BRSC LN |

### SHARE DEALING

Investors wishing to purchase more shares in the Company or sell all or part of their existing holding may do so through a stockbroker. Most banks also offer this service. It is also possible to trade the Company's shares through many of the online dealing service providers.

### COMPUTERSHARE INVESTOR SERVICES PLC

For existing shareholders, the Company's registrar, Computershare Investor Services PLC, has both internet and telephone share dealing services. To access the internet share dealing service, log on to computershare.com/sharedealingcentre/. The telephone share dealing service is available on 0870 703 0084. To use these services, you will need your shareholder reference number which is detailed on your share certificate.

**Internet dealing** – The fee for this service is 1% of the value of each sale or purchase of shares (subject to a minimum of £30). Stamp duty of 0.5% is payable on purchases.

**Telephone dealing** – The fee for this service will be 1% of the value of the transaction (plus £35). Stamp duty of 0.5% is payable on purchases.

### CREST

The Company's shares may be held in CREST, an electronic system for uncertificated securities trading.

Private investors can continue to retain their share certificates and remain outside the CREST system. Private investors are able to buy and sell their holdings in the same way as they did prior to the introduction of CREST, although there may be differences in dealing charges.

### ELECTRONIC COMMUNICATIONS

We encourage you to play your part in reducing our impact on the environment and elect to be notified by email when your shareholder communications become available online. This means you will receive timely, cost-effective and greener online annual reports, half yearly financial reports and other relevant documentation.

Shareholders who opt for this service will receive an email from Computershare with a link to the relevant section of the BlackRock website where the documents can be viewed and downloaded. Please submit your email address by visiting www.investorcentre.co.uk/ecomms. You will require your shareholder reference number which you will find on your share certificate or tax voucher.

You will continue to receive a printed copy of these reports if you have elected to do so. Alternatively, if you have not submitted your email address nor have elected to receive printed reports, we will write and let you know where you can view these reports online.

## ELECTRONIC PROXY VOTING

Shareholders are able to submit their proxy votes electronically via Computershare's internet site at eproxyappointment.com using their shareholder reference number, control number and a unique identification PIN which will be provided with voting instructions and the Notice of Annual General Meeting.

CREST members who wish to appoint one or more proxies or give an instruction through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST manual. More details are set out in the notes on the Form of Proxy and the Notice of Annual General Meeting.

## RISK FACTORS

- Past performance is not necessarily a guide to future performance. The value of your investment in the Company and the income from it can fluctuate as the value of the underlying investments fluctuate.

- The price at which the Company's shares trade on the London Stock Exchange is not the same as their net asset value (although they are related) and therefore you may realise returns which are lower or higher than NAV performance.

## NOMINEE CODE

Where shares are held in a nominee company name, the Company undertakes:

- to provide the nominee company with multiple copies of shareholder communications, so long as an indication of quantities has been provided in advance;

- to allow investors holding shares through a nominee company to attend general meetings, provided the correct authority from the nominee company is available; and

- that investors in the BlackRock Investment Trusts Savings Plan and ISA are automatically sent shareholder communications, including details of general meetings, together with a Form of Direction to facilitate voting and to seek authority to attend.

Nominee companies are encouraged to provide the necessary authority to underlying shareholders to attend the Company's general meetings.

## PUBLICATION OF NET ASSET VALUE/PORTFOLIO ANALYSIS

The net asset value ("NAV") per share of the Company is calculated daily, with details of the Company's investments and performance being published monthly.

The daily NAV per share and monthly information are released through the London Stock Exchange's Regulatory News Service and are available on the BlackRock website at blackrock.co.uk/brsc and through the Reuters News Service under the code "BLRKINDEX", on page 8800 on Topic 3 (ICV terminals) and under "BLRK" on Bloomberg (monthly information only).

## ONLINE ACCESS

Other details about the Company are available on the BlackRock website at www.blackrock.co.uk/brsc. The financial statements and other literature are published 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.

Shareholders can also manage their shareholding online by using Investor Centre, Computershare's secure website, at www.investorcentre.co.uk.

To access Computershare's website you will need your shareholder reference number (SRN) which can be found on paper or electronic communications you have previously received from Computershare. Listed below are the most frequently used features of the website.

- Holding enquiry – view balances, values, history, payments and reinvestments.

- Payments enquiry – view your dividends and other payment types.

- Address change – change your registered address.

- Bank details update – choose to receive your dividend payment directly into your bank account instead of by cheque.

- Outstanding payments – reissue payments using the online replacement service.

# Additional information

## Shareholder Information continued

- Downloadable forms – including dividend mandates, stock transfer, dividend reinvestment and change of address forms.
- The Company's shares can be purchased through retail banks, stockbrokers and a range of online dealing platforms, many of which also offer Individual Savings Accounts.

### SAVINGS PLAN

The Company also participates in the BlackRock Investment Trusts Savings Plan, which facilitates both regular monthly investments and occasional lump sum investments in the Company's ordinary shares. Shareholders who would like information on the BlackRock Savings Plan should call BlackRock free on 0800 44 55 22.

### STOCKS AND SHARES INDIVIDUAL SAVINGS ACCOUNTS ("ISA")

ISAs are a tax-efficient method of investment and the Company's shares are eligible investments for inclusion within stocks and shares Individual Savings Accounts. Investors currently have an annual ISA allowance of £11,880. With effect from 1 July 2014, investors will be able to invest up to £15,000 in New ISAs (NISAs), either as cash or shares. Details of the BlackRock ISA's are available by calling free on 0800 44 55 22.

### SHAREHOLDER ENQUIRIES

The Company's registrar is Computershare Investor Services PLC. Certain details relating to your holding can be checked through the Computershare Investor Centre website. As a security check, specific information needs to be input accurately to gain access to an individual's account. This includes your shareholder reference number, available from either your share certificate, tax voucher or other communications you have previously received from Computershare. The address of the Computershare website is www.investorcentre.co.uk. Alternatively, please contact the registrar on 0870 707 1649.

Changes of name or address must be notified in writing either through Computershare's website, or to the registrar at:

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ

### GENERAL ENQUIRIES

Enquiries about the Company should be directed to:

The Secretary
BlackRock Smaller Companies Trust plc
12 Throgmorton Avenue
London EC2N 2DL
Telephone: 020 7743 3000

Enquiries about the Savings Plan or ISA should be directed to:

Freepost RLTZ-KHUH-KZSB
BlackRock Investment Management (UK) Limited
PO Box 9036
Chelmsford CM99 2XD
Telephone: 0800 44 55 22

# Glossary

## NET ASSET VALUE PER SHARE ("NAV")

This is the value of the Company's assets attributable to one ordinary share. It is calculated by dividing shareholders' funds by the total number of shares in issue. For example, as at 28 February 2014, shareholders' funds were £471,843,000 and there were 47,879,792 ordinary shares in issue (excluding shares held in treasury); the NAV was therefore 985.47p per share (debenture at par value) and 978.01 per share (debenture at fair value).

Shareholders' funds are calculated by deducting the Company's current and long term liabilities and any provision for liabilities and charges from its total assets.

## NET ASSET VALUE PER SHARE WITH INCOME REINVESTED ("TOTAL RETURN NAV")

This is the theoretical return on shareholders' funds per share, reflecting the change in value of the NAV per share assuming that dividends paid to shareholders were reinvested in the Company's shares at the first opportunity.

As at 28 February 2014, the Company's NAV stood at 985.47p; a reinvestment factor of 1.40893 (rounded) was applied to reach a calculation of NAV with income reinvested of 1,388.46p. Based on this adjusted NAV, the total NAV return for the year ended 28 February 2014 was 38.7%.

## DISCOUNT

Investment trust shares can frequently trade at a discount to NAV. This occurs when the share price (based on the mid-market share price) is less than the NAV and investors may therefore buy shares at less than the value attributable to them by reference to the underlying assets. This discount is the difference between the share price and the NAV, expressed as a percentage of the NAV. For example, if the share price was 550.00p and the NAV 620.00p, the discount would be 11.3%.

## PREMIUM

A premium occurs when the share price (based on the mid-market share price) is more than the NAV and investors therefore would be paying more than the value attributable to the shares by reference to the underlying assets. For example, if the share price was 550.00p and the NAV 540.00p, the premium would be 1.9%.

Discounts and premiums are mainly the consequence of supply and demand for the shares on the stock market.

## ONGOING CHARGES RATIO

The AIC define ongoing charges ratios as the annual operating costs of an investment company expressed as a percentage of net assets. Ongoing charges are defined as those charges and expenses which are likely to recur in the foreseeable future, whether charged to capital or revenue, and which relate to the operation of the investment company as a collective fund, excluding the cost of acquisition/disposal of investments, finance charges and gains/losses arising on investments.

Ongoing charges are based on costs incurred in the year as being the best estimate of future costs. In addition, the Company discloses its ongoing charges inclusive of any performance fees incurred in the year to give shareholders a transparent view of all costs associated with the investment management services provided.

## GEARING

Gearing is calculated in line with AIC guidelines and represents net gearing. This is defined as total assets of the Company less current liabilities (excluding bank overdrafts) less any cash or cash equivalents held minus total shareholders' funds, divided by Shareholders' funds. At 28 February 2014 the Company had total assets less current liabilities (excluding bank overdrafts) of £511,720,000, cash and cash equivalents (defined by the AIC as net current assets) of £1,093,000 and Shareholders' Funds of £471,843,000. The Company's gearing ratio on this basis is 8.2%. Gearing at 28 February 2013 was calculated on the same basis except that cash and cash equivalents were defined as cash rather than net current assets.

# Annual general meeting

## Notice of annual general meeting

Notice is hereby given that the Annual General Meeting of BlackRock Smaller Companies Trust plc will be held at the offices of BlackRock Investment Management (UK) Limited, 12 Throgmorton Avenue, London EC2N 2DL on Tuesday, 10 June 2014 at 11.30 a.m. for the purpose of considering and, if thought fit, passing the following resolutions (which will be proposed in the case of resolutions 1 to 11 as ordinary resolutions and, in the case of 12 to 14 as special resolutions).

Resolution 2 is an advisory vote on the Directors' Remuneration Report, excluding any content relating to the proposed future remuneration policy as set out in the future policy table on page 26. Resolution 3 is a new resolution subject to a binding vote, required for the first time this year as a result of new remuneration disclosure regulations published by the Department for Business, Innovation and Skills (BIS) which became effective from 1 October 2013. As required under the regulations, the Company is seeking approval in this resolution for its remuneration policy as set out in the policy table on page 26 of the Directors' Remuneration Report. The remuneration policy will take effect immediately on approval by shareholders and will continue to apply for the next three financial years, unless amended by the Company in general meeting at an earlier date.

### ORDINARY BUSINESS

1. To receive the report of the Directors and the financial statements for the year ended 28 February 2014, together with the report of the auditor thereon.

2. To approve the Directors' Remuneration Report for the year ended 28 February 2014 (excluding the remuneration policy of the Company as set out in the policy table on page 26).

3. To approve the Directors' Remuneration Policy as set out in the policy table In the Directors' Remuneration Report on page 26.

4. To declare a final dividend of 7.40p per ordinary share.

5. To re-elect Mrs G Nott as a Director.

6. To re-elect Mr R Robertson as a Director.

7. To re-elect Mr N Fry as a Director.

8. To reappoint Scott-Moncrieff, Chartered Accountants, as auditor to the Company.

9. To authorise the Directors to determine the auditor's remuneration.

### SPECIAL BUSINESS

To consider and, if thought fit, pass the following resolutions as ordinary resolutions in the case of resolutions 10 and 11 as special resolutions in the case of resolutions 12 to 14:

### ORDINARY RESOLUTIONS

10. That pursuant to Article 35(1) of the Company's Articles of Association, the aggregate remuneration of the Directors (excluding amounts payable under any other provision of the Articles) shall not exceed the sum of £200,000 per annum.

11. That, in substitution for all existing authorities, the Directors of the Company be and they are hereby generally and unconditionally authorised pursuant to section 551 of the Companies Act 2006 (the "Act"), to exercise all the powers of the Company to allot relevant securities in the Company (as defined in that section) up to an aggregate nominal amount of £1,196,994 (being 10% of the aggregate nominal amount of the issued share capital, excluding treasury shares, of the Company at the date of this notice) provided this authority shall expire at the conclusion of the next Annual General Meeting to be held in 2015 but so that the Company may, before such expiry, make any offer or agreement which would or might require relevant securities to be allotted pursuant to any such offer or agreement as if the authority hereby conferred had not expired.

### SPECIAL RESOLUTIONS

12. That, in substitution for all existing authorities and subject to the passing of resolution 10 above, the Directors of the Company be and are hereby empowered pursuant to sections 570 and 573 of the Companies Act 2006 (the "Act") to allot equity securities (as defined in section 560 of the Act), and to sell equity securities held by the Company as treasury shares (as defined in section 724 of the Act) for cash pursuant to the authority granted by the resolution numbered 9 above, as if section 561(1) of the Act did not apply to any such allotments and sales of equity securities, provided that this power:

    (a) shall expire at the conclusion of the next Annual General Meeting of the Company in 2015, except that the Company may before such expiry make offers or agreements which would or might require equity securities to be allotted or sold after such expiry and notwithstanding such expiry the Directors may allot and sell equity securities in pursuance of such offers or agreements;

    (b) shall be limited to the allotment of equity securities and/or the sale of equity securities held in treasury for cash up to an aggregate nominal amount of £1,196,994 (representing 10% of the aggregate nominal amount of the issued share capital, excluding treasury shares, of the Company at the date of this notice); and

    (c) shall be limited to the allotment of equity securities at a price of not less than the cum-income net asset value per share (debt at fair value).

13. That, in substitution for the Company's existing authority to make market purchases of ordinary shares of 25p each in the Company ("Shares"), the Company be and it is hereby authorised in accordance with section 701 of the Companies Act 2006 (the "Act") to make market purchases of Shares (within the meaning of section 693 of the Act) provided that:

    (a) the maximum number of Shares hereby authorised to be purchased is 7,177,180 (being the equivalent of 14.99% of the Company's issued share capital, excluding treasury shares, at the date of this notice);

    (b) the minimum price (exclusive of expenses) which may be paid for a Share shall be 25p, being the nominal value per ordinary share;

    (c) the maximum price (exclusive of expenses) which may be paid for a Share shall be the higher of (i) 5% above the average of the market values of the Shares for the five business days immediately preceding the date of the purchase as derived from the Daily Official List of the London Stock Exchange and (ii) the higher of the price quoted for (a) the last independent trade of, and (b) the highest current independent bid for, any number of Shares on the trading venue where the purchase is carried out; and

    (d) unless renewed, the authority hereby conferred shall expire at the conclusion of the next Annual General Meeting of the Company in 2015, save that the Company may, prior to such expiry, enter into a contract to purchase Shares which will or may be completed or executed wholly or partly after such expiry.

    All Shares purchased pursuant to the above authority shall be either:

    (i) held, sold, transferred or otherwise dealt with as treasury shares in accordance with the provisions of the Act; or

    (ii) cancelled immediately upon completion of the purchase.

14. That the regulations contained in the printed document produced to the meeting and marked 'A' (and for the purposes of identification initialled by the Chairman of the meeting) be hereby approved and adopted as the Articles of Association of the Company in substitution for, and to the exclusion of all, existing Articles of Association.

**BY ORDER OF THE BOARD**

BLACKROCK INVESTMENT MANAGEMENT (UK) LIMITED

Company Secretary

25 April 2014

# Annual general meeting

## Notice of annual general meeting continued

Notes:

1. A member entitled to attend and vote at the meeting convened by the above Notice is also entitled to appoint one or more proxies to exercise all or any of the rights of the member to attend, speak and vote instead of him/her. A proxy need not be a member of the Company. If a member appoints more than one proxy to attend the meeting, each proxy must be appointed to exercise the rights attached to a different share or shares held by the member.
2. To appoint a proxy you may use the form of proxy enclosed with this annual report. To be valid, the form of proxy, together with the power of attorney or other authority (if any) under which it is signed or a notarially certified or office copy of the same, must be completed and returned to the office of the Company's registrar in accordance with the instructions printed thereon as soon as possible and in any event by not later than 11.30 a.m. on 6 June 2014 (excluding non-working days). Alternatively you can vote or appoint a proxy electronically by visiting eproxyappointment.com. You will be asked to enter the Control Number, the Shareholder Reference Number and PIN which are printed on the form of proxy. The latest time for the submission of proxy votes electronically is 11.30 a.m. on 6 June 2014 (excluding non-working days).
3. Completion and return of the form of proxy will not prevent a member from attending the meeting and voting in person.
4. Any person receiving a copy of this Notice as a person nominated by a member to enjoy information rights under section 146 of the Companies Act 2006 (a "Nominated Person") should note that the provisions in notes 1 to 2 above concerning the appointment of a proxy or proxies to attend the meeting in place of a member, do not apply to a Nominated Person as only shareholders have the right to appoint a proxy. However, a Nominated Person may have a right under an agreement between the Nominated Person and the member by whom he or she was nominated to be appointed, or to have someone else appointed, as proxy for the meeting. If a Nominated Person has no such proxy appointment right or does not wish to exercise it, he/she may have a right under such agreement to give instructions to the member as to the exercise of voting rights at the meeting.
5. Nominated persons should also remember that their main point of contact in terms of their investment in the Company remains the member who nominated the Nominated Person to enjoy the information rights (or perhaps the custodian or broker who administers the investment on their behalf). Nominated Persons should continue to contact that member, custodian or broker (and not the Company) regarding any changes or queries relating to the Nominated Person's personal details and interest in the Company (including any administrative matter). The only exception to this is where the Company expressly requests a response from the Nominated Person.
6. Pursuant to regulation 41 of the Uncertificated Securities Regulations 2001, only shareholders registered in the register of members of the Company by not later than 6.00 p.m. two days prior to the time fixed for the meeting shall be entitled to attend and vote at the meeting in respect of the number of shares registered in their name at such time. If the meeting is adjourned, the time by which a person must be entered on the register of members of the Company in order to have the right to attend and vote at the adjourned meeting is 6.00 p.m. two days prior to the time of adjournment. Changes to the register of members after the relevant times shall be disregarded in determining the rights of any person to attend and vote at the meeting.
7. In the case of joint holders, the vote of the senior holder who tenders a vote whether in person or by proxy shall be accepted to the exclusion of the votes of the other joint holders and, for this purpose, seniority will be determined by the order in which the names stand in the register of members of the Company in respect of the relevant joint holding.
8. Holders of shares through the Savings Schemes are entitled to attend and vote at the meeting if the voting instruction form, which is enclosed with this document, is correctly completed and returned in accordance with the instructions printed thereon.
9. Shareholders who hold their shares electronically may submit their votes through CREST, by submitting the appropriate and authenticated CREST message so as to be received by the Company's registrar not later than 48 hours before the start of the meeting (excluding non-working days). Instructions on how to vote through CREST can be found by accessing the following website: euroclear.com/CREST. Shareholders are advised that CREST and the internet are the only methods by which completed proxies can be submitted electronically.
10. If you are a CREST system user (including a CREST personal member) you can appoint one or more proxies or give an instruction to a proxy by having an appropriate CREST message transmitted. To appoint one or more proxies or to give an instruction to a proxy (whether previously appointed or otherwise) via the CREST system, CREST messages must be received by Computershare (ID number 3RA50) not later than 48 hours before the time appointed for holding the meeting. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp generated by the CREST system) from which Computershare is able to retrieve the message. CREST personal members or other CREST sponsored members should contact their CREST sponsor for assistance with appointing proxies via CREST. For further information on CREST procedures, limitations and system timings please refer to the CREST manual. The Company may treat as invalid a proxy appointment sent by CREST in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.
11. If the Chairman, as a result of any proxy appointments, is given discretion as to how the votes subject of those proxies are cast and voting rights in respect of those discretionary proxies, when added to the interest in the Company's securities already held by the Chairman, result in the Chairman holding such number of voting rights that he has a notifiable obligation under the Disclosure and Transparency Rules, the Chairman will make the necessary notifications to the Company and the Financial Conduct Authority. As a result, any member holding 3 per cent. or more of the voting rights in the Company, who grants the Chairman a discretionary proxy in respect of some or all of those voting rights and so would otherwise have a notification obligation under the Disclosure and Transparency Rules, need not make a separate notification to the Company and the Financial Conduct Authority.
12. Any question relevant to the business of the meeting may be asked at the meeting by anyone permitted to speak at the meeting. A shareholder may alternatively submit a question in advance by a letter addressed to the Company Secretary at the Company's registered office. Under section 319A of the Companies Act 2006, the Company must answer any question a shareholder asks relating to the business being dealt with at the meeting, unless (i) answering the question would interfere unduly with the preparation for the meeting or involve the disclosure of confidential information; (ii) the answer had already been given on a website in the form of an answer to a question; or (iii) it is undesirable in the interests of the Company or the good order of the meeting that the question be answered.
13. Any corporation which is a member can appoint one or more corporate representatives who may exercise on its behalf all of its powers as a member provided that, if it is appointing more than one corporate representative, it does not do so in relation to the same shares. It is therefore no longer necessary to nominate a designated corporate representative.
14. Under section 527 of the Companies Act 2006, members meeting the threshold requirements set out in that section have the right to require the Company to publish on a website a statement setting out any matter relating to:
    (i) the audit of the Company's accounts (including the auditor's report and the conduct of the audit) that are laid before the meeting; or
    (ii) any circumstance connected with an auditor of the Company ceasing to hold office since the previous meeting at which annual accounts and reports were laid in accordance with section 437 of the Companies Act 2006.

The Company may not require the members requesting such website publication to pay its expenses in complying with sections 527 or 528 of the Companies Act 2006. Where the Company is required to place a statement on a website under section 527 of the Companies Act 2006, it must forward the statement to the Company's auditor not later than the time when it makes the statement available on the website. The business which may be dealt with at the meeting includes any statement that the Company has been required under section 527 of the Companies Act 2006 to publish on a website.

15. Under sections 338 and 338A of the Companies Act 2006, members meeting the threshold requirements in those sections have the right to require the Company:
    - (i) to give, to members of the Company entitled to receive notice of the meeting, notice of a resolution which may properly be moved and is intended to be moved at the meeting; and/or
    - (ii) to include in the business to be dealt with at the meeting any matter (other than a proposed resolution) which may be properly included in the business.

    A resolution may properly be moved or a matter may properly be included in the business unless:
    - (a) (in the case of a resolution only) it would, if passed, be ineffective (whether by reason of inconsistency with any enactment or the Company's constitution or otherwise);
    - (b) it is defamatory of any person; or
    - (c) it is frivolous or vexatious.

    Such a request may be in hard copy form or in electronic form, and must identify the resolution of which notice is to be given or the matter to be included in the business, must be authorised by the person or persons making it, must be received by the Company not later than 28 April 2014, being the date six weeks clear before the meeting and (in the case of a matter to be included in the business only) must be accompanied by a statement setting out the grounds for the request.
16. Further information regarding the meeting which the Company is required by section 311A of the Companies Act 2006 to publish on a website in advance of the meeting (including this Notice), can be accessed at www.blackrock.co.uk/brsc.
17. As at the date of this report, the Company's issued share capital comprised 47,879,792 ordinary shares of 25 pence each, excluding shares held in treasury. Each ordinary share carries the right to one vote and therefore the total number of voting rights in the Company on 25 April 2014 is 47,879,792.
18. No service contracts exist between the Company and any of the Directors, who hold office in accordance with letters of appointment and the Articles of Association.

# Warning to Shareholders

## SHARE FRAUD WARNING

Share fraud includes scams where investors are called out of the blue and offered shares that often turn out to be worthless or non-existent, or an inflated price for shares they own. These calls come from fraudsters operating in 'boiler rooms' that are mostly based abroad.

While high profits are promised, those who buy or sell shares in this way usually lose their money.

The Financial Conduct Authority (FCA) (formerly the Financial Services Authority ('FSA')) has found most share fraud victims are experienced investors who lose an average of £20,000, with around £200m lost in the UK each year.

## PROTECT YOURSELF

If you are offered unsolicited investment advice, discounted shares, a premium price for shares you own, or free company or research reports, you should take these steps before handing over any money:

1. Get the name of the person and organisation contacting you.
2. Check the Financial Services Register via **fca.org.uk** to ensure they are authorised.
3. Use the details on the Financial Services Register to contact the firm.
4. Call the FCA Consumer Helpline on **0800 111 6768** if there are no contact details on the Register or you are told they are out of date.
5. Search the FCA's website list of unauthorised firms and individuals to avoid doing business with.
6. **REMEMBER: if it sounds too good to be true, it probably is!**

If you use an unauthorised firm to buy or sell shares or other investments, you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme (FSCS) if things go wrong.

## REPORT A SCAM

If you are approached about a share scam you should tell the FCA using the share fraud reporting form at **fca.org.uk/consumers/scams**, where you can find out about the latest investment scams. You can also call the Consumer Helpline on **0800 111 6768**.

**If you have already paid money to share fraudsters you should contact Action Fraud on**

0300 123 2040

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