The Henderson Smaller Companies Investment Trust plc

Report and Financial Statements for the year ended 31 May 2012

The Henderson Smaller Companies Investment Trust plc

Objective	The objective of The Henderson Smaller Companies Investment Trust plc is to maximise shareholders' total returns by investing mainly in smaller companies that are quoted in the United Kingdom.
Investment selection	The investment selection process seeks, by rigorous research, to identify high-quality smaller companies with strong growth potential. Generally new investments are made in constituents of the benchmark index. Investments may continue to be held when the underlying companies grow out of the smaller companies sector but strong selling disciplines are applied regardless of the size of the entity.
Benchmark Index	Numis Smaller Companies Index (excluding investment companies).*
Manager	The Board has appointed Henderson Global Investors to manage the investments and to provide the related administrative services.
Independent Board	The directors, who are independent of the Manager, meet regularly to consider investment strategy and to monitor the performance of the Company.
Website	Information about the Company can be found on the website www.hendersonsmallercompanies.com

*until 28 March 2012, known as the Hoare Govett Smaller Companies Index (excluding investment companies). Prior to 1 June 2003 the benchmark was the FTSE SmallCap Index (excluding investment companies)

Financial Highlights

	31 May 2012	31 May 2011
Total net assets	**£280 million**	£298 million
Net asset value per ordinary share	**374.5p**	398.1p
Net asset value per ordinary share on an alternative basis*	**367.9p**	392.5p
Market price per ordinary share	**284.3p**	319.4p
Total (loss)/return per ordinary share	**(19.6)p**	124.6p
Revenue return per ordinary share	**6.1p**	4.9p
Dividend per ordinary share	**5.5p**	4.2p
Gearing†	**8.7%**	9.5%

*Calculated by deducting from the net assets the debt at its market value, as disclosed in note 20 on page 53.

†Defined here as the total market value of the Company's investments less shareholders' funds as a percentage of shareholders' funds.

Performance: comparative total return figures for periods ended 31 May 2012

	1 year %	2 years %	3 years %	5 years %	10 years %
The Henderson Smaller Companies Investment Trust plc:					
net asset value per share*	(5.2)(1)	39.8(1)	100.1(1)	0.5(2)	121.7(2)
The Henderson Smaller Companies Investment Trust plc: share price (2)	(9.7)	35.4	80.2	(4.9)	110.2
Numis Smaller Companies Index (excluding investment companies) (3)#	(7.7)	22.2	58.3	0.5	132.0
FTSE SmallCap Index (excluding investment companies) (3)	(9.4)	11.6	34.9	(31.7)	22.6
FTSE All-Share Index(3)	(8.0)	10.7	36.1	(3.5)	58.1

Source: (1) Henderson Global Investors (2) Morningstar (3) Datastream
The net asset value total return figures are calculated on the basis that the Company's issue of Debenture Stock is included at its par value, as in the financial statements that follow.

*The net asset value per share total return figures include an adjustment to reflect that since 2005 investments are valued at bid prices (ie at fair value) rather than at mid-market prices.

#Previously the Hoare Govett Smaller Companies Index (excluding investment companies).

Historical Record

Year end	Market price per ordinary share in pence	Net asset value per ordinary share in pence*	Revenue earnings per ordinary share in pence*	Final dividend per ordinary share in pence	Special dividend per ordinary share in pence†
31 May 2002	150.5	181.1	(0.77)	0.50	–
31 May 2003	96.0	121.8	0.20	0.50	–
31 May 2004	134.75	172.1	1.17	1.00	–
31 May 2005	169.5	214.5	1.44	1.15	–
31 May 2006	232.75	280.4	1.83	1.35	–
31 May 2007	323.5	392.1	2.12	1.70	–
31 May 2008	252.0	317.6	4.64	2.20	1.60
31 May 2009	167.0	202.1	6.30	3.00	2.60
31 May 2010	216.0	277.1	4.59	3.60	–
31 May 2011	319.4	398.1	4.91	4.20	–
31 May 2012	**284.3**	**374.5**	**6.07**	**5.50**	**–**

*The figures for 2006 (and the figures for subsequent years) have been calculated in accordance with International Financial Reporting Standards ('IFRS'), 2005 figures were restated on first adoption of IFRS. The figures for the earlier years have not been restated.

†In 2008 and 2009 the revenue earnings included the write-back of VAT borne on management fees in certain periods between 1990 and 2007 and the simple interest receivable on those refunds. Most of the amounts recognised were distributed by way of special dividends.

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Warning to Shareholders

Many companies have become aware that their shareholders have received unsolicited phone calls or correspondence concerning investment matters. These are typically from overseas based 'brokers' who target UK shareholders offering to sell them what often turn out to be worthless or high risk shares in US or UK investments. They can be very persistent and extremely persuasive. Shareholders are therefore advised to be very wary of any unsolicited advice, offers to buy shares at a discount or offers of free company reports.

Please note that it is very unlikely that either the Company or the Company's Registrar, Computershare Investor Services PLC, would make unsolicited telephone calls to shareholders and that any such calls would relate only to official documentation already circulated to shareholders and never in respect of investment 'advice'.

If you are in any doubt about the veracity of an unsolicited phone call, please call either the Company Secretary or the Registrar at the numbers provided on page 56.

Chairman's Statement

Jamie Cayzer-Colvin

This year has been difficult and although I am pleased to report that the Company has again outperformed on a relative basis, despite being geared, and that there has been substantial growth in the portfolio's revenue allowing us to increase the dividend by 30%, the Company's second-half gains could not counter the first-half losses and therefore the net asset value (NAV) declined by 5.2% in the year.

This relative outperformance is testimony to good stock picking and I am pleased to report that we have outperformed the benchmark in eight of the nine full financial years in which Neil Hermon has been our portfolio manager. In that period the Company has produced an NAV total return of 228.3%, resulting in a compounded annual return of 14.1%. Such a return demonstrates that a long term approach is the appropriate one to take when investing in smaller companies.

I would like to pay tribute to all the Henderson staff and my Board for their efforts throughout the year on behalf of shareholders. They do battle with an ever-growing jungle of legislation, and I thank them all for the tremendous contribution which they have made.

Revenue and dividend

The revenue return per share is significantly up at 6.1p, compared with 4.9p for the previous year. We expect the dividend growth from our investment portfolio to continue in the coming year and therefore propose a notable increase in the final dividend for the year to 5.5p per share (2011: 4.2p). This is of course subject to shareholder approval at the Annual General Meeting in October. If approved this would be an elevenfold increase over these past 9 years, and a compounded annual growth rate of 30%.

Share buy-backs and discount

During the year the smaller companies sector as a whole traded at an average discount of 15.7% with highs and lows of 18.9% and 7.4% respectively. The Company's discount ranged from 11.9% to 25.2% with the average discount over the year being 20.8%. This offered a compelling investment opportunity and therefore we bought back 165,000 shares at an average discount of 23.0% and average price of 286.35p. The Board continues to keep a close eye on the discount and will from time to time buy back shares. However we do not believe that share buy-backs have a significant effect on the discount other than in the short term.

Outlook

As I stated in my interim statement, markets are going to continue to be volatile whilst the world endures the struggle with deficits and the continuing saga of the Euro. As Benjamin Graham said, equities "are subject to irrational and excessive price fluctuations in both directions, as the consequence of the ingrained tendency of most people to speculate or gamble". This tends to be exaggerated in the smaller companies sector, where coverage and research are poor, but there lies the opportunity. It is vitally important that we don't forget some simple principles: understand the businesses you are investing in, take advantage when the market is either too optimistic or depressed and always look for a margin of safety while taking a longer term view. These basic ideas are enduring and essential for long-term success. I believe that Neil Hermon is well equipped to face these challenges and to build upon his performance to date.

Annual General Meeting

Our Annual General Meeting will be held at 10:30am on Friday, 5 October 2012 at the Registered Office, 201 Bishopsgate, London EC2M 3AE. The Notice of Meeting is set out in the accompanying circular to shareholders. We would encourage as many shareholders as possible to attend for the opportunity to meet the Board and to watch a presentation from Neil Hermon reviewing the year and looking forward to the year ahead.

J M B Cayzer-Colvin
Chairman
23 August 2012

Fund Manager's Review

Neil Hermon

Analysis of the portfolio by sector	31 May 2012 %	31 May 2011 %
Support Services	**18.2**	18.2
Electronic & Electrical Equipment	**12.8**	11.8
Software & Computer Services	**7.8**	7.5
Chemicals	**7.3**	7.2
Media	**6.7**	6.9
Financial Services	**5.5**	6.8
Oil & Gas Producers	**5.5**	4.3
Household Goods & Home Construction	**4.7**	4.8
Real Estate	**4.6**	4.6
Industrial Engineering	**3.8**	3.3
General Retailers	**3.3**	4.2
Construction & Materials	**3.3**	3.8
Technology Hardware & Equipment	**3.2**	3.1
Aerospace & Defence	**3.1**	4.5
Travel & Leisure	**3.0**	2.5
Oil Equipment, Services & Distribution	**2.4**	1.3
Health Care Equipment & Services	**1.7**	1.4
Mining	**1.5**	1.9
Industrial Metals & Mining	**0.6**	0.9
Pharmaceuticals & Biotechnology	**0.5**	0.7
General Industrials	**0.3**	–
Food Producers	**0.2**	0.3
	100.0	100.0

Market – year in review

The year under review was, as you say in football parlance, 'a game of two halves'. The first 6 months of our year was extremely difficult with the net asset value falling sharply. This was caused by a rating downgrade in the US, continued political wrangling over the US budget deficit and the mounting European sovereign credit crisis. Equity markets, however, enjoyed a sharp rally in the second half of our year as investors focused on better economic news from the US, hopes of a 'soft landing' in China and the relative attractiveness of equities over other asset classes. Even concerns over the Eurozone were temporarily forgotten. Indeed we might well have ended the year with a positive net asset value performance were it not for May being a poor month for equities. Although macro economic conditions remained volatile, the fundamentals of the corporate sector continued to improve. Profit growth was strong, balance sheets continued to strengthen and merger and acquisition activity continued at a reasonable pace. Foreign corporates were particularly active in looking to acquire UK companies with strong domestic or international market niche positions.

Smaller companies marginally outperformed larger companies over the year. In fact the Numis Smaller Companies Index has now outperformed the FTSE All-Share Index for the last four years consecutively (and in 11 of the last 12 years).

Fund performance

The Company had a mixed year in performance terms – outperforming its benchmark but falling in absolute terms. The net asset value fell 5.2%, on a total return basis. This compares to a decline of 7.7% (total return) from the Numis Smaller Companies Index (excluding investment companies) and a decline of 9.4% (total return) from the FTSE Small Cap Index (excluding investment companies). The outperformance came from a combination of underlying positive portfolio performance offset by a negative contribution from gearing in the Company. The year under review is the eighth year of outperformance of our benchmark, the Numis Smaller Companies Index (excluding investment companies), since I have been the Fund Manager.

Fund Manager's Review

continued

Gearing

Gearing started the year at 9.5% and ended it at 8.7%. The majority of the gearing is provided by the £20 million 10.5% 2016 debenture with the remainder by short term bank borrowings. Gearing was a negative contributor to performance in the year as markets declined but has been a significant positive over the 9 years I have managed the investment portfolio.

Attribution analysis

The tables below show the top five contributors to, and the bottom five detractors from, the Company's relative performance.

Principal contributors	12 month return %	Relative contribution %
Oxford Instruments	+53.0	+1.0
Croda	+18.0	+0.9
Anite	+63.3	+0.7
Melrose	+33.2	+0.7
Spectris	+5.7	+0.5

Oxford Instruments produces advanced instrumentation equipment for industrial and scientific research markets. The company has benefited from a recovery in its end markets and substantial growth in Asia Pacific. China has been particularly strong with it now representing Oxford's largest end market. Margins have expanded significantly and the outlook is promising for further strong growth.

Croda manufactures a range of chemicals, including oleo-chemicals and industrial chemicals. The company has an excellent track record over many years benefiting from pricing power, exposure to robust and growing end markets, a strong acquisitive record and excellent management. With strong profit growth forecast, the future continues to look bright for Croda.

Anite is an IT software and services business supplying into the telecommunications and travel industry. Its success in the last year has been based on its telecommunication business. Its testing software is seeing rapid growth on the back of strong demand from network operators, handset and chipset manufacturers who are investing heavily in the new 4G telecommunication networks. As a world leader in this area Anite is well placed to enjoy strong growth as investment in 4G increases.

Melrose is a diversified engineering group. Its raison d'etre is to acquire under-performing companies and then turn round their performance through application of strict financial controls, better management practices and investment in growth areas leading to significant expansion in margins and cash generation. When this has been achieved and significant value created Melrose will sell the business on to a trade or private equity buyer. This has been done to great effect with the acquisitions of Dynacast, McKechnie and FKI.

Spectris manufactures, designs and markets products for the electronic control and process instrumentation sectors. The company has a number of subsidiaries which are market leaders in global market niches. Cash generation is very sound, the management team is well respected and the balance sheet is strong. Recovering industrial markets mean profit growth is forecast to be robust.

Principal detractors	12 month return %	Relative contribution %
Northgate	-46.7	-0.6
Logica*†	+84.7	-0.5
WSP	-20.1	-0.5
Premier Oil	-28.6	-0.4
Ophir Energy†#	+101.5	-0.4

*Included in the benchmark but not owned by the Company.

†Joined the benchmark index on 1 January 2012; share price return shown since that date.

#Purchased for the Company during the year to 31 May 2012

Northgate is a provider of commercial vehicles for rent with operations in the UK and Spain. The poor economic conditions in these two countries has affected demand and meant a contraction in Northgate's fleet on hire. Earnings have therefore been under some pressure even though the company has been restructuring and improving business processes which have taken significant cost out of the business. Although the outlook remains difficult Northgate is de-leveraging rapidly and trades at a substantial discount to its tangible net asset value, which is primarily made up of second-hand commercial vehicles that are selling at above book value. The shares are a deep value situation and will bounce sharply when markets recover.

Logica is an IT services business. The share price rose significantly after CGI Group, a Canadian business, made an agreed bid for the company. The Company had no holding in Logica.

Fund Manager's Review

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WSP is an international engineering consultant, principally in the built environment. Although market conditions are tough, profits have held up well as the company has adjusted its cost base to match revenues. The share price underperformed the market as investors were frustrated by the lack of profit progress, the uncertain outlook for growth and the cut-backs in UK Government spending. We continued to hold the company as we felt that although trading conditions were tough recovery potential was significant when markets recovered and there was a high chance of the company being acquired in a consolidating global industry. This patience paid off as WSP was acquired for a near 70% premium by the Canadian company, Genivar, subsequent to our year-end.

Premier Oil is an international oil explorer and producer. The company has expanded through acquisition and bought Encore Oil, a North Sea specialist, in the year. Although production is ramping up to plan and oil prices have been relatively strong in the year the shares have performed poorly. This is due to some indigestion from new equity issued to buy Encore and a perception that Premier has been unsuccessful in its exploration programme. We believe this assessment is harsh and the shares look very cheap trading at a discount to its core net asset value even before we take into account potential upside from exploration wells planned in the coming year.

Ophir Energy is an oil and gas explorer predominantly exposed to offshore East Africa. The shares have performed particularly well as this part of the world has become the 'hottest' area for oil and gas exploration with significant new gas finds in the region. Ophir has substantial acreage and has already made some highly promising discoveries of its own. Interest in the shares has also been increased by the bidding war for Cove Energy, a peer with similar interests in East Africa. We took a position in Ophir during the year.

Portfolio activity

Trading activity in the portfolio was consistent with an average holding period of over 5 years. Our approach is to consider our investments as long term in nature and to avoid unnecessary turnover. The focus has been on adding stocks to the portfolio that have good growth prospects, sound financial characteristics and strong management, at a valuation level that does not reflect these strengths. Likewise we have been employing strong sell discipline to cut out stocks that fail to meet these criteria.

In the year we have added a number of new positions to our portfolio. We increased our exposure to the oil and gas sector. We targeted companies that have the ability to add significant value through exploration. Acquisitions in this area included **Afren**, with operations in Africa and Kurdistan, **Ophir Energy**, which has substantial acreage in East Africa, a current 'hot' area with substantial new gas discoveries and **Faroe Petroleum**, a North Sea producer and explorer. We also took a small position in **Borders & Southern**, which is currently undertaking high impact drilling in the South Atlantic, near to the Falkland Islands. To finance these acquisitions we disposed of our holdings in Valiant Petroleum, Bowleven and Oilex where drilling results had not lived up to our expectations.

Other new additions to our portfolio included:

RPS, an international environmental, planning and oil and gas consultancy. RPS has been particularly successful in evolving its business to gain exposure to strong growth areas. In recent years it has significantly expanded its oil and gas consultancy to the point where it represents over 50% of earnings. With the moratorium on Gulf of Mexico drilling over and 2011 acquisitions to kick in, 2012 and beyond are set for positive earnings growth.

Hunting, an oil services company which has re-invented itself in recent years. Post the disposal of its Canadian oil transportation business it has re-invested the proceeds into down-hole oil and gas well technology. The explosion of demand generated by the exploitation of shale oil and gas reserves in the USA is driving strong growth. Longer term Hunting is likely to be a takeover target for a larger American company, given the history of US companies buying UK technology based oil service companies.

St Modwen, a property developer and investor with a particular skill in brownfield development and housing land. This acquisition, in some ways, was opportunistic in that the share price had sunk to a near 60% discount to its asset value and was absurdly cheap. However, even though valuation was one of the attractions, St Modwen has a strong long-term track record in creating value by taking brownfield land through the planning process, substantially enhancing values in the process. Although we have already made over 40% on our initial investment we believe the share price has further to go.

Fund Manager's Review

continued

Spirit, a UK pub group. Spirit is the managed house arm of Punch Taverns and was de-merged from this business in August 2011. During its ownership under Punch, the business had been under-managed and under-invested due to the balance sheet constraints of its parent. However under a new impressive management team, lead by its CEO, Mike Tye, the company is re-investing in its business, with new systems, a significantly strengthened operational team and improved branding. This is leading to operating margins and return on capital increasing to more industry norms driving strong earnings growth.

To balance the additions to our portfolio we have disposed of positions in companies which we felt were set for poor price performance. We disposed of our holding in Chemring, the defence products business, where weak markets and the withdrawal of troops from Afghanistan and Iraq are putting profitability and cashflow under pressure. We also disposed of our holding in Carillion, the international contracting and support services group, where the acquisition of Eaga has proved to be strategically unsound and expensive. Earnings growth will be anaemic at best for at least the next two years. Other disposals included Hansteen, the property investor, as we are concerned for the outlook for European industrial property markets, Halfords, the automotive accessories retailer, as it is facing increasing competition in core product markets which is leading to margin pressure and Phoenix IT, the IT services business, where even though the shares look cheap, growth has been minimal for the last few years with little prospect of this changing in the future due to competitive pressure.

We benefited from a level of takeover activity in the year. The level was down on the previous year as the macro-economic uncertainty meant corporates were unwilling to be overly aggressive in leveraging their balance sheets to acquire competitors. Within our portfolio takeover bids were received for Globe-Op Financial Services, a hedge fund back office administrator, from SS&C Technologies, Kalahari Minerals, a uranium miner with operations in Namibia, from Guangdong Nuclear, a Chinese company and Encore Oil, a North Sea oil explorer, from Premier Oil.

We participated in only one IPO (initial public offering) in the year. This reflects a very quiet market for new issues. The IPO we participated in was NMC Health, a Middle East based distribution and healthcare provider. The company has a strong track record of growth and has ambitious plans to expand its private healthcare operations in the United Arab Emirates with a number of new facilities planned in the short to medium term. With increasing healthcare spend per population and supportive government legislation NMC is well placed to display healthy earnings growth.

Portfolio outlook

The following table shows the Company's key stock positions versus the Numis Smaller Companies Index (excluding investment companies) at 31 May 2012.

Top ten active positions	Holding %	Index Weight %	Active Weight %
Spectris	3.2	–	3.2
Croda	3.2	–	3.2
e2v technologies	3.1	0.2	2.9
Informa	2.7	–	2.7
Oxford Instruments	2.9	0.5	2.4
WSP	2.3	0.1	2.2
Melrose	2.0	–	2.0
Rotork	1.8	–	1.8
Domino Printing Sciences	2.2	0.4	1.8
Victrex	2.5	0.8	1.7

Brief descriptions of Spectris, Croda, WSP, Melrose and Oxford Instruments have been included earlier. A brief description of the remaining largest active positions follows:

e2v technologies manufactures high technology electronic components. The company had a difficult recession as weakening demand and an over-leveraged balance sheet forced it into a rescue rights issue. With a strengthened management team, substantial cost reduction and improving end markets, profit recovery has been rapid. The company has now rationalised its manufacturing base and established a credible long term growth plan. With the company now establishing a record for under-promising and over delivering the shares remain too cheap and have further re-rating potential.

Informa is a leading business to business information group. Its activities include the provision of academic journals, books, data services, trade exhibitions, conferences and training services. The company produced a very resilient profit performance during the downturn, helped by aggressive cost cutting. Additionally the balance sheet has been strengthened and the company is set for a return to growth in coming years. Given its low valuation, we believe the share price is set for further gains.

Fund Manager's Review

continued

Rotork designs and manufactures actuators and related products for use in the valve industry. Its products are principally used in the oil and gas, power and water industries. It is a global leader in its industry and has consistently grown through high levels of quality and investment in new product development. The company has a fantastic long term track record and has consistently grown faster than its peer group. Margins are high, the balance sheet is very strong, sales exposure is geared towards growing industries and emerging economies and management are high quality. Although the shares are on a reasonably high valuation Rotork has been and will continue to be an attractive long term investment.

Domino Printing Sciences is a manufacturer of industrial printing equipment. It is one of the leaders in its global market and a major exporter. As with many other UK companies, management responded quickly and aggressively to the downturn and took significant costs out of the business. As demand recovered, profits have seen a sharp recovery. Combined with a strong balance sheet, a well respected management team and a strong new product pipeline, we believe the shares will continue to outperform. A new Joint Venture in the USA, TEN Media, which is involved in the coding of eggs for food safety, opens up a potentially lucrative growth opportunity for Domino in future years.

Victrex is a manufacturer of a speciality thermoplastic PEEK. It is the world leader in its field with a 90%+ market share. Victrex has shown consistent long term growth as demand for PEEK has grown as customers look to replace metals with lighter plastics with similar thermal properties. This is best evidenced by the aerospace industry where the most technologically advanced large commercial jet in the world, the Boeing 787, uses one tonne of PEEK per plane compared to minimal use in jets of a decade ago. Although demand for PEEK is subject to the vagaries of the economic cycle, longer term its use will continue to increase and drive Victrex's profitability upwards. Additionally Victrex has developed a very successful medical business with PEEK used particularly in spinal and arthroscopy operations which is growing independent of the economic cycle.

Market outlook

The year under review has seen equity markets dogged by a number of macro-economic concerns – from the US politicking over the budget deficit, the sovereign debt crisis in Europe, a slowing Chinese economy, slow or even negative economic growth in Western Europe and politicians' inability to deal with the threats to the viability of the Euro.

The UK economy has shown at best minimal growth and indeed has lurched back into negative territory recently. The need to rein in public spending and reduce the public sector deficit is forcing large cuts in government spending. This combined with weak economies of our major trading partners in Europe has dampened economic recovery. In this environment, with rising unemployment, a high debt burden, low wage growth and a rising cost of living, the resilience of the UK consumer is being tested and making conditions for domestically focused businesses very challenging.

Despite these negative factors, there are plenty of reasons to be positive about equity markets. Valuations are low by historic standards and compare well to other asset classes. Corporate profitability has proved remarkably robust and earnings look set to see reasonable growth in the coming year. M&A activity has continued at a respectable level with foreign corporates prominent in attempting to pick up cheap UK assets. With a weak currency, liberal markets and low valuations, UK assets are attractive to overseas companies. This is a trend which will help smaller companies in particular as mergers and acquisition activity tends to be focused in this area.

In conclusion, the year under review has been a difficult one for the equity market and which, on balance, the Company has dealt with reasonably well. Relative performance was good and our portfolio companies have, overall, performed robustly. Our investments are generally trading well, are soundly financed and attractively valued. Additionally, the small cap market continues to throw up exciting growth opportunities in which the Company can invest.

Neil Hermon
Fund Manager
23 August 2012

Investment Portfolio

at 31 May 2012

Company	Main activity	Valuation as at 31 May 2012 £'000	% of portfolio
Spectris	***electronic control and process instrumentation***	**9,791**	**3.22**
Croda	***speciality chemicals***	**9,727**	**3.20**
e2v Technologies	***electronic components***	**9,520**	**3.13**
Oxford Instruments	***advanced instrumentation equipment***	**8,732**	**2.87**
Informa	***business to business information***	**8,186**	**2.69**
Victrex	***speciality chemicals***	**7,522**	**2.48**
WSP	***business support services***	**6,980**	**2.29**
Domino Printing Sciences	***industrial printing equipment***	**6,776**	**2.22**
Bellway	***house building***	**6,368**	**2.09**
Taylor Wimpey	***house building***	**6,227**	**2.04**
10 largest		**79,829**	**26.23**
Senior	*aerospace and automotive products*	6,027	1.98
Melrose	*diversified engineering*	6,006	1.98
Interserve	*international contractor*	5,485	1.80
Rotork	*process control solutions*	5,481	1.80
Intermediate Capital	*mezzanine finance*	5,311	1.75
Anite	*telecom software*	5,299	1.74
WS Atkins	*engineering consultancy*	5,244	1.72
AZ Electronic Materials	*speciality chemicals*	4,938	1.62
Premier Oil	*oil and gas exploration and production*	4,694	1.54
Ashtead	*hire of plant*	4,491	1.48
20 largest		132,805	43.64
John Menzies	*news distributor and aviation services*	4,459	1.46
Babcock International	*defence outsourcer*	4,420	1.45
Paragon	*buy to let mortgage provider*	4,221	1.38
Euromoney Institutional Investor	*business to business information*	4,045	1.33
Renishaw	*precision measuring and calibration equipment*	4,012	1.32
Restaurant Group	*restaurants*	3,919	1.29
Filtrona	*speciality plastic and fibre producer and distribution*	3,884	1.28
Ultra Electronics	*specialised defence contractor*	3,527	1.16
Ophir Energy	*oil and gas explorer*	3,492	1.15
Laird	*electronic products*	3,480	1.14
30 largest		172,264	56.60
Aveva Group	*design software*	3,332	1.09
Spirent Communications	*telecoms testing*	3,276	1.07
Fidessa	*financial software*	3,234	1.06
Balfour Beatty	*international contractor*	3,215	1.06
*RWS	*patent translation services*	3,159	1.04
NCC	*IT security*	3,137	1.03
Howden Joinery	*manufacturer and retailer of kitchens*	3,079	1.01
Northgate	*commercial vehicle hire*	3,067	1.01
Shaftesbury	*West End property investor*	3,030	1.00
Greene King	*pub operator*	2,935	0.97
40 largest		203,728	66.94

*quoted on the Alternative Investment Market.

Investment Portfolio

at 31 May 2012 continued

Company	Main activity	Valuation as at 31 May 2012 £'000	% of portfolio
Synergy Healthcare	*healthcare support services*	2,812	0.92
Grainger	*residential property investor*	2,773	0.91
Dunelm	*homewares retailer*	2,743	0.90
Aberdeen Asset Management	*fund manager*	2,722	0.90
Perform	*online media information*	2,606	0.86
Hunting	*oil equipment and services*	2,463	0.81
Afren	*oil and gas production and exploration*	2,432	0.81
Kentz	*oil and gas contractor*	2,377	0.78
*Lupus Capital	*building products*	2,322	0.76
ITE Group	*exhibition organiser*	2,292	0.75
50 largest		229,270	75.34
Telecity	*internet infrastructure*	2,250	0.74
LSL Property Services	*retail property investor*	2,233	0.73
Debenhams	*department stores*	2,227	0.73
RPS Group	*business support services*	2,225	0.73
CSR	*semiconductors*	2,196	0.72
*Playtech	*internet gaming software*	2,126	0.70
Hyder Consulting	*engineering consultancy*	2,034	0.67
SIG	*builders merchant*	2,033	0.67
Costain	*contractor*	1,988	0.65
Kenmare Resources	*titanium dioxide mining*	1,935	0.64
60 largest		250,517	82.32
Chime Communications	*advertising and marketing services*	1,875	0.62
Kofax	*electronic capture software*	1,872	0.62
*London Mining	*iron ore mining*	1,839	0.60
Ted Baker	*clothing retailer*	1,837	0.60
*Majestic Wines	*wine retailer*	1,791	0.59
Tribal Group	*education support services and software*	1,748	0.57
*Rockhopper Exploration	*oil and gas explorer*	1,665	0.55
Capital Regional	*retail property investor*	1,659	0.55
F&C Asset Management	*investment management company*	1,564	0.51
St Modwen Properties	*real estate holding and investment*	1,560	0.51
70 largest		267,927	88.04
John Wood	*oil and gas services*	1,540	0.50
Consort Medical	*healthcare products*	1,518	0.50
Rathbone Brothers	*private client asset management*	1,495	0.49
*Nautical Petroleum	*oil and gas explorer*	1,495	0.49
Keller	*ground engineering*	1,490	0.49
*LXB Retail Properties	*retail property investor*	1,480	0.49
*Abcam	*internet retailer of antibodies*	1,475	0.48
Avocet Mining	*gold mining*	1,402	0.46
Spirit Pub	*restaurant and bars*	1,390	0.46
*Digital Barriers	*digital security*	1,324	0.44
80 largest		282,536	92.84

*quoted on the Alternative Investment Market.

Investment Portfolio

at 31 May 2012 continued

Company	Main activity	Valuation as at 31 May 2012 £'000	% of portfolio
Carphone Warehouse	*mobile telephone retailer*	1,322	0.44
Jupiter Fund Management	*investment management company*	1,320	0.43
Unite Group	*retail property investor*	1,186	0.39
Norcos	*shower and tile manufacturer*	1,116	0.37
*Faroe Petroleum	*oil and gas exploration and production*	1,108	0.36
*WYG	*engineering consultancy*	1,095	0.36
RM	*education software*	1,062	0.35
Persimmon	*house building*	1,051	0.35
*Enteq Upstream	*oil equipment and services*	1,043	0.34
*Next Fifteen Communications	*PR and media services*	1,043	0.34
90 largest		293,882	96.57
Speedy Hire	*tool hire*	1,040	0.34
RPC	*containers and packaging manufacturer*	966	0.32
NMC Health	*healthcare provider*	927	0.30
*Goals Soccer Centres	*five-a-side soccer centres*	907	0.30
*IQE	*semiconductor manufacturer*	890	0.29
*Borders & Southern Petroleum	*oil and gas explorer*	696	0.23
*Asian Plantations	*palm oil plantations*	672	0.22
*Metminco	*copper mining*	629	0.21
CPP Group	*credit card and identity protection insurance*	609	0.20
Heritage Oil	*oil and gas exploration and production*	607	0.20
100 largest		301,825	99.18
Aga Rangemaster	*heating and stove manufacturer*	586	0.19
Premier Farnell	*industrial suppliers*	453	0.15
Tarsus Group	*exhibition organiser*	405	0.13
*Bullabulling Gold	*gold mining*	353	0.12
*Falkland Oil & Gas	*oil and gas explorer*	286	0.09
*Chariot Oil & Gas	*oil and gas explorer*	246	0.08
*Ncondezi Coal	*coal explorer*	179	0.06
Total investments		**304,333**	**100.00**

There were no convertible or fixed interest securities at 31 May 2012.

*quoted on the Alternative Investment Market.

Directors


Jamie Cayzer-Colvin


James Nelson


Keith Percy


Mary Ann Sieghart


Beatrice Hollond

J M B Cayzer-Colvin (Chairman), Jamie joined the Board in May 2011 and was appointed as Chairman on 30 September 2011. He is an executive director of Caledonia Investments plc. He joined the Caledonia group in 1995, initially working at its Amber specialty chemicals subsidiary before becoming an investment executive at Caledonia in 1999. He was appointed an associate director in 2002 and a director in 2005. He is a non-executive director of Close Brothers Group plc. Among other appointments, he is a director of Polar Capital Holdings plc and of a number of unquoted companies.

J J Nelson, James joined the Board in 2002. He is the Company's Senior Independent Director. He was formerly an executive partner of Graphite Capital, a director of Intermediate Capital Group PLC and is a former chairman of the BVCA. He is a director of Aurora Investment Trust plc and Syncora Guarantee (UK) Limited.

K E Percy, Keith joined the Board in 2006. He is chairman of Brunner Investment Trust plc and a director of JPMorgan Japanese Investment Trust plc, Standard Life Equity Income Trust plc, The Children's Mutual and F&C Asset Management plc.

M A Sieghart, Mary Ann joined the Board in July 2008. She was assistant editor of The Times from 1998 to 2007. She is also a former city editor and Lex columnist. She chairs the Social Market Foundation, sits on the council of Tate Modern and the advisory council of Into University and is a trustee of the Radcliffe Trust and a non-executive director of DLN Digital Limited. She writes occasional columns for The Independent and presents programmes on Radio 4.

B Hollond, Beatrice joined the Board in July 2010 and became Chairman of the Audit Committee on 24 September 2010. She is deputy chairman of Millbank Financial Services, an independent family office, and chairman of Millbank Investment Management Limited, its investment management subsidiary. She is chairman of Keystone Investment Trust plc and a director of ORA Capital Partners Plc and Oldfield & Co. (London) Limited. Among other appointments she is a trustee of the Esmée Fairbairn Foundation, is chairman of the Institute for Philanthropy and chairman of the Investment Committee, and an advisory fellow, of Pembroke College, Oxford.

All the directors are independent and all are members of the Management Engagement Committee and the Nomination Committee. Mr Cayzer-Colvin chairs these two committees.

Mrs Hollond chairs the Audit Committee, the other members of which are Mr Nelson, Mr Percy and Ms Sieghart.

Management


Neil Hermon


Tracey Lago

Neil Hermon joined Henderson Global Investors in November 2002 as head of its UK smaller companies team. A chartered accountant, he was formerly head of smaller companies at Morley, the fund management arm of Aviva.

Tracey Lago ACIS has acted as company secretary since August 2011. She is an authorised representative of Henderson Secretarial Services Limited, the corporate company secretary.

Directors' Report

The directors present the audited financial statements of the Company and the report for the year ended 31 May 2012.

Business Review

The business review seeks primarily to provide information about the Company's business, its principal risks and uncertainties and its results for the year ended 31 May 2012. It should be read in conjunction with the Chairman's Statement on page 3 and the Fund Manager's Review on pages 4 to 8, which reviews the investment activity in the year and the outlook for the portfolio.

a) Status

The Company is incorporated in England and Wales under registration number 25526, and domiciled in the United Kingdom. The Company traded throughout the year and was not dormant. It is an investment company as defined in section 833 of the Companies Act 2006 and operates as an investment trust in accordance with section 1158 of the Corporation Tax Act 2010. HM Revenue & Customs approval of the Company's status as an investment trust has been received in respect of the year ended 31 May 2011, although approval for that year is subject to review should there be any subsequent enquiry under Corporation Tax Self Assessment. The Company intends to continue to operate and conduct its affairs to enable it to apply for Investment Trust status for the current and subsequent years.

The Company intends to continue to manage its affairs so that its investments fully qualify for the stocks and shares component of an ISA.

The Company's wholly owned subsidiary, Henderson Smaller Companies Finance Limited, had not traded for several years and was no longer required, it was therefore put into members voluntary liquidation on 18 May 2012. Consequently, these financial statements relate to the Company only.

b) Investment objective

The Company's investment objective is to maximise shareholders' total returns by investing mainly in smaller companies that are quoted in the United Kingdom. The strategy is to use rigorous research to identify high-quality smaller companies with strong growth potential. The benchmark is the Numis Smaller Companies Index (excluding investment companies) (previously called Hoare Govett Smaller Companies Index). Generally, new investments are made in constituents of the benchmark index but they may continue to be held when the underlying companies grow out of the smaller companies sector. Once a portfolio company enters the FTSE 100 Index the Fund Manager has, in normal circumstances, six months to sell the position.

c) Investment policy

The Company's portfolio is managed within a framework of investment limits and restrictions determined by the Board, the primary purpose of which is to spread and mitigate investment risk.

Diversification

The Company maintains a diversified portfolio, which is detailed on page 4 and pages 9 to 11. The portfolio is actively managed by the Manager (Henderson Global Investors Limited), which provides regular reports on investment activity and portfolio construction to the directors at and between Board meetings.

The Company will not invest more than 5 per cent of its total gross assets, calculated as at the time of investment (or additional investment), in any one holding. The Company will not make any investment that, calculated at the time of investment (or additional investment), would result in it holding more than 10 per cent of an investee company's equity. The Board may give approval to the Manager to exceed these limits to as far as 10 per cent and 20 per cent respectively but only in exceptional circumstances.

Asset Allocation

Generally, the Company will invest in smaller companies that are quoted in the United Kingdom. Investments may include shares, securities and related financial instruments, including derivatives.

Gearing

The Company will borrow money for investment purposes if the Board considers it appropriate. Net borrowings are limited to a maximum of 30 per cent of the value of shareholders' funds.

General

In accordance with the Listing Rules of the UK Listing Authority, the Company will not invest more than 15 per cent of its gross assets in the shares of other listed closed-ended investment funds, including investment trusts, and will not invest more than 10 per cent of its gross assets in companies that themselves may invest more than 15 per cent of their gross assets in listed closed-ended investment funds.

d) Principal activity

The principal activity of the Company is to pursue its objective by operating as an investment trust company. The investment trust company structure allows the shareholders, whether institutions or private investors, to access a diversified portfolio of

Directors' Report

continued

investments that is professionally managed. The principal activity remained unchanged throughout the year ended 31 May 2012.

e) Strategy

The Company has appointed Henderson Global Investors Limited ('Henderson') to manage the investments and to provide the related administrative services. Henderson provides a specialist fund manager whose role is to pursue the Company's objective within parameters determined by the Board. These parameters reflect investment policy and the Board's assessment of the risks facing the Company, including the importance of retaining the Company's taxation status as an investment trust. As an investment company the Company invests its shareholders' funds in the securities of other companies. In addition it has the ability to borrow money (termed 'gearing') in order to increase the funds available for investment. It does this by means of both fixed borrowings (its £20 million issue of 10½ per cent debenture stock, repayable in 2016) and short term borrowings (drawn down from facilities provided by ING Bank N.V., London Branch with a current capacity of £20 million). In the event that the investment outlook becomes unfavourable, the Company may reduce its gearing to nil. However, it would expect the shareholders' funds to remain invested in all but unusual circumstances.

f) Performance measurement and key performance indicators

In order to measure the success of the Company in meeting its objectives and to evaluate the performance of the Manager, the directors take into account the following key performance indicators:

Performance measured against the benchmark

The Board reviews, at each of its meetings, the performance of the portfolio, the net asset value per share and the share price and compares them with the performance of the Company's benchmark.

Discount to the net asset value per share ('NAV')

The Board monitors the level of the discount to the NAV at which the Company's shares trade and reviews the average discount for the Company's relevant AIC (Association of Investment Companies) sector (the UK Smaller Companies sector). The Board considers whether to use share buy-backs to enhance shareholder value. Shares are only bought back at a price below the prevailing NAV, thereby increasing the NAV for the remaining shareholders. The Company publishes a NAV figure on a daily basis, through the official newswire of the London Stock Exchange. This figure is calculated in accordance with the AIC formula (and since 1 June 2008 includes current financial year revenue items).

Performance measured against the Company's peer group

The Company is included in the AIC's UK Smaller Companies sector, which represents the Company's peer group. In addition to comparison against the benchmark, the Board also considers the performance against the peer group.

Ongoing charges

Ongoing charges are those expenses of a type 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 costs of acquisition or disposal of investments, financing charges and gains or losses arising on investments. Ongoing charges are based on actual costs incurred in the year as being the best estimate of future costs. The Board reviews the ongoing charges and monitors the expenses incurred by the Company.

The Company previously applied a Total Expense Ratio; under recommendation of the AIC the terminology and methodology has been changed to ensure consistency of approach and calculation across the investment company sector and UCITS funds.

g) Principal risks and uncertainties

The principal risks and uncertainties facing the Company relate to the activity of investing in the shares of smaller companies that are listed (or quoted) in the United Kingdom. Although the Company invests almost entirely in securities that are quoted on recognised markets, share prices may move rapidly and it may not be possible to realise an investment at the Manager's assessment of its value. The companies in which investments are made may operate unsuccessfully, or fail entirely, such that shareholder value is lost. The Company is also exposed to the operational risk that one or more of its suppliers may not provide the required level of service. The Board considers regularly the principal risks facing the Company in order to mitigate them as far as practicable.

A fuller description of the principal risks and uncertainties follows.

With the assistance of the Manager, the Board has drawn up a risk matrix which identifies the key risks to the Company. These key risks fall broadly under the following categories:

Investment activity and strategy

An inappropriate investment strategy (for example, in terms of asset allocation or the level of gearing) may lead to

Directors' Report

continued

underperformance against the Company's benchmark and the companies in its peer group; it may also result in the Company's shares trading at a wider discount to the net asset value per share. The Board manages these risks by ensuring a diversification of investments and a regular review of the extent of borrowings. The Manager operates in accordance with investment limits and restrictions determined by the Board; these include limits on the extent to which borrowings may be used. The Board reviews its investment limits and restrictions regularly and the Manager confirms its compliance with them each month. The Manager provides the directors with management information, including performance data and reports and shareholder analysis. The Board monitors the implementation and results of the investment process with the Fund Manager, who attends all Board meetings, and reviews regularly data that monitors risk factors in respect of the portfolio. The Board reviews investment strategy at each Board meeting.

Accounting, legal and regulatory

In order to qualify as an investment trust the Company must comply with section 1158 of the Corporation Tax Act 2010, to which reference is made on page 13 under the heading 'Status'. A breach of section 1158 could result in the Company losing investment trust status and, as a consequence, capital gains realised within the Company's portfolio would be subject to Corporation Tax. The section 1158 criteria are monitored by the Manager and the results are reported to the directors at each Board meeting. The Company must comply with the provisions of the Companies Act 2006 ('the Companies Act'), and, as the Company's shares are listed for trading on the London Stock Exchange, the Company must comply with the UK Listing Authority's Listing Rules and Disclosure and Transparency Rules ('UKLA Rules'). A breach of the Companies Act could result in the Company and/or the directors being fined or becoming the subject of criminal proceedings. Breach of the UKLA Rules could result in the suspension of the Company's shares which would in turn lead to a breach of section 1158. The Board relies on its company secretary and its professional advisers to ensure compliance with the Companies Act and UKLA Rules.

Corporate governance and shareholder relations

Details of the Company's compliance with corporate governance best practice, including information on relations with shareholders, are set out in the Corporate Governance Statement on pages 18 to 23.

Operational

Disruption to, or failure of, the Manager's accounting, dealing or payment systems or the Custodian's records could prevent the accurate reporting and monitoring of the Company's financial position. The Manager has contracted some of its operational functions, principally those relating to trade processing, investment administration and accounting, to BNP Paribas Securities Services. Details of how the Board monitors the services provided by the Manager and its other suppliers, and the key elements designed to provide effective internal control, are explained further in the internal control section of the Corporate Governance Statement on pages 22 and 23.

Financial instruments and the management of risk

By its nature as an investment trust, the Company is exposed in varying degrees to market risk (comprising market price risk, currency risk and interest rate risk), liquidity risk and credit and counterparty risk. An analysis of these financial risks and the Company's policies for managing them are set out in note 16 on pages 48 to 52.

h) Financial review

Capital

At 31 May 2012 the Company had in issue 74,741,796 ordinary shares of 25p each. The market price per share at that date was 284.3p, giving the Company a market capitalisation of £212.5 million. Total equity equalled £279.9 million, the NAV being 374.5p per share. Accordingly, the market price per share stood at a discount of 24.1% to the NAV. The Company seeks annually shareholder authority to buy back its shares in the market for cancellation. During the year the Company bought back 165,000 of its ordinary shares (2011: nil) and since the year end has bought back a further 35,000 ordinary shares.

Performance

The Company had a strong year in terms of relative performance but fell in absolute terms. The stock market fell over the year and, because of good stock selection, which offset the negative effects of gearing, the Company outperformed its benchmark on a total return basis.

On a total return basis the benchmark index fell 7.7% over the year ended 31 May 2012 (2011: rose by 32.4%). By comparison the Company's net asset value total return was -5.2% (2011: 45.3%).

Directors' Report

continued

Performance attribution

	Year ended 31 May 2012
Net asset value per share total return	(5.2)
Benchmark total return	(7.7)
Relative performance	**2.5**
Made up:	
Stock selection	4.3
Gearing	(1.4)
Share buy backs	0.1
Expenses	(0.5)
	2.5

Notes:

1. The benchmark is the Numis Smaller Companies Index (excluding investment companies).
2. Source: Henderson Global Investors Limited. The table sets out the Manager's understanding of the movement, relative to the benchmark, between the net asset value per share at 31 May 2011 (398.1p) and the net asset value per share at 31 May 2012 (374.5p).

Assets

The Company's net assets decreased during the year from £298.2 million to £279.9 million. The net asset value per ordinary share decreased during the year from 398.1p to 374.5p.

The Company has no employees and no premises or physical assets of its own.

Costs

The Company's most significant items of expenditure are the costs of borrowing money for investment (the costs of gearing) and the management and, if applicable, performance fees payable to the Manager. Other expenses include investment transaction costs, the directors' fees and insurance, the fees of professional advisers and regulators, marketing, and the production and issue of reports to shareholders. In the year under review borrowing costs totalled £2,261,000, the management fee was £1,008,000 and other expenses totalled £422,000. These figures include VAT where applicable. A performance fee was not payable in respect of the year. The transaction costs, which include stamp duty and totalled £226,000, are included within the purchase costs or netted against the sales proceeds of investments.

The ongoing charge is a measure of the Company's running costs as defined on page 14. For the year ended 31 May 2012 no performance fee was payable, the ongoing charge is 0.50% (2011: 1.16% including the performance fee, 0.50% excluding the performance fee).

Revenue and dividend

The Company's investment income and other revenue totalled £8,231,000 (2011: £7,123,000). After deducting expenses the revenue profit for the year was £4,538,000 (2011: £3,674,000).

The Board seeks to increase each year the dividend per ordinary share that it puts to the shareholders for approval. The amount available for distribution represents the investment income of the Company less all borrowing costs, taxation, management fees and administrative expenses (except the performance fee). The difference between the totals of income and expenditure may vary from year to year because the Company's most significant costs are not necessarily related closely to the investment income. Accordingly, it is not possible to be certain that a progressive dividend policy can be maintained.

In respect of the year under review the directors recommend a final dividend of 5.50p per ordinary share (2011: 4.20p). Subject to approval at the Annual General Meeting, the final dividend will be paid on 12 October 2012 to shareholders on the register of members on 21 September 2012.

Donations

During the year the Company made charitable donations totalling £5,000 (2011: £6,000). No political donations were made (2011: £nil).

Payment of creditors

It remains the Company's policy for the forthcoming financial year to obtain the best terms for all business and therefore there is no single policy as to the terms used. In general the Company agrees with its suppliers the terms on which business will take place and it is the Company's policy to abide by such terms. There were no trade creditors at 31 May 2012 (2011: none).

i) Going concern

The Company's shareholders are asked every three years to vote on the continuation of the Company. An ordinary resolution to this effect was put to the Annual General Meeting on 24 September 2010 and passed by a substantial majority of the shareholders. A similar resolution will be put in 2013. The assets of the Company consist almost entirely of securities that are listed (or quoted on AIM) and, accordingly, the directors believe that the Company has adequate financial resources to continue in operational existence for the foreseeable future. For these reasons, the Board has decided that it is appropriate for the financial statements to be prepared on a going concern basis. In reviewing the position as at the date of this report, the Board has considered the guidance on this matter issued by the Financial Reporting Council.

Directors' Report

continued

j) Future developments

The future success of the Company is dependent primarily on the performance of its investments, which will to a significant degree reflect the performance of the stock market and the Manager. Although the Company invests in companies that are listed or quoted in the United Kingdom, the underlying businesses of those companies are affected by various economic factors, many of an international nature. The Board's intention is that the Company will continue to pursue its investment objective in accordance with its investment policy. Further comment on the outlook for the Company is given in the Chairman's Statement and in the Fund Manager's Review.

k) Life of the Company

The Board announced on 27 September 2002 that it proposed to introduce regular continuation votes for the Company. Accordingly, a continuation vote was put to the Annual General Meeting of the Company in September 2004, 2007 and 2010. A similar resolution will be put to the Annual General Meeting in 2013, and at every subsequent third Annual General Meeting, an ordinary resolution will be put asking the shareholders to approve the continuation of the Company as an investment trust.

In the event of the shareholders in general meeting voting against the continuation of the Company, the directors would expect to convene a further general meeting, as soon as practicable, at which proposals to liquidate, reorganise or reconstruct the Company would be put forward.

Directors

a) The directors

The directors of the Company, as shown on page 12, are Mr J M B Cayzer-Colvin, Mr J J Nelson, Mr K E Percy, Ms M A Sieghart and Mrs B Hollond. All served throughout the year under review. Mr J D Fishburn was Chairman until he retired from the Board at the conclusion of the Annual General Meeting on 30 September 2011.

The Board may appoint directors to the Board without shareholder approval. Any director so appointed must stand for reappointment by the shareholders at the next Annual General Meeting in accordance with the Articles of Association. The total number of directors shall not be less than two nor more than fifteen.

In addition, under the Articles of Association, shareholders may remove a director before the end of his or her term by passing a special resolution at a general meeting of the Company. A special resolution is passed if more than 75% of the votes cast, in person or by proxy, are in favour of the resolution.

In accordance with the Company's Articles of Association, Mr K E Percy and Mr J J Nelson will retire by rotation at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election. The Board considers that the directors should be re-elected because they bring wide, current and relevant business experience that allows them to contribute effectively to the leadership of the Company.

No director has, or during the financial year had, a contract of service with the Company. No director is or was materially interested in any contract subsisting during or at the end of the year that was significant in relation to the Company's business.

The directors have reviewed their independence in the context of the Combined Code and by reference to the AIC's Code of Corporate Governance. The directors have had no material connections with Henderson at all, other than as directors of the Company. The Board is of the opinion that each of the directors is independent in character and judgement and that there are no relationships or circumstances that are likely to affect their judgement. Mr J J Nelson has now served on the Board for more than nine years and will therefore stand for election by the shareholders each year. The Board is firmly of the view, however, that length of service does not of itself impair a director's ability to act independently. As such, the Board considers Mr J J Nelson to be independent but, in accordance with the Combined Code, his role and contribution will be subject to particularly rigorous review every year.

b) Directors' interests

The interests of the directors, at the end and beginning of the financial year, in the ordinary shares of 25p in the Company were as shown below:

	31 May 2012	1 June 2011
With beneficial interest:		
J M B Cayzer-Colvin	**12,000**	–
J J Nelson	**45,000**	45,000
K E Percy	**5,700**	5,200
M A Sieghart	**2,259**	1,676
B Hollond	**4,550**	700

No director had an interest in the preference or debenture stocks of the Company. There were no changes in the directors' interests between the year end and the date of this report.

Directors' Report

continued

c) Directors' fees

A report on the directors' remuneration is set out on pages 26 and 27.

d) Directors' conflicts of interest

Directors have a duty to avoid situations where they have, or could have, a direct or indirect interest that conflicts, or possibly could conflict, with the Company's interests. With effect from 1 October 2008, the Companies Act 2006 ('the Act') has allowed directors of public companies to authorise such conflicts and potential conflicts, where appropriate, but only if the Articles of Association contain a provision to this effect. The Act also allows the Articles of Association to contain other provisions for dealing with directors' conflicts of interest to avoid a breach of duty. There are two circumstances in which a conflict of interest can be permitted: either the situation cannot reasonably be regarded as likely to give rise to a conflict of interest or the matter has been authorised in advance by the directors. The Company's Articles of Association, which were adopted by shareholders on 24 September 2010, give the directors the relevant authority required to deal with conflicts of interest. Each of the directors has provided a statement of all conflicts of interest and potential conflicts of interest, if any, applicable to the Company. A register of conflicts of interest has been compiled and approved by the Board. The directors have also all undertaken to notify the Chairman as soon as they become aware of any new potential conflicts of interest that need to be approved by the Board and added to the Register, which is reviewed annually by the Board. It has also been agreed that directors will advise the Chairman and the company secretary in advance of any proposed external appointment and new directors will be asked to submit a list of potential situations falling within the conflicts of interest provisions of the Act in advance of joining the Board. The Chairman will then determine whether the relevant appointment causes a conflict or potential conflict of interest and should therefore be considered by the Board. Only directors who have no interest in the matter being considered would be able to participate in the Board approval process. In deciding whether to approve a conflict of interest, directors will act in a way they consider, in good faith, will be most likely to promote the Company's success. The Board can impose limits or conditions when giving authorisation if the directors consider this to be appropriate. The Board believes that its powers of authorisation of conflicts have operated effectively since they were introduced on 1 October 2008. The Board also confirms that its procedures for the approval of conflicts of interest have been followed by all the directors.

e) Directors' indemnity

Directors' and officers' liability insurance cover is in place in respect of the directors. The Company's Articles of Association provide, subject to the provisions of UK legislation, an indemnity out of the assets of the Company for every director or other officer of the Company against any liability which he or she may incur as a director or other officer of the Company in defending any proceedings (whether civil or criminal) in which judgement is given in his or her favour, or he or she is acquitted, or in connection with any application under the Companies Act in which he or she is granted relief by the court.

Corporate Governance Statement

a) Background

The UK Listing Authority requires all listed companies to disclose how they have applied the principles and complied with the provisions of the UK Corporate Governance Code ('the Code'). (The Code is accessible at www.frc.co.uk and was published in May 2010 for accounting periods commencing on or after 29 June 2010).

Throughout the year under review the Code was in force. In addition, the AIC Code of Corporate Governance, issued by the Association of Investment Companies in October 2010 ('the AIC Code'), applies to the Company. (The AIC Code, and the related Corporate Governance Guide for Investment Companies, are accessible at www.theaic.co.uk).

b) Statement of compliance

The directors consider that the Company has complied during the year ended 31 May 2012 with all the relevant provisions set out in the Code and with the AIC Code.

c) Application of the Principles of the Code

The Company is committed to high standards of corporate governance and the Board attaches importance to the matters set out in the Code and applies its principles. However, as an investment trust company, most of the Company's day to day responsibilities are delegated to third parties and the directors are all non-executive. Thus not all of the provisions of the Code are directly applicable to the Company.

d) The Board of directors

The Board is collectively responsible for the success of the Company. Its role is to provide entrepreneurial leadership within

Directors' Report

continued

a framework of prudent and effective controls that enable risk to be assessed and managed. The Board is responsible for setting the Company's standards and values and for ensuring that its obligations to its shareholders and others are understood and met. The Board sets the Company's strategic aims (subject to the Company's Articles of Association, and to such approval of the shareholders in general meeting as may be required from time to time) and ensures that the necessary resources are in place to enable the Company's objectives to be met.

The Board currently consists of five non-executive directors, all of whom the directors consider to be independent of the Company's Manager. Their biographical details, set out on page 12, demonstrate a breadth of investment, commercial and professional experience with an international perspective.

The Board meets at least six times a year and deals with the important aspects of the Company's affairs, including the setting of parameters for and the monitoring of investment strategy and the review of investment performance. The Board sets limits on the size and concentration of new investments, on any use of derivatives and on the extent to which borrowings may be used. The application of these and other restrictions, including those which govern the Company's tax status as an investment trust, are reviewed regularly at meetings of the Board. The Manager takes decisions as to the purchase and sale of individual investments and is responsible for effecting those decisions on the best available terms.

The Chairman is responsible for leading the Board and for ensuring that it continues to deal effectively with all the aspects of its role. In particular, he ensures that the Manager provides the directors, in a timely manner, with management, regulatory and financial information that is clear, accurate and relevant. Representatives of the Manager attend each Board meeting, enabling the directors to seek clarification on specific issues or to probe further on matters of concern. Matters specifically reserved for decision by the full Board have been defined and there is an agreed procedure for directors, in the furtherance of their duties, to take independent professional advice, if necessary, at the Company's expense. The directors have access to the advice and services of the corporate company secretary, through its appointed representative, who is responsible to the Board for ensuring that Board procedures are followed.

When a director is appointed he or she is offered a tailored introductory programme organised by the Manager. Directors are also provided, on a regular basis, with key information on the Company's policies, regulatory and statutory requirements and internal controls. Changes affecting directors' responsibilities are advised to the Board as they arise. Directors are encouraged to attend suitable training courses on an ongoing basis at the Company's expense.

Directors are appointed for specified terms, subject to re-election and to the provisions of the Companies Act. In accordance with the Company's Articles of Association, directors stand for election at the first annual general meeting following their appointment and stand for re-election at every third annual general meeting thereafter. Directors who serve for more than nine years stand for re-election annually.

The Board's tenure and succession policy seeks to ensure that the Board is well balanced and refreshed regularly by the appointment of new directors with the skills and experience necessary, in particular, to replace those lost by directors' retirements. Directors must be able to demonstrate their commitment, including in terms of time, to the Company. The Board is of the view that length of service does not of itself impair a director's ability to act independently. Rather, a long-serving director can offer a perspective that adds value to the deliberations of a well-balanced investment trust company board. Accordingly, the Board does not consider that directors lose their independence solely by virtue of length of service but the roles and contributions of long-serving directors will be subject to particularly rigorous review every year.

The Board's procedure in the current year for evaluating the performance of the Board, its committees and the individual directors has been by means of questionnaire. The evaluation process is designed to show whether individual directors continue to contribute effectively to the Board and to clarify the strengths and weaknesses of the Board's composition and processes. The Chairman takes the lead in acting on the results of the evaluation process. In respect of the Chairman, a meeting of the directors was held under the chairmanship of the Senior Independent Director, without the Chairman present, to evaluate his performance.

The Chairman of the Company is an independent non-executive director. A Senior Independent Director, Mr J J Nelson, has been appointed. The Board considers that all the directors have different qualities and areas of expertise on which they may lead when issues arise.

e) Board committees

The Board has established Audit, Management Engagement and Nomination Committees with defined terms of reference and duties. All three committees comprise non-executive directors appointed by the Board; the Board also appoints the Chairman of each of the Committees. The membership of these Committees is set out on page 12. A record of the meetings held during the year is set out on page 20.

Directors' Report

continued

The terms of reference of the three committees are available for inspection on the Company's website www.hendersonsmallercompanies.com or on application to the Company's registered office.

Audit Committee

Although none of the members of the Audit Committee is by profession an accountant, the Board considers that several of the directors, including the Chairman of the Audit Committee, have recent and relevant financial experience from their senior management roles elsewhere. The Audit Committee's usual programme is to meet at least three times a year: in advance of the publication of both the annual and the half year results and on at least one other occasion with an agenda that is focused on its broader responsibilities.

The role of the Audit Committee is to assist the Board in applying financial reporting and internal control principles and to maintain an appropriate relationship with the auditors. The Audit Committee is responsible for the review of the annual report and the half year report and for monitoring the integrity of the Company's financial statements generally, including consideration of the Company's accounting policies and significant reporting judgements. It reviews the nature and scope of the external audit and the findings therefrom, and the terms of appointment of the auditors, including their remuneration and the provision of any non-audit services by them. It also monitors the auditors' independence and objectivity and the effectiveness of the audit process. The Audit Committee remains satisfied with the effectiveness of the audit provided by PricewaterhouseCoopers LLP. The Audit Committee has reviewed the audit appointment in the past and does not consider it necessary to repeat this at present. The auditors are required to rotate the audit partner every five years, this is the second year that the current partner has been in place. It meets with representatives of the Manager and receives reports on the quality and effectiveness of the accounting records and management information maintained on behalf of the Company. It is responsible to the Board for monitoring the Company's internal control and risk management procedures. The Audit Committee met twice during the year to carry out these duties. Audit fees paid to PricewaterhouseCoopers LLP are detailed in note 5 on page 41.

In July 2011 the Audit Committee adopted a new policy on the provision of non-audit services. The auditors, currently PricewaterhouseCoopers LLP, will not be engaged to provide any non-audit services where the Committee considers there to be any significant risk of their independence, objectivity and effectiveness being compromised by the provision of such services. The Committee may approve the provision of non-audit services if it considers such services to be (a) relevant to the statutory audit work; (b) more efficiently provided by the external audit firm than by a third party; and (c) at low risk of impairing the independence, objectivity and effectiveness of the audit. The Audit Committee will refer to the Board any engagement with a cost or potential cost greater than £20,000 (or the cost, excluding VAT, of the most recent annual audit if higher). All engagements for non-audit services will be determined on a case-by-case basis. No such services were provided in the year under review.

Management Engagement Committee

The Management Engagement Committee is responsible for the regular review of the terms of the management contract with the Manager. The Management Engagement Committee met once formally during the year. The details of the management arrangements and the Board's review of them is set out on pages 23 and 24.

Nomination Committee

The Nomination Committee is responsible for making recommendations on the appointment of new directors. Each director is invited to submit nominations and external advisers may be used to identify potential candidates. The nominations list is considered by the Board as a whole, in accordance with its agreed procedures, although the Chairman would not expect to be involved in the selection of his successor. The Nomination Committee met formally once during the year.

f) Board attendance

The number of full meetings during the year of the Board and its Committees, and the attendance of individual directors at those meetings, is shown below.

	Board	Audit Committee	Nomination Committee	Board Committee
Number of meetings	6	2	1	1
J M B Cayzer-Colvin*	6	2	1	1
J J Nelson	5	1	1	1
K E Percy	5	1	1	1
M A Sieghart	6	2	1	1
B Hollond	6	2	1	1
J D Fishburn†	3	1	–	1

All the above directors attended the Annual General Meeting.
*Mr J M B Cayzer-Colvin stood down from the Audit Committee on appointment as Chairman of the Board but has attended its meetings by invitation.
†Resigned as a director on 30 September 2011.

Directors' Report

continued

g) Board remuneration

The Board has not appointed a separate remuneration committee. The directors' fees are detailed in the Directors' Remuneration Report on pages 26 and 27. The directors have undertaken to use part of their fees, after statutory deductions, to purchase shares in the Company.

h) Share capital

The Company's share capital comprises:

a) *ordinary shares of 25p nominal value each ('shares')*
The voting rights of the shares on a poll are one vote for each share held. At 31 May 2011 and 31 May 2012 the number of shares in issue, and thus the number of voting rights, was 74,906,796 and 74,741,796 respectively.

The Company's Articles of Association permit the Company to purchase its own shares and to fund such purchases from its accumulated realised capital reserves. At the Annual General Meeting in September 2011 a special resolution was passed giving the Company authority, until the conclusion of the Annual General Meeting in 2012, to make market purchases for cancellation of the Company's own ordinary shares up to a maximum of 11,228,528 shares (being 14.99% of the issued ordinary share capital as at 30 September 2011). As at 31 May 2012 the Company had valid authority, outstanding until the conclusion of the Annual General Meeting in 2012, to make market purchases for cancellation of 11,063,528 shares. A fresh buy-back authority will be sought at the Annual General Meeting in October. Shares are not bought back unless the result is an increase in the NAV per ordinary share.

b) *preference stock units of £1 each ('preference stock units')*
The preference stockholders have no rights to attend and vote at general meetings (except where the dividend is six months in arrears or on a resolution to wind up the Company). At 31 May 2011 there were 4,257 preference stock units in issue. No preference stock units were bought back during the year. Therefore, at 31 May 2012 the number of preference stock units in issue was 4,257. A fresh buy-back authority will be sought at the Annual General Meeting in October. Further details of the preference stock units are given in note 15 on page 47.

In the period from 31 May 2012 to 23 August 2012 the Company bought back 35,000 ordinary shares. There remained 11,028,528 ordinary shares available within the buy-back authority granted in 2011.

There are no restrictions on the transfer of the Company's share capital and there are no shares or stock which carry specific rights with regards to control of the Company.

i) Substantial share interests

As at 23 August 2012 the following had declared an interest in 3% or more of the voting rights of the Company:

Shareholder	Number of shares	% of voting rights
Prudential plc group of companies	5,254,163	7.03
The Standard Life Investments Group	5,054,695	6.77
East Riding of Yorkshire Council	4,700,000	6.29
1607 Capital Partners LLC	4,328,136	5.79
Newton Investment Management Limited	3,697,223	4.95
Royal London Asset Management Limited	3,691,666	4.94
Legal & General Investment Management Limited	2,912,722	3.90

The above percentages are calculated by applying the shareholdings as notified to the Company to the issued share capital as at 23 August 2012 (the shareholdings being the voting rights).

The Board is aware that, as at 31 May 2012, 3.60% of the issued share capital was held on behalf of participants in the Halifax Share Dealing Products (run by Halifax Share Dealing Limited ('HSDL') which is now part of Lloyds Banking Group) who transferred from the products formerly managed by Henderson Global Investors Limited ('Henderson') or who have subsequently been introduced via Henderson. In accordance with the arrangements made between HSDL and Henderson, these participants in the Halifax Share Dealing Products are given the opportunity to instruct the nominee company of HSDL to exercise the voting rights appertaining to their shares in respect of all general meetings of the Company. HSDL has undertaken to instruct its nominee company to exercise the voting rights of any such shares held through the Halifax Share Dealing Products that have not been exercised by the individual participants in them. It will do so by voting for or against all resolutions to be put at all general meetings of the Company (or by withholding votes on such resolutions) pro

Directors' Report

continued

rata to the aggregate voting instructions for each resolution received from those participants who have chosen to exercise their voting rights.

j) Relations with shareholders

It is the Chairman's role to ensure effective communication with the Company's shareholders and it is the responsibility of the Board to ensure that satisfactory dialogue takes place, based on the mutual understanding of objectives.

The Board seeks to develop an understanding of the views of the major shareholders by receiving reports from the Manager on meetings it has with shareholders and analysts and from the Company's stockbrokers on contact it has with shareholders and with potential investors. The Chairman, and other members of the Board if requested, expect to be available to talk to major shareholders if asked to do so.

The Board considers that the Annual General Meeting should provide an effective forum for individual investors to communicate with the directors. The Annual General Meeting is chaired by the Chairman of the Board. All the other directors, including the Chairman of the Audit Committee, expect to be present. Details of the proxy votes received in respect of each resolution are made available to shareholders and shown on the Henderson website. Representatives of the Manager make a presentation to the meeting. The Company has adopted a nominee share code which is set out on page 55.

k) Accountability and audit

The directors' statement of responsibilities in respect of the financial statements is set out on page 28. The responsibilities of the independent auditors are set out on pages 29 and 30. The directors' statement that the business is a going concern is set out on page 16.

The Board has delegated contractually to external agents, including the Manager, the management of the investment portfolio, the custodial services (which include the safeguarding of the assets), the day to day accounting, company secretarial and administration requirements and the registration services. Each of these contracts was entered into after full and proper consideration by the Board of the quality and cost of the services offered, including the control systems in operation in so far as they relate to the affairs of the Company. The Board receives and considers regular reports from the Manager and ad hoc reports and information are supplied to the Board as required. In addition, either the Chairman or another director attends meetings of all the chairmen of the investment trust companies managed by the Manager; these meetings provide a forum to discuss industry matters and the Chairman reports on them to the Board.

The Manager (and BNP Paribas Securities Services, which acts for the Manager) have arrangements in place by which their staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.

The Board has reviewed the implications of the Bribery Act 2010 which came into force on 1 July 2011. Assurance has been provided by the Company's main contractors and suppliers that they will maintain adequate safeguards to protect against any potentially illegal behaviour by their employees or agents.

l) Internal control

The Manager has established an internal control framework to provide reasonable, but not absolute, assurance on the effectiveness of the internal controls operated on behalf of its clients. The effectiveness of the internal controls is assessed by the Manager's internal audit and compliance and risk departments on an ongoing basis.

The Board has overall responsibility for the Company's system of internal control and for reviewing its effectiveness. The Board has established an ongoing process for identifying, evaluating and managing the significant risks faced by the Company. This process is subject to regular review by the Board and accords with the Financial Reporting Council ('FRC') guidance. The process was fully in place during the year under review and up to the date of this annual report. In addition, the Board has conducted its annual review of the effectiveness of the Company's system of internal control, covering all the controls, including financial, operational and compliance controls and risk management systems. This review took into account points raised during the year in the Board's regular appraisal of specific areas of risk. The Board confirms that, had any significant failings or weaknesses been identified by that review, necessary actions would have been taken to remedy them. The Company's system of internal control is designed to manage rather than eliminate the risks of failure to achieve the Company's business objective and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Board, assisted originally by the Manager, undertook a full

Directors' Report

continued

review of the Company's business risks and these are analysed and recorded in a risk map. This was reviewed in detail by the Audit Committee during 2011. The Board receives each quarter from the Manager a formal report which details the steps taken to monitor the areas of risk, including those that are not directly the responsibility of the Manager, and which reports the details of any known internal control failures. The Board receives each year from the Manager a report on its internal controls (an AAF 01/06 report) which includes a report from the Manager's auditors on the control policies and procedures in operation.

The Company does not have an internal audit function; it delegates to third parties most of its operations and does not employ any staff. Accordingly, in practice the Board must place reliance on the Manager and its other contractors to ensure that they operate effective internal audit functions. The Board will continue to monitor its system of internal control in order to provide assurance that it operates as intended and the directors will review at least annually whether a function equivalent to an internal audit is needed.

m) Corporate responsibility (SEE statement)

Responsible investment

Responsible Investment is the term used by the Company's Manager, Henderson Global Investors Limited ('Henderson'), to cover its work on corporate governance and corporate responsibility (or social, environmental and ethical issues) in the companies in which it invests on its clients' behalf, across all funds. In May 2005 Henderson became a founding signatory to the United Nations Principles for Responsible Investment. The Principles, developed under the auspices of the UN Secretary-General, are a voluntary and aspirational framework for incorporating environmental, social and corporate governance issues into mainstream investment decision-making and ownership practices. The way companies respond to sustainability and corporate responsibility can affect their business performance, both directly and indirectly. An investee company's policy on social responsibility and the environment is therefore considered as part of the investment risk decision.

Voting policy and the UK Stewardship Code

Henderson's Responsible Investment Policy sets out the approach to corporate governance and corporate responsibility for all the companies in which it invests on behalf of its clients, and its policy on proxy voting. The Policy also sets out how Henderson implements the Stewardship Code. The Company has delegated responsibility for voting to Henderson as its Manager. The Board will receive a report, at least annually, on the voting undertaken by Henderson on behalf of the Company. The Board and Henderson believe that voting at general meetings is an important aspect of corporate stewardship and a means of signalling shareholder views on board policy, practices and performance. Voting recommendations are guided by the best interests of the investee companies' shareholders. Depending on the nature of the resolution, the Portfolio Manager will give specific instructions on voting non-routine and unusual or controversial resolutions, after liaising with the Chairman or the full Board as appropriate. Decisions not to support resolutions and the rationale therefore are fed back to the investee company prior to voting. The Henderson Responsible Investment Policy and further details of Henderson's responsible investment activities can be found on the Henderson website, www.henderson.com

Environmental matters

The Company's core activities are undertaken by Henderson, which has implemented environmental management practices, including systems to limit the use of non-renewable resources and to minimise the impact of operations on the environment, and is focused on reducing greenhouse gas emissions and minimising waste, where possible.

The Manager

Investment management, together with investment administration, company secretarial and accounting services, are provided to the Company by wholly-owned subsidiary companies of Henderson Group plc ('Henderson' or 'the Manager'). Some of the administration and accounting services are carried out, on behalf of Henderson, by BNP Paribas Securities Services.

Other than fees payable by the Company in the ordinary course of business, there have been no material transactions with the Manager affecting the financial position or performance of the Company during the year under review.

The management agreement between the Company and Henderson provides for the payment of a composite annual management fee, calculated as a percentage of the value of the assets under management. The management fee is calculated quarterly as a percentage of the value of the assets under management on the last day of the quarter preceding the quarter in respect of which the calculation is made. Assets under management for the purpose of calculating the management fee exclude any holdings in funds managed by Henderson. The management fee is payable quarterly in

Directors' Report
continued

advance. During the year ended 31 May 2012 the percentage fee rate was 0.0875 per cent per quarter (0.35 per cent per annum) (2011: the same).

In addition, the management agreement provides for the payment of a performance fee, calculated as 15 per cent of any outperformance of the benchmark index, on a total return basis, over the Company's accounting year. This is subject to a limit on the total management fees payable in any one year of 1.0 per cent of the average value of the net assets of the Company during the year (calculated monthly) and an absolute limit to the performance fee of £2 million in any one year. There is a further cap to the effect that any enhancement to net asset value resulting from share buy-backs in excess of 5 per cent of the opening issued share capital is excluded from the calculation of the performance fee for the year. No performance fee is payable if on the last day of the Company's accounting year the Company's share price is lower than the share price as at the preceding year end. If on the last day of the Company's accounting year the net asset value per share, calculated, in accordance with the Company's accounting policies, net of costs (including any performance fee), is equal to or lower than the net asset value per share as at the preceding year end, the performance fee payable will be restricted to such amount, if any, as will result in the net asset value per share being higher than the net asset value per share at the preceding year end. Any underperformance relative to the benchmark, or any unrewarded outperformance (for example as a result of a cap), will be carried forward and set against any outperformance or underperformance respectively in subsequent years. The net amount of outperformance or underperformance carried forward is termed the Historic Amount.

A performance fee is not payable in respect of the year ended 31 May 2012, although the Company outperformed its benchmark the share price was lower at the end of the year than at the start of the year. The Historic Amount carried forward at 31 May 2012 was £15,726,310.

The management agreement provides for a formal review every three years of the fee arrangements with the Manager. Neither the Manager nor the Board required any changes following the review in 2011.

The notice period under the management agreement between Henderson and the Company is six months, the amount of any compensation payable by the Company to be pro rata to any notice given. No compensation is payable if six months' notice of termination is given. In the event that the continuation vote to be put to the annual general meeting every third year is not passed, no compensation will be payable on the subsequent termination of the contract.

During the year under review the Manager used certain services which were provided by or paid for by various brokers. In return the Manager placed business, which may have included transactions relating to the Company, with these brokers.

In the opinion of the directors the continuing appointment of the Manager on the terms agreed is in the interests of the Company's shareholders as a whole. The main reasons for this opinion are the talents and expertise of the Fund Manager and his team, the extensive investment management resources of the Manager and the Manager's experience in managing and administering investment trust companies.

Custodian
JPMorgan Chase Bank, N.A. is the Company's appointed global custodian; its fees for UK custody are offset against the management fees payable to Henderson.

Annual General Meeting
The next Annual General Meeting will be held at 10.30 am on Friday 5 October 2012 at the Company's Registered Office, 201 Bishopsgate, London EC2M 3AE. The Notice of Meeting is set out in the accompanying circular to shareholders.

Independent auditors
Resolutions to reappoint PricewaterhouseCoopers LLP as auditors to the Company, and to authorise the directors to determine their remuneration, will be proposed at the forthcoming Annual General Meeting.

Directors' statement as to the disclosure of information to the auditors
The directors who were members of the Board at the time of approving this Report are listed on page 12. Each of those directors confirms that:

Directors' Report

continued

- to the best of his or her knowledge and belief, there is no information relevant to the preparation of the Report and Financial Statements of which the Company's auditors are unaware; and
- he or she has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Company's auditors are aware of that information.

By order of the Board
T A Lago ACIS
For and on behalf of Henderson Secretarial Services Limited,
Company Secretary
23 August 2012

Directors' Remuneration Report

Introduction

The Directors' Remuneration Report ('the Report') is prepared in accordance with the Companies Act 2006 ('the Act') in respect of the year ended 31 May 2012. An ordinary resolution to receive and approve the Report will be put to the Annual General Meeting on 5 October 2012. The Act requires the auditors to report to the Company's members on certain parts of the Report and to state whether in their opinion those parts of the Report have been properly prepared in accordance with the Act. Therefore the Report has been divided into separate sections for audited and unaudited information.

UNAUDITED INFORMATION

Consideration by the directors of matters relating to directors' remuneration

The Board as a whole considered the directors' remuneration. Therefore the Board has not appointed a committee to consider matters relating to the directors' remuneration. The Board has not been provided with advice or services by any person in respect of its consideration of the directors' remuneration (although the directors, from time to time, to review the fees paid to the boards of directors of other investment trust companies).

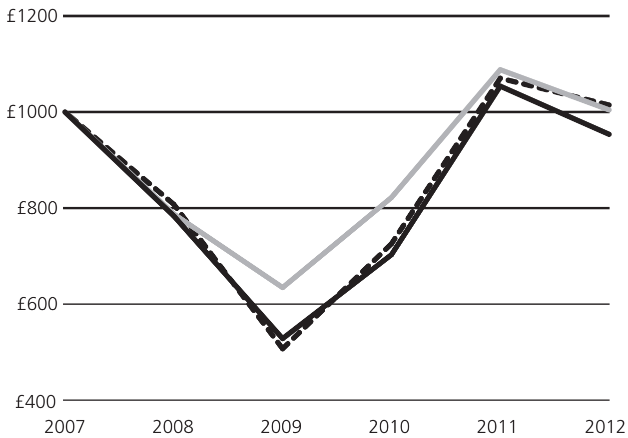
Statement of the Company's policy on directors' remuneration

The Board consists entirely of non-executive directors who meet at least six times a year to deal with the important aspects of the Company's affairs. New directors are appointed with the expectation that they will serve for a period of three years. Directors' appointments are reviewed formally every three years thereafter by the Board as a whole. None of the directors has a contract of service or a contract for services and a director may resign by notice in writing to the Board at any time; there are no set notice periods. The Company's policy is for the directors to be remunerated in the form of fees, payable quarterly in arrears, to the director personally or to a third party specified by him or her. The directors have undertaken to use a proportion of their fees to purchase shares in the Company. There are no long term incentive schemes and the fees are not specifically related to the directors' performance, either individually or collectively.

The Company's policy is that the fees payable to the directors should reflect the time spent by the Board on the Company's affairs and the responsibilities borne by the directors and should be sufficient to enable candidates of high calibre to be recruited. The policy is for the Chairman of the Board and the Chairman of the Board's Audit Committee to be paid higher fees than the other directors in recognition of their more onerous roles.

The Company's Articles of Association limit the fees payable to the directors to £150,000 per annum. The directors' fees were last increased, with effect from 1 January 2010, as follows: the Chairman from £27,500 to £28,000 per annum, the Chairman of the Audit Committee from £17,000 to £21,000 per annum and the other directors from £16,000 to £18,000 per annum. The policy is to review the fee rates from time to time, although such review will not necessarily result in any change to them.

Performance graph



The Henderson Smaller Companies share price total return, assuming the investment of £1,000 on 31 May 2007 and the reinvestment of all dividends (excluding dealing expenses)

Numis Smaller Companies Index (excluding investment companies), assuming the notional investment of £1,000 into the Index on 31 May 2007 and the reinvestment of all income (excluding dealing expenses)

The Henderson Smaller Companies NAV total return for 2008 and cum income fair value NAV total return for the period 2009 – 2012, assuming the investment of £1,000 on 31 May 2007 and the reinvestment of all dividends (excluding dealing expenses).

(Source: Datastream).

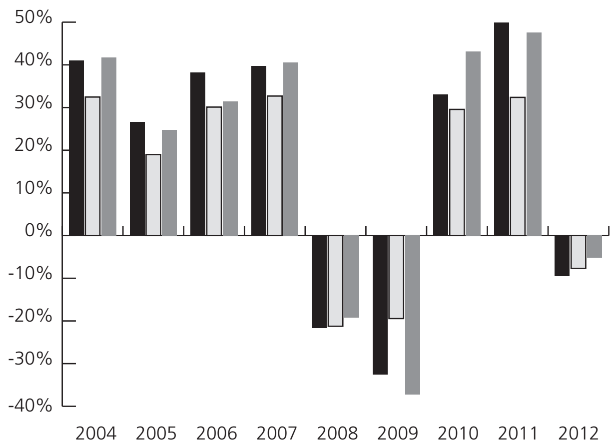
The Numis Smaller Companies Index (excluding investment companies) is selected here because it was the Company's benchmark for the five year period covered by the graph.

The information given in the graph above, which is set out in the format required by the Act, may be more readily

Directors' Remuneration Report

continued

understood in the form of a bar chart. The bar chart below compares the performance of the Company's share price to the performance of the benchmark index in each of the nine years up to 31 May 2012. Neil Hermon was appointed Fund Manager in November 2002 and the bar chart covers the full years to date of his management.



The Henderson Smaller Companies Investment Trust plc: share price total return for the year ended 31 May

The Numis Smaller Companies Index (excluding investment companies): total return for the year ended 31 May

The Henderson Smaller Companies Investment Trust plc: NAV total return for the year ended 31 May for the period 2004 – 2008 and cum income fair value NAV total return for the period 2009 – 2012.

AUDITED INFORMATION

Amount of each director's emoluments

The fees payable in respect of each of the directors who served during the year, and during 2011, were as follows:

	2012 **£**	2011 £
J M B Cayzer-Colvin(i)	**22,737**	809
B Hollond(ii)	**21,000**	15,806
J J Nelson	**18,000**	18,000
K E Percy	**18,000**	18,000
M A Sieghart	**18,000**	18,000
J D Fishburn(iii)	**12,333**	28,000
S M Davis(iv)	**–**	8,324
TOTAL	**110,070**	106,939

Notes:

(i) Mr Cayzer-Colvin was appointed to the Board on 13 May 2011 and appointed as Chairman on 30 September 2011.

(ii) Mrs Hollond was appointed to the Board on 23 July 2010 and as Chairman of the Audit Committee on 24 September 2010.

(iii) Mr Fishburn retired from the Board on 30 September 2011.

(iv) Mrs Davis retired from the Board on 24 September 2010.

No other remuneration or compensation was paid or payable by the Company during the year to any of the current or former directors.

By order of the Board

T A Lago ACIS

For and on behalf of Henderson Secretarial Services Limited, Company Secretary

23 August 2012

Statement of Directors' Responsibilities

in respect of the Annual Report, the Directors' Remuneration Report and the Financial Statements

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 elected to prepare the financial statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union. 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 profit 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 IFRS as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; 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 and, as regards the financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Statement under DTR 4.1.12

Each of the directors, who are listed on page 12, confirm that to the best of their knowledge:

- the financial statements, which have been prepared in accordance with IFRS as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Company; and
- the directors' report in this Annual Report 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.

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

For and on behalf of the Board
J M B Cayzer-Colvin
Chairman
23 August 2012

Independent Auditors' Report

to the members of The Henderson Smaller Companies Investment Trust plc

We have audited the financial statements of The Henderson Smaller Companies Investment Trust plc for the year ended 31 May 2012 which comprise the Balance Sheet, the Statement of Comprehensive Income, the Cash Flow Statement, the Statement of Changes in Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 28, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements:

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

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; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

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

Under the Listing Rules we are required to review:

- the directors' statement, set out on page 16, in relation to going concern;

Independent Auditors' Report
continued

- the parts of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on directors' remuneration.

Sally Cosgrove (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
23 August 2012

Statement of Comprehensive Income

for the year ended 31 May 2012

Notes		**Year ended 31 May 2012** Revenue return £'000	Capital return £'000	Total £'000	Year ended 31 May 2011 Revenue return £'000	Capital return £'000	Total £'000
2	Investment income	**8,195**	**–**	**8,195**	7,088	–	7,088
3	Other income	**36**	**–**	**36**	35	–	35
10	(Losses)/gains on investments held at fair value through profit or loss	**–**	**(19,160)**	**(19,160)**	–	91,312	91,312
	Total income	**8,231**	**(19,160)**	**(10,929)**	7,123	91,312	98,435
	Expenses						
4	Management and performance fees	**(1,008)**	**–**	**(1,008)**	(906)	(1,644)	(2,550)
5	Other expenses	**(422)**	**–**	**(422)**	(407)	–	(407)
	Profit/(loss) before finance costs and taxation	**6,801**	**(19,160)**	**(12,359)**	5,810	89,668	95,478
6	Finance costs	**(2,261)**	**–**	**(2,261)**	(2,132)	–	(2,132)
	Profit/(loss) before taxation	**4,540**	**(19,160)**	**(14,620)**	3,678	89,668	93,346
7	Taxation	**(2)**	**–**	**(2)**	(4)	–	(4)
	Net profit/(loss) for the year and total comprehensive income	**4,538**	**(19,160)**	**(14,622)**	3,674	89,668	93,342
8	**Earnings/(loss) per ordinary share**	**6.07p**	**(25.62)p**	**(19.55)p**	4.91p	119.70p	124.61p

The total column of this statement represents the Statement of Comprehensive Income, prepared in accordance with IFRS as adopted by the European Union.

The revenue return and capital return columns are supplementary to this and are prepared under guidance published by the Association of Investment Companies.

The notes on pages 35 to 54 form part of these financial statements.

Statement of Changes in Equity

for the year ended 31 May 2012

Notes		Year ended 31 May 2012 Called up share capital £'000	Capital redemption reserve £'000	Retained earnings Capital reserves £'000	Revenue reserve £'000	Total £'000
	Total equity at 31 May 2011	**18,727**	**26,694**	**243,800**	**8,963**	**298,184**
	Total comprehensive income:					
	(Loss)/profit for the year	**–**	**–**	**(19,160)**	**4,538**	**(14,622)**
	Transactions with owners, recorded directly to equity:					
9	Ordinary dividends paid	**–**	**–**	**–**	**(3,146)**	**(3,146)**
17	Buy-backs of ordinary shares	**(41)**	**41**	**(490)**	**–**	**(490)**
	Total equity at 31 May 2012	**18,686**	**26,735**	**224,150**	**10,355**	**279,926**

Notes		Year ended 31 May 2011 Called up share capital £'000	Capital redemption reserve £'000	Retained earnings Capital reserves £'000	Revenue reserve £'000	Total £'000
	Total equity at 31 May 2010	18,727	26,694	154,133	7,979	207,533
	Total comprehensive income:					
	Profit for the year	–	–	89,667	3,675	93,342
	Transactions with owners, recorded directly to equity:					
9	Ordinary dividends paid	–	–	–	(2,696)	(2,696)
	Dividends unclaimed after 12 years	–	–	–	5	5
	Total equity at 31 May 2011	18,727	26,694	243,800	8,963	298,184

The notes on pages 35 to 54 form part of these financial statements.

Balance Sheet

at 31 May 2012

Notes		2012 £'000	2011 £'000
	Non current assets		
10	Investments held at fair value through profit or loss	**304,333**	326,405
	Current assets		
13	Other receivables	**1,521**	1,633
	Cash and cash equivalents	**270**	642
		1,791	2,275
	Total assets	**306,124**	328,680
	Current liabilities		
14	Other payables	**(94)**	(4,492)
16(v)	Bank loans	**(6,100)**	(6,000)
		(6,194)	(10,492)
	Total assets less current liabilities	**299,930**	318,188
	Non current liabilities		
15	Financial liabilities	**(20,004)**	(20,004)
	Net assets	**279,926**	298,184
	Equity attributable to equity shareholders		
17	Called up share capital	**18,686**	18,727
18	Capital redemption reserve	**26,735**	26,694
	Retained earnings		
18	Capital reserves	**224,150**	243,800
19	Revenue reserve	**10,355**	8,963
	Total equity	**279,926**	298,184
20	**Net asset value per ordinary share**	**374.5p**	398.1p

These financial statements were approved by the Board of directors on 23 August 2012 and signed on their behalf by:

J M B Cayzer-Colvin
Chairman

The notes on pages 35 to 54 form part of these financial statements.

Cash Flow Statement

for the year ended 31 May 2012

Notes		2012 £'000	2011 £'000
	Operating activities		
	(Loss)/profit before taxation	**(14,620)**	93,346
	Add: interest payable	**2,261**	2,132
	Add/(less): losses/(gains) on investments held at fair value through profit or loss	**19,160**	(91,311)
	Purchases of investments	**(35,933)**	(54,186)
	Sales of investments	**36,584**	48,678
	Decrease/(increase) in other receivables	**7**	(88)
	Decrease in amounts due from brokers	**–**	563
	Decrease/(increase) in accrued income	**100**	(675)
	(Decrease)/increase in other payables	**(1,634)**	1,523
	(Decrease)/increase in amounts due to brokers	**(502)**	395
	Taxation on investment income	**3**	(6)
	Net cash inflow from operating activities before interest and taxation	**5,426**	371
6	Interest paid	**(2,261)**	(2,132)
	Net cash inflow/(outflow) from operating activities	**3,165**	(1,761)
	Financing activities		
9	Equity dividends paid	**(3,146)**	(2,696)
	Dividends unclaimed after 12 years	**–**	5
	Buy-backs of ordinary shares	**(490)**	–
	Drawdown of bank loans	**100**	3,997
	Net cash (outflow)/inflow from financing	**(3,536)**	1,306
	Decrease in cash and cash equivalents	**(371)**	(455)
	Exchange movements	**(1)**	–
	Cash and cash equivalents at the start of the year	**642**	1,097
	Cash and cash equivalents at the end of the year	**270**	642

The notes on pages 35 to 54 form part of these financial statements.

Notes to the Financial Statements

1 Accounting policies

(a) Basis of preparation

The Henderson Smaller Companies Investment Trust plc ('the Company') is a company incorporated and domiciled in the United Kingdom under the Companies Act 2006. The financial statements of the Company for the year ended 31 May 2012 have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. These comprise standards and interpretations approved by the International Accounting Standards Board ('IASB'), together with interpretations of the International Accounting Standards and Standing Interpretations Committee approved by the International Financial Reporting Standards Committee ('IFRSC') that remain in effect, to the extent that IFRS have been adopted by the European Union.

The financial statements have been prepared on a going concern basis and on the historical cost basis, except for the revaluation of certain financial instruments held at fair value through profit or loss. The principal accounting policies adopted are set out below. Where presentational guidance set out in the Statement of Recommended Practice ('the SORP') for investment trusts issued by the Association of Investment Companies ('the AIC') in January 2009 is consistent with the requirements of IFRS, the directors have sought to prepare the financial statements on a basis consistent with the recommendations of the SORP.

Accounting Standards

(i) New and amended standards adopted by the Company

- IFRS 1 (amendment), First Time Adoption of International Financial Reporting Standards – amendments resulting from the 2010 annual improvement review. No impact on the financial statements.
- IFRS 7 (amendment), Financial Instruments – Disclosures – amendments resulting from the 2010 annual improvement review. No impact on the financial statements.
- IAS 1 (amendment), Presentation of Financial Statements – amendments resulting from the 2010 annual improvement review. No impact on the financial statements.
- IAS 24 (revised), Related Party Disclosures – revised definition of related parties. No impact on the financial statements.

(ii) New standards, amendments and interpretations issued but not effective for the current financial year and not early adopted by the company:

- IFRS 7 (amendment), Financial Instruments – Disclosure (effective for periods beginning on or after 1 July 2011) – amendments enhancing disclosures about transfers of financial assets.
- IFRS 7 (amendment), Financial Instruments – Disclosures (effective for periods beginning on or after 1 January 2013) – amendments enhancing disclosures about offsetting financial assets and financial liabilities.
- IFRS 7 (amendment), Financial Instruments – Disclosures (effective for periods beginning on or after 1 January 2015, or otherwise when IFRS 9 is first applied) – amendments requiring disclosures about the initial application of IFRS 9.
- IFRS 9, 'Financial instruments' (effective for financial periods beginning on or after 1 January 2015) – addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39

Notes to the Financial Statements
continued

1 Accounting policies (continued)

requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The Company is yet to assess IFRS 9's full impact and intends to adopt IFRS 9 no later than the accounting period beginning on or after 1 January 2013, subject to endorsement by the EU.

- IFRS 12, 'Disclosures of interests in other entities' includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles. The Company is yet to assess IFRS 12's full impact and intends to adopt IFRS 12 no later than the accounting period beginning on or after 1 January 2013, subject to endorsement by the EU.
- IFRS 13, 'Fair value measurement', aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. The Company is yet to assess IFRS13's full impact and intends to adopt IFRS 13 no later than the accounting period beginning on or after 1 January 2012, subject to endorsement by the EU.

(iii) New standards, amendments and interpretations issued but not effective for the current financial year and not relevant to the Company's operations:

- IFRS 1 (amendments), First Time Adoption of International Financial Reporting Standards
- IFRS 10, Consolidated financial statements
- IFRS 11, Joint Arrangements
- IAS 12 (amendment), Income Taxes
- IAS 27 Separate Financial Statement
- IAS 28 Associates and joint venture
- IAS 19, Employee benefits

(b) Going concern

The Company's shareholders are asked every three years to vote for the continuation of the Company. An ordinary resolution to this effect was put to the Annual General Meeting held on 24 September 2010 and passed by a substantial majority of the shareholders. The assets of the Company consist almost entirely of securities that are listed (or quoted on AIM) and, accordingly, the directors believe that the Company has adequate financial resources to continue in operational existence for the foreseeable future. For these reasons, the Board has decided that it is appropriate for the financial statements to be prepared on a going concern basis.

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

All investments are designated upon initial recognition as held at fair value through profit or loss. Investment transactions are accounted for on a trade date basis. Assets are de-recognised at the trade date of the disposal. Proceeds are measured at fair value, which is regarded as the proceeds of sale less any transaction costs. The fair value of the financial instruments is based on their quoted bid price at the balance sheet date, without deduction of the estimated future selling costs. Unquoted investments are valued by the directors using primary valuation techniques such as earnings multiples, recent transactions and net assets. Where fair value cannot be reliably measured the investment will be carried at the previous reporting date value unless there is evidence that the investment has since been impaired, in which case the value will be reduced.

Notes to the Financial Statements

continued

1 Accounting policies (continued)

Changes in the fair value of investments held at fair value through profit or loss and gains and losses on disposal are recognised in the Statement of Comprehensive Income as "Gains or losses on investments held at fair value through profit or loss". Also included within this caption are transaction costs in relation to the purchase or sale of investments, including the difference between the purchase price of an investment and its bid price at the date of purchase.

(d) Presentation of the Statement of Comprehensive Income

In order to better reflect the activities of an investment trust company, and in accordance with guidance issued by the Association of Investment Companies ('the AIC'), supplementary information which analyses the Statement of Comprehensive Income between items of a revenue and capital nature has been presented alongside the Statement of Comprehensive Income. In accordance with the Company's status as a UK investment company under section 833 of the Companies Act 2006, net capital returns are no longer prohibited to be distributed by way of dividend where authority is given within the Company's Articles of Association. Additionally, the net revenue is the measure the directors believe appropriate in assessing the Company's compliance with certain requirements set out in section 1158 of the Corporation Tax Act 2010.

(e) Income

Dividends receivable on equity shares are recognised as revenue for the year on an ex-dividend basis. Special dividends are treated as revenue return or as capital return, depending on the facts of each individual case. Interest is recognised using the effective interest rate method. Bank deposit interest is accounted for on an accruals basis.

Where the Company enters into a commitment to sub-underwrite an issue of securities, in exchange for the receipt of commission, a derivative financial instrument is created. Any such derivatives are recognised initially at fair value. They are re-measured subsequently at fair value, with the related gains and losses being reflected in the Statement of Comprehensive Income. Net losses arising from these derivatives, where the actual or expected loss from taking up the securities underwritten exceeds the commission income, are allocated to the capital return. Net gains are allocated to the revenue return.

(f) Expenses

All expenses and interest payable are accounted for on an accruals basis. All administration expenses, including the management fee and interest payable, are charged to the revenue column of the Statement of Comprehensive Income. Expenses which are incidental to the purchase or sale of an investment are charged to the capital column of the Statement of Comprehensive Income and allocated to the capital reserves.

Any performance fee is allocated wholly to capital, reflecting the fact that, although it is calculated on a total return basis, it is expected to be attributable largely, if not wholly, to capital performance.

(g) Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on the taxable profit for the period. Taxable profit differs from net profit as reported in the Statement of Comprehensive Income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that were applicable at the balance sheet date.

Notes to the Financial Statements

continued

1 Accounting policies (continued)

In line with the recommendations of the SORP, the allocation method used to calculate tax relief on expenses presented against capital returns in the supplementary information in the Statement of Comprehensive Income is the "marginal basis". Under this basis, if taxable income is capable of being offset entirely by expenses presented in the revenue return column of the Statement of Comprehensive Income, then no tax relief is transferred to the capital return column.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Investment trusts which have approval as such under section 1158 of the Corporation Tax Act 2010 (formerly section 842 of the Income and Corporation Taxes Act 1988) are not liable for taxation on capital gains.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the Statement of Comprehensive Income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

(h) Foreign currency

For the purposes of the financial statements, the results and financial position are expressed in pounds sterling, which is the functional currency of the Company and the presentational currency of the Company. Sterling is the functional currency because it is the currency of the primary economic environment in which the Company operates.

Transactions recorded in overseas currencies during the year are translated into sterling at the appropriate daily exchange rates. Monetary assets and liabilities and investments held at fair value through profit or loss which are denominated in overseas currencies at the balance sheet date are translated into sterling at the exchange rates ruling at that date. Gains and losses arising on the retranslation of investments held at fair value through profit or loss are included within the "Gains or losses on investments held at fair value through profit or loss".

(i) 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.

(j) Borrowings

Interest-bearing bank loans, overdrafts, debentures and preference stock are recorded initially at fair value, being the proceeds received, net of direct issue costs. They are subsequently measured at amortised cost. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accruals basis in the Statement of Comprehensive Income using the effective interest rate method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Notes to the Financial Statements

continued

1 Accounting policies (continued)

The preference stock has been classified as a liability as it represents a contractual obligation on behalf of the Company to deliver to the stockholders a fixed and determinable amount at the date of redemption.

(k) Operating segments

Under IFRS 8, operating segments are considered to be components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The directors meet regularly to consider investment strategy and to monitor the Company's performance, the Fund Manager, who has been appointed to manage the Company's investments, attends all Board meetings at which investment strategy and performance are discussed.

The directors consider that the Company has one operating segment, being the activity of investing in shares and securities primarily for capital appreciation in accordance with the Company's published investment objective. The Company operates within the United Kingdom.

(l) Dividends payable to shareholders

Dividends payable to shareholders are recognised in the financial statements when they are paid or, in the case of final dividends, when they are approved by shareholders. Dividends are recorded in the Statement of Changes in Equity.

(m) Capital reserves

Capital reserve arising on investments sold

The following are accounted for in this reserve:

– gains and losses on the disposals of investments;

– expenses and finance costs allocated to capital net of tax relief;

– realised foreign exchange differences of a capital nature; and

– costs of repurchasing ordinary share capital.

Capital reserve arising on revaluation of investments held

The following are accounted for in this reserve:

– increases and decreases in the valuation of investments held at the year end; and

– unrealised foreign exchange differences of a capital nature.

(n) Key estimates and assumptions

Estimates and assumptions used in preparing the Financial Statements are reviewed on an ongoing basis and are based on historical experience and various other factors that are believed to be reasonable under the circumstances. The results of these estimates and assumptions form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources.

There are no estimates and assumptions that may cause material adjustment to the carrying value of assets and liabilities other than the estimates used in the valuation of unquoted investments.

Notes to the Financial Statements

continued

2 Investment income	2012 £'000	2011 £'000
Franked income from companies listed or quoted in the United Kingdom:		
Dividends	**7,346**	6,454
Special dividends	**116**	399
Unfranked income from companies listed or quoted in the United Kingdom:		
Dividends	**665**	149
Property income distributions	**68**	86
Total investment income	**8,195**	7,088

3 Other income	2012 £'000	2011 £'000
Bank interest	**3**	6
Underwriting income (allocated to revenue)*	**33**	29
	36	35

*None of the income receivable from sub-underwriting commitments was allocated to capital during the year (2011: £nil).

4 Management and performance fees	2012 Revenue return £'000	2012 Capital return £'000	2012 Total £'000	2011 Revenue return £'000	2011 Capital return £'000	2011 Total £'000
Management fee	**1,008**	**–**	**1,008**	906	–	906
Performance fee	**–**	**–**	**–**	–	1,644	1,644
	1,008	**–**	**1,008**	906	1,644	2,550

A summary of the management agreement is given on pages 23 and 24 in the Directors' Report.

Notes to the Financial Statements

continued

5	Other expenses	2012 £'000	2011 £'000
	Directors' fees (see the directors' remuneration report on pages 26 and 27)	**110**	107
	Remuneration for the audit of the Company and the financial statements (2011: included £1,000 relating to the subsidiary)	**24**	29
	Payable to FRP Advisory LLP for services relating to the subsidiary liquidation	**4**	–
	Other professional fees	**39**	43
	FSA and London Stock Exchange fees	**18**	16
	Registration costs	**14**	12
	Annual and half year reports and shareholder circulars: printing and distribution	**22**	29
	Insurances	**13**	20
	AIC subscriptions	**26**	20
	Custody and other bank charges	**19**	23
	Bank facilities: commitment fees	**86**	48
	Charitable donations	**5**	6
	Other expenses payable to the management company*	**18**	19
	Share price listings in newspapers and websites	**8**	8
	Other expenses	**16**	27
		422	407

*Other expenses payable to the management company ('Henderson') relate to the employment of additional marketing staff by Henderson.

All the above expenses include VAT where VAT is applied to them.

6	Finance costs	2012 £'000	2011 £'000
	Bank overdraft and loan interest	**161**	32
	Interest on debentures that are repayable wholly or partly after five years	**2,100**	2,100
		2,261	2,132

Notes to the Financial Statements

continued

7 Taxation

(a) Analysis of charge for the year

	2012 Revenue return £'000	2012 Capital return £'000	2012 Total £'000	2011 Revenue return £'000	2011 Capital return £'000	2011 Total £'000
Overseas tax suffered	**2**	**–**	**2**	4	–	4
Current and total tax charge for the year	**2**	**–**	**2**	4	–	4

(b) Factors affecting the tax charge for the year

UK corporation tax at 25.67% (2011: 27.66%)

Approved investment trusts are exempt from tax on capital gains made by the investment trust.

The tax assessed for the year is lower than the average standard rate of corporation tax in the UK of 25.67% (2011: 27.66%) for the year ended 31 May 2012.

The differences are explained below.

	2012 Revenue return £'000	2012 Capital return £'000	2012 Total £'000	2011 Revenue return £'000	2011 Capital return £'000	2011 Total £'000
Net profit/(loss) on ordinary activities before taxation	**4,540**	**(19,160)**	**(14,620)**	3,678	89,668	93,346
Corporation tax at 25.67% (2011: 27.66%)	**1,165**	**(4,918)**	**(3,753)**	1,017	24,802	25,819
Effects of:						
Non-taxable UK dividends	**(1,916)**	**–**	**(1,916)**	(1,896)	–	(1,896)
Non-taxable overseas dividends	**(171)**	**–**	**(171)**	(47)	–	(47)
Income taxable in different years	**–**	**–**	**–**	5	–	5
Excess management expenses and loan deficits	**922**	**–**	**922**	921	455	1,376
Overseas withholding tax suffered	**2**	**–**	**2**	4	–	4
Other capital returns (e.g. investment gains)	**–**	**4,918**	**4,918**	–	(25,257)	(25,257)
Tax charge	**2**	**–**	**2**	4	–	4

Notes to the Financial Statements

continued

7 Taxation (continued)

(c) Provision for deferred taxation

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

The Company has not provided for deferred tax on capital gains or losses arising on the revaluation or disposal of investments as it is exempt from tax on these items because of its status as an investment trust company.

(d) Factors that may affect future tax charges

The Company has not recognised a deferred tax asset of £12,581,000 (2011: £12,687,000) arising as a result of having unutilised management expenses and deficits on loan relationships. These expenses will only be utilised if the tax treatment of the Company's income and capital gains changes or if the Company's investment profile changes.

8 (Loss)/earnings per ordinary share

The (loss)/earnings per ordinary share figure is based on the net losses for the year of £14,622,000 (2011: gains of £93,342,000) and on 74,781,723 (2011: 74,906,796) ordinary shares, being the weighted average number of ordinary shares in issue during the year.

The earnings per ordinary share figure detailed above can be further analysed between revenue and capital, as below.

The Company has no securities in issue that could dilute the return per ordinary share. Therefore the basic and diluted earnings per ordinary share are the same.

	2012 £'000	2011 £'000
Net revenue profit	**4,538**	3,674
Net capital (loss)/profit	**(19,160)**	89,668
Net total (loss)/profit	**(14,622)**	93,342
Weighted average number of ordinary shares in issue during the year	**74,781,723**	74,906,796

	Pence	Pence
Revenue earnings per ordinary share	**6.07**	4.91
Capital (loss)/earnings per ordinary share	**(25.62)**	119.70
Total (loss)/earnings per ordinary share	**(19.55)**	124.61

Notes to the Financial Statements

continued

9	**Dividends**	**2012 £'000**	2011 £'000
	Amounts recognised as distributions to equity holders in the year:		
	Final dividend for the year ended 31 May 2011 of 4.20p (2010: 3.60p) per ordinary share	**3,146**	2,696
		3,146	2,696

The final dividend of 4.20p per ordinary share in respect of the year ended 31 May 2011 was paid on 7 October 2011 to shareholders on the register of members at the close of business on 16 September 2011. The dividend paid amounted to £3,146,000 in total.

Subject to approval at the Annual General Meeting, the proposed final dividend of 5.50p per ordinary share will be paid on 12 October 2012 to shareholders on the register of members at the close of business on 21 September 2012.

The proposed final dividend for the year ended 31 May 2012 has not been included as a liability in these financial statements. Under IFRS, the final dividend is not recognised until approved by the shareholders.

The total dividends payable in respect of the financial year which form the basis of the test under section 1158 of the Corporation Tax Act 2010 are set out below:

	2012 £'000
Revenue available for distribution by way of dividends for the year	**4,538**
Proposed final dividend for the year ended 31 May 2012: 5.50p (based on the 74,706,796 shares in issue at 23 August 2012)	**(4,109)**
Undistributed revenue for section 1158 purposes*	**429**

*Undistributed revenue comprises 5.2% of the income from investments of £8,195,000 (see note 2).

Notes to the Financial Statements
continued

10	**Investments held at fair value**	**Total £'000**
	Cost at 1 June 2011	**215,794**
	Investment holding gains at 1 June 2011	**110,611**
	Valuation at 1 June 2011	**326,405**
	Movements in the year:	
	Acquisitions at cost	**35,933**
	Liquidation of subsidiary	**(2,262)**
	Disposals at cost	**(30,574)**
	Movement in investment holding gains	**(25,169)**
	Valuation at 31 May 2012	**304,333**
	Cost at 31 May 2012	**221,153**
	Investment holding gains	**83,180**
	Valuation at 31 May 2012	**304,333**

Included in the total investments are (i) unlisted investments that are quoted on the Alternative Investment Market with an aggregate valuation of £27,823,000 (2011: £32,434,000) and (ii) unlisted investments that are unquoted and shown at the directors' fair valuation of £nil (2011: £2,262,000).

Purchase and sale transaction costs for the year ended 31 May 2012 were £181,000 and £45,000 respectively (2011: transaction costs of purchases £259,000; transaction costs of sales £66,000). These comprise mainly stamp duty and commission.

Analysis of investments at fair value:

	2012 £'000	2011 £'000
Listed:		
United Kingdom	**276,510**	291,709
Unlisted:		
United Kingdom (quoted on the Alternative Investment Market)	**27,823**	32,434
Investment in subsidiary	**–**	2,262
	304,333	326,405

All the investments are listed or quoted in the United Kingdom but a few of the investments are in companies that are incorporated overseas. There were no unquoted investments at 31 May 2012.

Notes to the Financial Statements

continued

10 Investments held at fair value (continued)

Total capital gains from investments	**2012 £'000**	2011 £'000
Gains on the sale of investments based on historical cost	**6,010**	15,584
Revaluation gains recognised in previous years	**(11,556)**	(6,414)
(Loss)/gains on investments sold in the year based on the carrying value at the previous balance sheet date	**(5,546)**	9,170
Investment holding (loss)/gains	**(13,613)**	82,142
Net movement on foreign exchange on cash and cash equivalents	**(1)**	–
	(19,160)	91,312

All capital gains are from investments that are listed (or quoted on AIM) in the United Kingdom.

11 Subsidiary undertaking

The Company had an investment in the entire issued ordinary share capital, fully paid, of £2 in its wholly owned subsidiary undertaking, Henderson Smaller Companies Finance Limited, which was registered in England and Wales and operated in the United Kingdom as an investment dealing company. The subsidiary company was placed into members voluntary liquidation on 18 May 2012. Therefore the financial statements are no longer prepared on a consolidated basis and Company only accounts will be produced.

12 Substantial interests

The Company held interests in 3% or more of any class of share capital in three investee companies (2011: two investee companies). These investments are not considered by the directors to be significant in the context of these financial statements.

Company	**Valuation £'000**	**% of portfolio**
e2v	**9,520**	**3.1**
WSP	**6,980**	**2.3**
WYG	**1,095**	**0.4**

13 Other receivables	**2012 £'000**	2011 £'000
Tax recoverable	**28**	33
Prepayments and accrued income	**1,493**	1,600
	1,521	1,633

All receivables are due for less than six months, except for withholding tax recoverable of £14,000 (2011: £16,000) which is past due but not impaired.

Notes to the Financial Statements

continued

14	**Other payables**	**2012 £'000**	2011 £'000
	Securities purchased for future settlement	**–**	502
	Amounts owed to the subsidiary undertaking	**–**	2,262
	Accruals and deferred income	**94**	1,728
		94	4,492

15	**Non current liabilities**	**2012 £'000**	2011 £'000
	Debenture stock: redemption after more than three years:		
	10½ per cent Debenture Stock 2016 (redeemable at par on 31 May 2016)	**20,000**	20,000
	Preference stock:		
	4,257 preference stock units of £1 each (2011: 4,257)	**4**	4
		20,004	20,004

The Company may at any time purchase any of the debenture stock, in accordance with the provisions of the trust deed constituting and securing the debenture stock. However, it is not the Company's present intention to redeem the debenture stock before the final redemption date. Accordingly the debenture stock has been included in amounts falling due after one year by reference to the final redemption date. The debenture stock is secured by way of a floating charge on all of the Company's assets. Interest on the debenture stock is payable half yearly, on 31 May and 30 November.

The preference stock units carry the right to receive a non-cumulative dividend at a final rate of 0.001% payable on 1 June each year. On a winding-up of the Company, preference stockholders are entitled to repayment of the capital paid up thereon. The preference stock does not entitle the holder to attend or vote at any general meeting of the Company except where the dividend is six months in arrears or on a resolution to liquidate the Company.

Notes to the Financial Statements

continued

16 Risk management policies and procedures

As an investment trust the Company invests for the long term in equity securities, in accordance with its investment objective as stated on the inside front cover of this document. In pursuing its investment objective, the Company is exposed to a variety of risks that could result in either a reduction in the Company's net assets or a reduction in the revenue available for distribution by way of dividends.

These risks, market risk, liquidity risk and credit risk, and the directors' approach to the management of them, are set out below. The Manager, in close co-operation with the Board, co-ordinates the Company's risk management.

The objectives, policies and processes for managing the risks, and the methods used to manage the risks, are set out below; they have not changed from the previous accounting period.

(i) Market risk

The fair value of a financial instrument held by the Company may fluctuate due to changes in market prices. This market risk comprises market price risk (see note 16 (ii)), currency risk (see note 16 (iii)) and interest rate risk (see note 16 (iv)). The Board reviews and agrees policies for managing these risks. The 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) Market price risk

Market price risk (i.e. changes in market prices other than those arising from interest rate risk or currency risk) may affect the fair value of the investments. The Company's investments are susceptible to market price risk arising from uncertainties about the 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 Manager. The Board regularly reviews investment performance. The Board monitors the 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 31 May 2012 on its equity investments was £304,333,000 (2011: £324,143,000).

Concentration of exposure to market price risk

An analysis of the Company's investments is shown on pages 9 to 11 and a sector analysis is set out on page 4. At 31 May 2012 all the investments were in companies listed or quoted in London, most of them being companies established in and operating from the United Kingdom. Accordingly, there is a concentration of exposure to the UK, although 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.

Market price risk sensitivity

The sensitivity of (a) the return after taxation for the year and (b) the Company's net assets to an increase or decrease of 25% in the fair values of the Company's investments at each balance sheet date is given below. This level of change is considered to be reasonably possible, based on observation of current market conditions.

The impact of a 25% increase in the value of the investments on the revenue return as at 31 May 2012 is a decrease of £266,000 (2011: £284,000) and on the capital return is an increase of £76,083,000 (2011: £81,036,000). Accordingly, the total impact on shareholders' funds is an increase of £75,817,000 (2011: £80,752,000).

Notes to the Financial Statements
continued

16 Risk management policies and procedures (continued)

The impact of a 25% decrease in the value of the investments on the revenue return as at 31 May 2012 is an increase of £266,000 (2011: £284,000) and on the capital return is a decrease of £76,083,000 (2011: £81,036,000). Accordingly, the total impact is a decrease of £75,817,000 (2011: £80,752,000).

(iii) Currency risk

The Company is not itself materially exposed to currency risk, although some of the investments will be in companies that have operations that involve currency risk.

As at 31 May 2012, the Company did not hold any non-sterling denominated investments (2011: nil).

(iv) Interest rate risk

Interest rate movements may affect:

– the level of income receivable from cash at bank and on deposit; and
– the interest payable on the Company's short term borrowings.

Interest rate changes may also have an impact on the market value of the Company's equity investments. In particular, the effect of interest rate changes on the earnings of companies held within the portfolio may have a significant impact on the valuations of those companies.

Management of the risk

The possible effects on the fair value of the investments that could arise as a result of changes in interest rates are taken into account when making investment decisions and borrowing decisions. The Company rarely holds significant cash balances but finances part of its investment activity through borrowings at levels approved and monitored by the Board. The debenture stock provides long term finance at a fixed rate of interest; it was issued in 1987 to enable the Company to benefit from long term planned gearing. In addition, the Company makes use of short term borrowings. At 31 May 2012 the Company had committed bank borrowing facilities for a total of £20 million; borrowings are drawn down for short periods at rates of interest that are determined by reference to the market rates applicable at the time of borrowing.

Interest rate exposure

The Company's financial liabilities at 31 May 2012 that give exposure to fixed interest rate risk are set out in note 15.

The exposure to floating interest rates can be found on the balance sheet (cash and cash equivalents and bank loans).

These amounts are not necessarily representative of the exposure to interest rates during the year, as the level of exposure changes as investments are made, borrowings are drawn down or repaid, and the mix of borrowings subject to floating or to fixed interest rates changes.

Interest rate sensitivity

The Company is not materially exposed to changes in interest rates. As at 31 May 2012 the Company's bank facility allowed borrowings to a maximum of £20 million; the interest payable on the Company's £20 million issue of debenture stock is fixed at 10.5%.

Notes to the Financial Statements
continued

16 Risk management policies and procedures (continued)

(v) Liquidity risk
This is the risk that the Company will encounter difficulty in meeting obligations associated with its financial liabilities.

Management of the risk
Liquidity risk is not significant as the majority of the Company's assets are investments in quoted equity securities that are readily realisable. The Company has borrowed £20 million by its issue in 1987 of £20 million 10½ per cent Debenture Stock 2016. The Company is able to draw short term borrowings of up to £20 million from its two £10 million committed borrowing facilities which expire on 11 February 2013, both with ING Bank N.V., London Branch. There were borrowings of £6,100,000 drawn down under the facility at 31 May 2012 (2011: £6,000,000).

Accordingly, the Company has access to borrowings of up to £40 million: the £20 million of fixed debt represented by the issue of Debenture Stock and committed bank facilities for £20 million.

The Board gives guidance to the 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 should be used to fund short term cash requirements.

Liquidity risk exposure
The remaining contractual maturities of the financial liabilities at 31 May 2012, based on the earliest date on which payment can be required, was as follows:

	2012 Due within 1 year £'000	**2012 Due between 1 and 5 years £'000**	2011 Due within 1 year £'000	2011 Due between 1 and 5 years £'000
Debenture stock*	**2,100**	**26,300**	2,100	28,400
Preference stock*	**–**	**–**	–	–
Bank loans and interest	**6,105**	**–**	6,035	–
Other payables and accruals	**94**	**–**	2,230	–
	8,299	**26,300**	10,365	28,400

*See also note 15 on page 47. The Company has in issue preference stock without a set redemption date with a total par value of £4,000 (2011: £4,000) which has a negligible ongoing finance cost. The bank loans in place at 31 May 2012 are to be rolled forward, together with interest.

(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 standard is reviewed regularly by the Manager, and limits are set on the amount that may be due from any one broker; and
– cash at bank is held only with reputable banks with high quality external credit ratings.

In summary, the exposure to credit risk at 31 May 2012 was to cash and cash equivalents of £270,000 (2011: £642,000) and to other receivables of £1,521,000 (2011: £1,633,000) (see note 13).

Notes to the Financial Statements

continued

16 Risk management policies and procedures (continued)

(vii) Fair values of financial assets and financial liabilities

The investments are held at fair value through profit or loss. All the net current liabilities are held in the balance sheet at a reasonable approximation of fair value. At 31 May 2012 the fair value of the debenture stock was £24,922,000 (2011: £24,186,000). The fair values of the debenture stock is calculated using the prices quoted on the exchange the instrument trades. The debenture stock is carried in the balance sheet at par.

(viii) Fair value hierarchy disclosures

The table below sets out the fair value measurements using the IFRS 7 fair value hierarchy.

Categorisation within the hierarchy has been determined on the basis of the lowest level of input that is significant to the fair value measurement of the relevant asset, as follows:
Level 1: valued using quoted prices in active markets for identical assets.
Level 2: valued by reference to valuation techniques using observable inputs other than quoted prices.
Level 3: valued by reference to valuation techniques using inputs that are not based on observable market data.

The valuation techniques used by the Company are explained in note 1 (c) on page 36.

Fair value hierarchy – 2012	**Level 1 £'000**	**Level 2 £'000**	**Level 3 £'000**	**Total £'000**
Equity investments	**304,333**	**–**	**–**	**304,333**

Fair value hierarchy – 2011	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Equity investments	324,143	–	2,262	326,405

There have been no transfers during the year between any of the levels. A reconciliation of fair value movements within Level 3 is set out below.

Level 3 investments at fair value through profit or loss	**2012 Company £'000**	2011 Company £'000
Opening balance	**2,262**	2,263
Total loss on assets held at year end	**–**	(1)
Liquidation of subsidiary	**(2,262)**	–
	–	2,262

(ix) 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 for the shareholders by investment in quoted securities in the UK.

This is to be achieved through an appropriate balance of equity capital and gearing. The Company's policy is that its borrowings must not exceed 30% of the shareholders' funds.

Notes to the Financial Statements

continued

16 Risk management policies and procedures (continued)

The Company's total capital at 31 May 2012 was £306,030,000 (2011: £324,188,000) comprising £6,100,000 (2011: £6,000,000) of unsecured bank loans, £20,000,000 (2011: £20,000,000) of debenture stock, £4,000 (2011: £4,000) of preference stock and £279,926,000 (2011: £298,184,000) of equity share capital and reserves.

At 31 May 2012 the Company had a two year revolving credit facility and a one year revolving credit facility, both of £10 million each with ING Bank N.V., London Branch. The Company had drawn down £6,100,000 under these facilities as at 31 May 2012. The Company was fully compliant with the terms of the two facilities, as they existed, for the period from 1 June 2011 to the date of this Annual Report.

17 Called up share capital

	2012 £'000	2011 £'000
Allotted, issued and fully paid:		
74,741,796 ordinary shares of 25p each (2011: 74,906,796)	**18,686**	18,727

During the year the Company purchased for cancellation 165,000 of its own issued ordinary shares (2011: nil) at a total cost of £490,000 (2011: £nil). Since 31 May 2012 the Company has bought back a further 35,000 ordinary shares.

18 Capital redemption reserve and capital reserves

Investment holding gains at 31 May 2012 include £2,982,000 in respect of unlisted investments (2011: £6,904,000).

	Capital redemption reserve £'000	**Capital reserve arising on revaluation of investments held £'000**	**Capital reserve arising on investments sold £'000**	**Capital reserves £'000**
At 1 June 2011	26,694	110,611	133,189	243,800
Transfer on disposal of investments (see note 10 (c))	–	(11,556)	11,556	–
Net capital losses for the year	–	(13,613)	(5,546)	(19,159)
Liquidation of subsidiary	–	(2,262)	2,262	–
Buy-backs of ordinary shares	41	–	(490)	(490)
Net movement on foreign exchange	–	–	(1)	(1)
At 31 May 2012	**26,735**	**83,180**	**140,970**	**224,150**

Notes to the Financial Statements
continued

19 Retained earnings – revenue reserve

	£'000
At 1 June 2011	8,963
Ordinary dividend paid	(3,146)
Revenue profit for the year	4,538
At 31 May 2012	**10,355**

20 Net asset value per ordinary share

The net asset value per ordinary share is based on the net assets attributable to the ordinary shares of £279,926,000 (2011: £298,184,000) and on the 74,741,796 ordinary shares in issue at 31 May 2012 (2011: 74,906,796).

An alternative net asset value per ordinary share can be calculated by deducting from the total assets less current liabilities of the Company, the preference stock and the debenture stock at their market (or fair) values rather than at their par (or book) values (see note 16 (vii) on page 51). The net asset value per ordinary share at 31 May 2012 calculated on this basis was 367.9p (2011: 392.5p).

The Company has no securities in issue that could dilute the net asset value per ordinary share.

The movement during the year of the net assets attributable to the ordinary shares was as follows:

	£'000
Net assets attributable to the ordinary shares at 1 June 2011	298,184
Net loss for the year	(14,622)
Ordinary dividend paid in the year	(3,146)
Buy-backs of ordinary shares	(490)
Net assets attributable to the ordinary shares at 31 May 2012	**279,926**

21 Capital commitments and contingent liabilities

Capital commitments

There were no capital commitments as at 31 May 2012 (2011: £nil).

Contingent liabilities

There were no contingent liabilities in respect of sub-underwriting commitments as at 31 May 2012 (2011: £nil).

Notes to the Financial Statements
continued

22 Transactions with the Manager

Under the terms of an agreement dated 29 September 2006, the Company has appointed wholly owned subsidiaries of Henderson Group plc ('Henderson') to provide investment management, accounting, administrative and company secretarial services. Henderson has contracted with BNP Paribas Securities Services to provide accounting and investment administration services.

Details of the fee arrangements for these services are given on pages 23 and 24 in the Directors' Report. The management fees payable to Henderson under this agreement in respect of the year ended 31 May 2012 were £1,008,000 (2011: £906,000) of which £101,000 was prepaid at 31 May 2012 (2011: prepaid £98,000). VAT is no longer payable on management (including performance) fees.

No performance fee was payable to Henderson in respect of the year ended 31 May 2012 (2011: £1,644,000).

In addition to the above services, Henderson has provided the Company with marketing services. The total fees paid or payable for these services for the year ended 31 May 2012 amounted to £18,000 (including VAT) (2011: £19,000), of which £3,000 was outstanding at 31 May 2012 (2011: £3,000).

The compensation payable to key management personnel in respect of short term employment benefits was £110,652 (2011: £106,939). In practice this disclosure relates wholly to the fees of £110,652 payable to the directors in respect of the year (2011: £106,939); the directors are all non-executive and receive no other compensation. The Directors' Remuneration Report on pages 26 and 27 provides details. The Company has no employees.

23 Value Added Tax on management fees

A decision of the European Court of Justice in 2007 that Value Added Tax ('VAT') should not be charged on fees paid for management services provided to investment trust companies, resulted in the Company receiving, over three financial years up to 31 May 2010, refunds of VAT totalling £2,943,000 (relating to management fees paid during the periods 1990 to 1996 and 2000 to 2007) and £985,000 of simple interest on those VAT refunds. The write-backs of VAT were allocated between revenue return and capital return according to the allocation of the amounts originally paid. The interest paid by HM Revenue & Customs ('HMRC') on the VAT recovered was included in other income.

There remain outstanding claims relating to the period 1996 to 2000 and claims for compound interest from 1990 onwards. No amounts have been recognised in respect of these claims as it is currently uncertain whether any further amounts will be recovered. The Company is a participant in an on-going action against HMRC, led by PricewaterhouseCoopers LLP, to recover these amounts.

General Shareholder Information

Release of results
Half-year results are announced in January. Full year results are ordinarily announced in August.

AGM
The Annual General Meeting will be held in London on 5 October 2012.

Dates of dividend and interest payments
Ordinary shares: final dividend announced ordinarily in August and paid in October.

10½ per cent debenture stock 2016: interest paid on 31 May and 30 November.

Final dividend warrants and tax vouchers
Dividend warrants and tax vouchers for the 2012 final dividend will be posted on 3 October 2012 to shareholders on the register on 21 September 2012. The dividend will be paid on 5 October 2012, subject to approval at the AGM.

Payment of dividends
Dividends can be paid to shareholders by means of BACS; mandate forms for this purpose are available from the Registrar. Alternatively, shareholders can write to the Registrar (the address is given on page 56 of this report) to give their instructions; these must include the bank account number, the bank account title and the sort code of the bank to which payments are to be made.

Share price listings
The market price of the Company's ordinary shares is published daily in The Financial Times and in other leading newspapers. The Financial Times also shows figures for the estimated net asset value and the discount.

Internet
Details of the Company's share price and net asset value, together with other information about the Company, can be found on the Henderson website. The address is **www.hendersonsmallercompanies.com** or **www.hendersoninvestmenttrusts.com**

Disability Act
Copies of this annual report and other documents issued by the Company are available from the Company Secretary. If needed, copies can be made available in a variety of formats, including Braille, audio tape or larger type as appropriate.

You can contact the Company's Registrar, Computershare Investor Services PLC, which has installed textphones to allow speech and hearing impaired people who have their own textphone to contact them directly, without the need for an intermediate operator, by dialling 0870 702 0005. Specially trained operators are available during normal business hours to answer queries via this service.

Alternatively, if you prefer to go through a 'typetalk' operator (provided by Action on Hearing Loss – formerly The Royal National Institute for Deaf People) you should dial 18001 followed by the number you wish to dial.

Nominee share code
Where notification has been provided in advance, the Company will arrange for copies of shareholder communications to be provided to the operators of nominee accounts. Nominee investors may attend general meetings and speak at meetings when invited to do so by the Chairman.

Those who invest through the Halifax Share Dealing Products (and who were formerly participants in the Share Plan or the ISA managed by Henderson) receive all shareholder communications. A form of instruction is provided to facilitate voting at general meetings of the Company.

History
The Company was incorporated under the Companies Acts 1862 to 1886 on 16 December 1887 with the name of The Trustees, Executors and Securities Insurance Corporation, Limited. The name was changed in August 1917 to The Trustees Corporation Limited, in April 1982 to TR Trustees Corporation PLC, in October 1990 to TR Smaller Companies Investment Trust PLC and in September 1997 to The Henderson Smaller Companies Investment Trust plc. Whilst the Trustee Department operated until June 1978, the principal business of the Company has been that of an investment trust company.

Directors and other Information

Directors
J M B Cayzer-Colvin *(Chairman)**
B Hollond *(Chairman of the Audit Committee)*
J J Nelson *(Senior Independent Director)*
K E Percy
M A Sieghart

*Mr Cayzer-Colvin was appointed Chairman on 30 September 2011 on the retirement of J D Fishburn.

Manager
Henderson Global Investors Limited,
represented by N M Hermon

Henderson Global Investors Limited is authorised and regulated by the Financial Services Authority.

Company Secretary
Henderson Secretarial Services Limited,
represented by T A Lago ACIS

Registered Office
201 Bishopsgate
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Telephone: 020 7818 1818

Registered Number
Registered in England and Wales as an investment company
No. 25526

Registrar
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Custodian
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Share Identification Codes
SEDOL: 0906506
ISIN: GB0009065060
EPIC: HSL

aic
The Association of
Investment Companies

London
Stock Exchange
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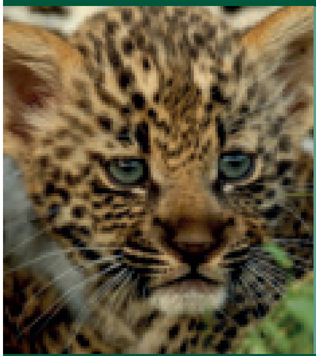
PREMIUM



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