ACORN INCOME

2012

# Acorn Income Fund Limited

Annual Financial Report
for the year ended
31 December 2012

Premier
independent asset managers

# Investment Objectives and Policy

The objectives of Acorn Income Fund Limited (the "Company") are to provide the Company's shareholders with a high income and also the opportunity for capital growth.

The Company's portfolio is invested in equities and high income and fixed interest securities in order to achieve its investment objectives. It is the aim of the Company to provide both income and capital growth predominantly through investment of approximately 70% to 80% of the portfolio in smaller capitalised United Kingdom companies, admitted to the Official List of the United Kingdom Listing Authority and traded on the London Stock Exchange or traded on AIM; and by investing approximately 20% to 30% of its assets in high yielding instruments which will be predominantly fixed interest securities (including corporate bonds, preference and permanent interest bearing shares, convertible and reverse convertible bonds and debentures) but may include up to 15% of the portfolio (measured at the time of acquisition) in high yielding investment company shares.

## Contents

# Performance Summary

for the year ended 31 December 2012

## Total Return performance

| | % change | 31 Dec 2012 | 31 Dec 2011 |
|---|---|---|---|
| Total Return on Gross Assets*# | 30.50 | | |
| Total Return on Net Assets (assets attributable to shareholders)* | 48.00 | | |
| Numis Smaller Companies (Ex Investment Companies) Index | 29.94 | 11,552 | 8,890 |
| FTSE All Share Index | 13.30 | 4,498 | 3,970 |
| FTSE SmallCap (Ex Investment Companies) | 36.30 | 3,822 | 2,804 |

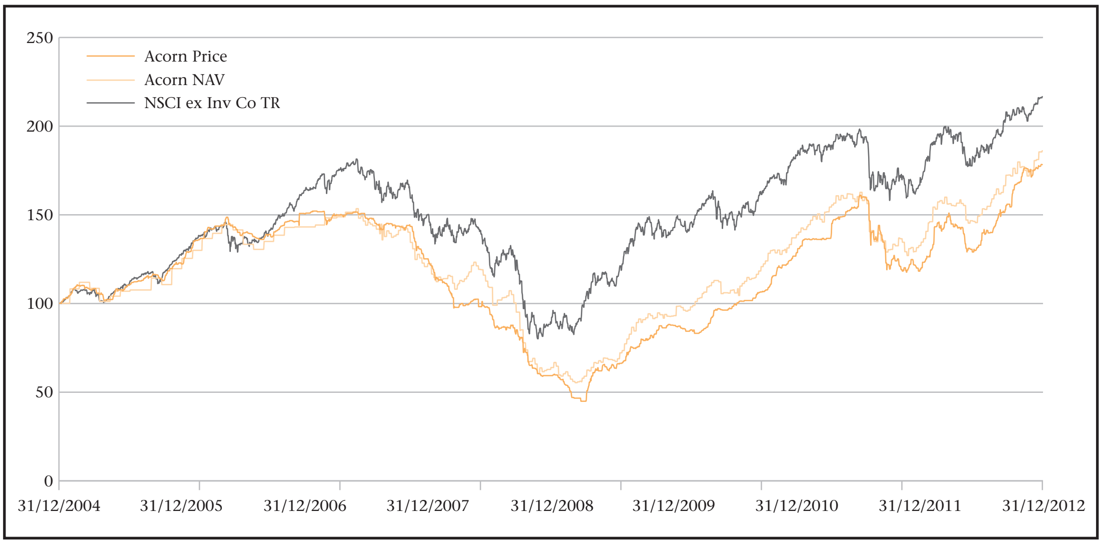
## Capital Return performance

| | % change | | |
|---|---|---|---|
| Capital Return on Gross Assets# | 26.30 | | |
| Numis Smaller Companies (Ex Investment Companies) Index | 26.22 | 4,958 | 3,928 |
| FTSE All Share Index | 8.20 | 3,092 | 2,858 |
| FTSE SmallCap (ex Investment Companies) | 32.30 | 2,863 | 2,164 |

## Share Price and NAV Returns

| | % change | | |
|---|---|---|---|
| Ordinary Share – share price | 50.81 | 231.50 | 153.50 |
| NAV | 40.37 | 261.25 | 186.12 |
| Dividends Declared per Ordinary Share | 71.43 | 12.00 | 7.00 |
| Ordinary Shares Total Return | 60.50 | – | – |
| Discount to NAV on Ordinary Shares | -34.91 | 11.39 | 17.50 |
| | | | |
| Zero Dividend Preference Share price | 10.46 | 113.50 | 102.75 |
| NAV (for accounting purposes) | 7.39 | 104.14 | 96.97 |
| NAV (for investment purposes) | 6.53 | 106.71 | 100.17 |

*assumes dividends reinvested
# adjusted for debt repayment and the issue of redeemable Zero Dividend Preference Shares




Source: Bloomberg
Data as at 31 December 2012, all performance figures for the period ended 31 December 2012. Past performance and dividends paid are not a guide to future returns.
Up-to-date information can be found on www.premierfunds.co.uk

# Company Summary

| | | |
|---|---|---|
| Launch date | 11 February 1999 | |
| Domiciled | Guernsey | |
| Registered Number | 34778 | |
| Year end | 31 December | |
| Shareholder funds | £22.794 million at 31 December 2012 | |
| Market Capitalisation of the Ordinary Shares | £20.198 million at 31 December 2012 | |
| Ordinary Income Shares | 8,724,790 | |
| Zero Dividend Preference Shares | 12,000,000 | |
| Treasury Shares | 215,000 | |
| Dividend History | In respect of year end 31 December | Total dividends declared Pence |
| | 2012 | 12.0 |
| | 2011 | 7.0 |
| | 2010 | 6.25 |
| | 2009 | 6.0 |
| | 2008 | 8.2 |
| | 2007 | 8.0 |
| | 2006 | 9.0* |
| | 2005 | 9.0* |
| | 2004 | 9.0* |
| | 2003 | 9.0* |
| | 2002 | 12.0 |
| | 2001 | 12.0 |
| | 2000 | 11.0 |
| | 1999 | 8.5 |

*includes four interim dividends and one special dividend

| | |
|---|---|
| Manager | Premier Asset Management (Guernsey) Limited |
| Investment Advisers | Unicorn Asset Management Limited ("Unicorn") – Smaller Companies Portfolio |
| | Premier Fund Managers Limited ("Premier") – Income Portfolio |
| Management fee | 0.7% per annum, charged 75% to Capital and 25% to Revenue, plus performance fee |
| | Minimum annual management fee – £100,000 |

# Chairman's Statement

Dear Shareholder,

In August 2012 John Boothman, who had been Chairman of the Company since October 2003, stood down from the Board and I took over as Chairman. We were fortunate in having David Warr join the Board and take my place as Chairman of the Audit Committee. I would like to take this opportunity to formally express my thanks to John for the significant contribution he made to the Company during his period in office and to welcome David to the Board. David brings considerable experience to the Board having previously served as a partner of Reads & Co and has been a qualified Chartered Accountant for over 30 years. In this, my first report as Chairman, I am delighted to be able to report a truly spectacular set of results for the Company. Measured on share price total return (share price with dividends reinvested), the Company was the best performing Investment Company in 2012. (Source: Winterflood Securities Annual Review).

The Company's performance record has in fact been exceptional over longer time periods as well. Comparing the Company to the forty one closed end funds in the Growth and Income, High Income, Small Companies High Income, UK mid cap and UK smaller companies sectors the Company was the best performing fund measured on Net Asset Value total return over one, three, five and ten years (as at 24 February 2013). (Source: Morning Star and Numis Securities Limited).

Shortly before the start of the year we issued 12 million Zero Dividend Preference ("ZDP") Shares enabling the Company to repay its bank loan shortly ahead of the expiry date for the facility. In issuing the ZDP Shares, your Board made a conscious decision to raise more capital than was required to repay the bank loan as our Investment Advisers saw value and opportunity in both smaller company equities and in the fixed interest markets and we felt it was an opportune time to increase gearing. This decision proved timely as UK smaller companies out performed larger capitalisation stocks and the broad market rallied well over the year. With the Income Portfolio also performing well the Company had an excellent year both in absolute terms and relative to the market. The split capital structure and consequent increased dividend on the Ordinary Shares also helped the Company sustain a better rating in the market (lower discount to net asset value) than had been the case with the conventional structure of Ordinary Shares only.

## Investment performance

As noted above, the Smaller Companies sector performed particularly well. The Numis Smaller Companies (Ex Investment Companies) Index (Total Return) rose by 29.9% over the year and the FTSE Small Cap (Ex Investment Trusts) Total Return Index was up 36.3%. This compares to a 12.3% rise in the FTSE All Share Total Return Index. The Company's total return on gross assets was 30.5% and with gearing from the ZDP Shares the return on net assets was 48%.

With a rerating to a narrower discount during the year Ordinary Shareholders enjoyed a total return on their share price of 60.5%.

## Dividends

When the ZDP Shares were issued, your Board indicated that it was expecting to increase the dividend and pay four quarterly dividends of 3 pence each. This was achieved over 2012.

Revenue earnings per share for the year were 12.33 pence (8.21 pence in 2011) and dividend of 12 pence compared to 7 pence in 2011. Revenue reserves stood at £268,891 at the start of the year and £297,363 at the year end, equivalent to 3.4 pence per Ordinary Share.

## Discount

At the start of the year the Ordinary Shares were trading on a 17.5% discount. By the year end this had narrowed to 11.4% and the package (total market capitalisation of the Ordinary and the ZDP Shares against the total assets of the Company) was at a 0.5% discount. The Board had anticipated that the higher yield on the Ordinary Shares resulting from the split structure would assist the rating. This together with good performance stimulated increased interest in the Company's shares from private investors. The Board reviewed its advisory arrangements at the end of 2012 and appointed Numis Securities Limited as the Company's Corporate Broker to work closely with the Investment Advisers to broaden awareness and ownership of the Company, particularly in the private wealth management sector.

## Authority to issue new shares

Simultaneously with announcing the year end results, the Company is posting a circular with proposals which include the issue of new Ordinary and new ZDP Shares, amendments to the Memorandum, the adoption of new Articles and to convene an Extraordinary General Meeting and a Class Meeting of the ZDP Shareholders to seek authority for the proposals. The proposals for further share issuance have been prepared to enable the Company to meet anticipated demand given the Company's strong investment performance. The proposed authority provides for potential issues of Ordinary Shares at discounts to NAV, but only in limited circumstances where new ZDP Shares can at the same time be issued at a premium to NAV, thereby resulting in the NAV per existing Ordinary Shares being enhanced where there is no increase in gearing. The proposed changes to the Memorandum and Articles are principally designed to bring them in line with The Companies (Guernsey) Law, 2008. The proposals are conditional on the approval of Ordinary Shareholders at an Extraordinary General Meeting and, where indicated, the approval of ZDP Shareholders at a Class Meeting.

## Outlook

As we entered 2013 the UK equity market rallied strongly, buoyed up by encouraging economic data from the US and recognition that equities looked increasingly attractive relative to the low yields available from UK government securities. Our Manager and Investment Advisers expect companies with strong balance sheets, good dividend cover and prospects for increasing earnings to be attractive to investors in search of real returns in a low interest rate environment. The Company's Smaller Companies Portfolio, with a focus on companies generating a high proportion of earnings from fast growing overseas economies, is well positioned to benefit from this trend and currently represents approximately 79% of the Company's total assets which is at the top end of the normal 70 to 80% range. In the Income Portfolio our Investment Advisor continues to see opportunities in the fixed interest markets to exploit wrongly priced credit risks whilst remaining cautious regarding the outlook for interest rates.

**Helen Green**
*Chair*

# Investment Advisers' Report

## Smaller Companies Portfolio

During the twelve months to 31 December 2012 the Smaller Companies Portfolio returned 32.7% before management costs, outperforming the benchmark Numis Smaller Companies Index (Ex Investment Companies) Index which returned 29.9%. The number of holdings at the year end was 30.

This outperformance is particularly pleasing given that UK Smaller Companies were the best performing IMA asset class over 2012. In fact all UK equity indices delivered robust returns, but UK Smaller Companies outperformed their larger capitalised counterparts by some margin. This resilience is particularly notable given the backdrop of political and economic uncertainty across Europe and the US, such as the US elections, the 'Fiscal Cliff' negotiations, and the continued indebtedness of large areas of the Eurozone.

Following the issue of ZDP Shares, just prior to the start of the year, the Company was able to top up the majority of its existing holdings. Six new holdings were also added: Silverdell, the environmental support services firm, was added as it is highly cash generative and focussed on geographically diverse markets facing stringent and increasing regulatory pressures; UK Mail, the provider of collection and delivery services, was added to get exposure to a major player in a restructuring market; Air Partner, the aircraft charter broker; Park Group, the payment card group; James Cropper, a specialist paper and technical fibre manufacturer; and Low & Bonar, the advanced textile developer and manufacturer.

Disposals from the Company were light with two holdings exited in full: Rotork was disposed of after its yield fell too far following an extended period of share price outperformance; a change in Stobart Group's strategy towards focussing on property prompted us to exit the holding. Partial disposals were made from Renishaw, again after a period of exceptionally strong share price performance reduced the yield to an insignificant level; and RPC.

It is pleasing to report that of the thirty-two stocks that were held over the year only three delivered a negative contribution to performance, and none of these at a significant level. Strong share price performances were seen from the majority of the portfolio, the strongest of which are detailed below:

**Renishaw** (+106.0%) – the advanced metrological equipment manufacturer has continued to benefit from an increase in capital expenditure from economies, such as China, that are strategically positioning themselves further up the chain of added value production.

**Vp** (+55.3%) – a specialist equipment rental company engaged in the rental and sale of products to the civil engineering, rail, oil and gas exploration, construction, outdoor events, and industrial markets. Recent results confirmed strong trading as the company continues to gain market share.

**Diploma** (+63.2%) – the distributor has primarily benefitted from the exposure of its seals division to US earth moving equipment and increased activity through an upturn in US construction.

**Secure Trust Bank** (+89.2%) – a UK retail bank focused on providing lending solutions to UK customers who may not otherwise be able to access credit. The bank is highly liquid; ending the year with robust capital and funding positions, and is successfully growing all lending portfolios and its current account product.

We believe the Smaller Companies Portfolio is well positioned to continue outperforming its benchmark as it remains focused on companies which sell specialised products and services to diverse international markets. There is still very limited exposure to the UK consumer as we expect this area to see persistent spending pressure. The Smaller Companies Portfolio should also benefit from an expected return of M&A activity.

**John McClure**
*Unicorn Asset Management Limited*

## Income Portfolio

Over the last year the High Income Portfolio provided a positive contribution to the performance of the Company, benefiting from the tightening in credit spreads, particularly Financials. The portfolio continues to generate a high income.

Inflation fell during the year with the Consumer Price Index falling from 3.6% to 2.7% and the Retail Prices Index from 3.9% to 3.0%. However, the rate of inflation did appear to be on the rise again towards the end of the year caused by the introduction of tuition fees and higher energy prices. LIBOR fell significantly over the year with the 3 month rate falling from 1.08% to 0.52% depicting the cheap finance now available to banks following various government and central bank policies.

The credit markets had a strong first quarter with the European Investment Grade Main Index which represents the most liquid investment grade names tightening from 174bps to 113bps in March before widening out to 184bps in June over concerns in Spain. Subsequent European policy actions calmed the markets and the index tightened to end the year at 117bps. The European Crossover Index which consists of the 40 most liquid sub investment grade names in the European market followed a similar pattern opening the year at 754bps and tightening to 504bps in March before widening out again to 751bps in late May and then performing strongly in the second half of the year tightening gradually to end the year at 484bps.

On the portfolio side we maintained an overweight in financials throughout the year believing that greatest value was to be found over the medium to longer term. This financials overweight consisted not only of contingent convertibles (CoCos) in stable banks such as Credit Suisse and Rabobank but also fund managers such as F&C and Fidelity and brokers such as ICAP. The Financials sector was the best performing sector in Sterling credit vindicating our large overweight position, and the financial bonds held also outperformed the sector by a handsome margin. As the year closed we moved to take profit in certain financials names rotating from the most junior tranches into more senior tranches in banks and in high yield exposure following the strong credit rally. We also added risk in Real Estate Credit Investments preference shares as we lacked exposure to this potentially cheap asset class. In the third quarter of 2012 we reduced our French government bond position at 63bps over the German government bonds having tightened in from a peak of 145bps during May. Towards the end of the year we moved to increase our exposure to corporates buying bonds in names such as Marks & Spencer, Mitchells & Butlers and Rentokil. Away from plain vanilla corporates we invested in the debut 3.75% due 2052 issue for University of Cambridge and the retail bond issue for the specialist property company Unite Group plc which is focused on UK student accommodation.

We remain overweight financial bonds despite some recent profit taking but are diversifying this financials exposure away from banks and are adding risk in corporate bonds and investment companies where the underlying asset class is cheap and we can see value in the discount to NAV. We strategically look to take longer credit duration and hedge out the government duration. We are not restrained by credit ratings and prefer exposure to the 5B's (bonds rated triple B and double B).

**Paul Smith**
*Premier Fund Managers Limited*

# Schedule of Principal Investments

as at 31 December 2012

| Top 10 Holdings | Nominal Holdings | Valuation GBP | Total Assets % |
|---|---|---|---|
| **Smaller Companies Portfolio** | | | |
| VP plc | 466,414 | 1,576,479 | 4.45 |
| James Halstead plc | 245,500 | 1,473,000 | 4.16 |
| Diploma plc | 263,960 | 1,434,623 | 4.05 |
| Lupus Capital plc | 882,242 | 1,358,653 | 3.84 |
| Castings plc | 424,112 | 1,340,194 | 3.79 |
| Consort Medical plc | 171,171 | 1,321,440 | 3.73 |
| Secure Trust Bank plc | 78,009 | 1,201,339 | 3.39 |
| Brewin Dolphin Holdings plc | 580,506 | 1,193,520 | 3.37 |
| RPC Group plc | 300,000 | 1,191,000 | 3.36 |
| British Polythene Industries | 282,500 | 1,115,875 | 3.15 |
| | | 13,206,123 | 37.29 |
| **Income Portfolio** | | | |
| GE Capital Funding 8% 14/01/2039 | 250,000 | 365,943 | 1.03 |
| Credit Suisse 7.875% 24/02/2041 | 500,000 | 324,131 | 0.92 |
| Greenwich Loan Income Fund Limited | 625,000 | 320,313 | 0.90 |
| Rabobank Nederland 6.875% 03/19/2020 | 350,000 | 316,375 | 0.89 |
| Real Estate Credit Preference Shares NPV | 300,000 | 301,500 | 0.85 |
| Standard Life UK 3.5% CULS 231/03/2018 | 250,000 | 270,000 | 0.76 |
| F&C Finance Plc 9% 20/12/2016 | 245,000 | 262,001 | 0.74 |
| Invesco Leveraged High Yield Fund | 425,000 | 261,375 | 0.74 |
| Unite Group 6.125% 12/06/2020 | 250,000 | 254,000 | 0.72 |
| Juridica Ord NPV | 250,000 | 225,000 | 0.64 |
| | | 2,900,637 | 8.17 |
| **TOTAL** | | 16,106,759 | 45.48 |

# Schedule of Principal Investments

as at 31 December 2011

| Top 10 Holdings | Nominal Holdings | Valuation GBP | Total Assets % |
|---|---|---|---|
| **Smaller Companies Portfolio** | | | |
| RPC Group plc | 396,875 | 1,420,812 | 5.03 |
| James Halstead plc | 245,500 | 1,031,100 | 3.65 |
| Castings plc | 384,112 | 1,017,897 | 3.61 |
| VP plc | 420,414 | 923,860 | 3.27 |
| Fenner plc | 228,375 | 911,445 | 3.23 |
| Lupus Capital plc | 775,714 | 868,800 | 3.08 |
| Diploma plc | 253,135 | 859,899 | 3.05 |
| Devro plc | 325,000 | 835,250 | 2.96 |
| Consort Medical plc | 153,171 | 811,806 | 2.88 |
| Stobart Group plc | 676,000 | 810,524 | 2.87 |
| | | 9,491,393 | 33.63 |
| **Income Portfolio** | | | |
| UK Treasury 8% 06/07/2021 | 250,000 | 382,800 | 1.36 |
| Credit Suisse 7.875% 24/02/2041 | 500,000 | 287,264 | 1.02 |
| Lloyds 7.8673% 17/12/2019 | 350,000 | 257,250 | 0.91 |
| Italy (Govt) 5% 03 01/08/2034 | 400,000 | 262,401 | 0.93 |
| Rabobank 6.875% 03/19/2020 | 350,000 | 250,843 | 0.89 |
| Greenwich Loan Income Fund | 625,000 | 259,375 | 0.92 |
| Standard Life UK 3.5% CULS 31/03/2018 | 250,000 | 251,250 | 0.89 |
| Invesco Leveraged High Yield | 500,000 | 248,750 | 0.88 |
| ICAP Group 7.5% 28/07/2014 | 250,000 | 210,995 | 0.75 |
| Electra Private Equity 5% CULS 29/12/17 | 200 | 213,000 | 0.75 |
| | | 2,623,928 | 9.30 |
| **TOTAL** | | 12,115,321 | 42.93 |

# Company Details

## History

The Company was incorporated on 5 January 1999 and commenced its activities on 11 February 1999. 29,600,002 Ordinary Shares were issued.

The special resolution proposed at the Company's Annual General Meeting in 2006, that the Company cease as an investment company, was not carried by the necessary 75% majority of votes cast. Nevertheless, to provide an exit opportunity for the shareholders the Company made a Tender Offer to repurchase up to all of its Ordinary Shares at net asset value, calculated after taking account of all costs. Applications under the Tender Offer were received for 20,660,212 Ordinary Shares, leaving 8,939,790 Ordinary Shares in issue after the Extraordinary General Meeting on 5 January 2007.

At the 5 January 2007 Extraordinary General Meeting, it was resolved that the issued share capital of the Company be reduced from £7,400,000.50 to £296,000.02, effected by the cancellation of 24 pence per issued Ordinary Share, thus reducing the nominal amount of such shares from 25 pence to 1 pence per Ordinary Share. It was also resolved that £17,000,000 standing to the credit of the Company's share premium account be cancelled. The £7,104,000.48, resulting from the cancellation of share capital, and the £17,000,000, resulting from the cancellation of the share premium account, were credited to a distributable reserve.

As part of the Tender Offer, the Manager changed from Collins Stewart Fund Management Limited to Premier Asset Management (Guernsey) Limited.

At the Extraordinary General Meeting on 15 December 2011 it was resolved to approve the issue of 12,000,000 ZDP Shares at the price of £1 each. Admission to the London Stock Exchange's market for listed securities became effective and unconditional and dealings in ZDP Shares commenced on the London Stock Exchange at 8.00 a.m. on 21 December 2011. Gross proceeds of £12 million were raised from the issue of the ZDP Shares which enabled the repayment of all of the Company's borrowings of £6 million with the Royal Bank of Scotland on 29 December 2011 and the borrowing facility was subsequently cancelled. The remainder of the proceeds raised from the redeemable ZDP Shares, being approximately £5.6 million have been invested into the Company's two portfolios.

## Investment objectives

The Company's investment objectives are to provide the Company's shareholders with a high income and also the opportunity for capital growth.

## Investment policy

The Company's investment policy is to allocate approximately 70% to 80% of the Company's assets to the Smaller Companies Portfolio with the balance to the Income Portfolio. (Prior to the Tender Offer, this was approximately 75% to the Smaller Companies Portfolio with the balance allocated to the Income Portfolio).

The Smaller Companies Portfolio is principally invested in UK equities with a market capitalisation of under £1 billion. Unicorn, as the Investment Adviser of the Smaller Companies Portfolio, focuses on companies with experienced and well motivated management, products or services supplying growth markets, sound operational and management controls, good cash generation and a progressive dividend.

# Company Details (continued)

Premier manages the Income Portfolio and aims to maximise income with the objective of capital protection. The Income Portfolio comprises sterling denominated fixed interest securities including corporate bonds, preference and permanent interest bearing shares, convertibles, reverse convertibles bonds, contingent convertible bonds, debentures and other similar securities. The Income Portfolio may also contain higher yielding shares of other investment companies, including property investment companies, however these will not exceed 15% of the overall portfolio (at the time of acquisition).

## Management fees

The management fee is 0.7% per annum of total assets and the Manager is also potentially entitled to a performance fee of 15% of any excess of the Net Asset Value per Ordinary Share (together with any dividends paid by reference to the relevant period) over the benchmark NAV per Ordinary Share. No performance fee was paid or is payable for the year under review. The total expenses ratio of the Company is capped at 1.5% of total assets, excluding performance fees and non-routine administration and professional fees and with adjustments made to allow for repayment of debt or the buy back of shares. The application of these calculations for 2012 indicates that no refund is due from the Manager. The net management fee charged in 2012 was £226,575.

# Directors

for the year ended 31 December 2012

At the Board meeting held on 22 August 2012, John Boothman resigned as Chairman of the Company. John Boothman was succeeded by Helen Green as Chairman and David Warr was subsequently appointed to the Board.

All three directors of the Board are non-executive directors and are considered independent of the Manager.

## Helen Foster Green (Chair)

Helen is a chartered accountant. She has been employed by Saffery Champness, a top 20 firm of chartered accountants, since 1984. She qualified as a chartered accountant in 1987 and became a partner in the London office in 1997. Since 2000 she has been based in the Guernsey office where she is client liaison director responsible for trust and company administration. Helen serves on the boards of LSE listed companies Tamar European Industrial Fund Limited and Henderson Diversified Income Limited and AIM listed companies Landore Resources Limited and Advance Frontier Markets Fund Limited.

## John Nigel Ward

Nigel has over 35 years experience in international investment markets, credit and risk analysis, portfolio management, corporate and retail banking, corporate governance, compliance and the managed funds industry. He is also an Independent Non-Executive Director on the board of several offshore funds and companies, including AIM and CISX listed, with investment mandates ranging across property, agricultural land, ground rents, UK and North American equities, credit and mining and exploration. Nigel was a founding Commissioner of the Guernsey Police Complaints Commission, an Associate of the Institute of Financial Services, a member of the Institute of Directors and holder of the IoD Diploma in Company Direction. He too is a resident of Guernsey.

## David John Warr

David is a Fellow of the Institute of Chartered Accountants in England and Wales having qualified as a chartered accountant in 1976. In 1981 David was appointed a partner in Reads & Co., a Guernsey based firm of chartered accountants, which he helped develop into a more broadly based financial services business leading up to its sale at the end of 1998. David's experience at Reads & Co. included audit, trust and company administration. David now acts as a non-executive director on a number of UK Listed companies whilst combining those responsibilities with charitable work most noticeably as Vice-Chairman of the Guernsey Community Foundation LBG. David is also a resident of Guernsey.

# Management Report

for the year ended 31 December 2012

A description of important events which have occurred during the financial period, their impact on the performance of the Company as shown in the Financial Statements and a description of the principal risks and uncertainties facing the Company is given in the Chairman's Statement, Investment Advisers' Reports, the schedule of Risk Factors and the notes to the Financial Statements and is incorporated here by reference.

There were no material related party transactions which took place in the financial period.

The Board concluded that, after making enquiries, there is a reasonable expectation that the Company has adequate resources to continue its existence for the foreseeable future. Thus it continues to adopt the going concern basis of accounting in preparing the annual financial statements.

## Director's responsibility statement

The directors confirm to the best of their knowledge and belief:

(a) The management report (comprising the Chairman's Statement, the Investment Advisers' Reports and the Directors' 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 the Company faces; and

(b) The financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profits of the Company.

| | |
|---|---|
| **Helen Green** | **Nigel Ward** |
| *Chair* | *Director* |

21 March 2013

# Directors' Report
for the year ended 31 December 2012

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

## Principal activities and business review
The principal activity of the Company is to carry on business as an investment company. The directors do not envisage any change in these activities for the foreseeable future. A description of the activities of the Company in the period under review is given in the Chairman's Statement on pages 4 and 5.

## Status
The Company is a closed-ended investment company and was incorporated with limited liability in Guernsey on 5 January 1999 with registered number 34778. The Company operates under The Companies (Guernsey) Law, 2008 and the Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended.

The Company's Ordinary Shares and ZDP Shares are traded on the London Stock Exchange ("LSE") with the Ordinary Shares having a premium listing and the ZDP Shares having a standard listing, as defined by the LSE.

The Company's management and administration takes place in Guernsey and the Company has been granted exemption from income tax within Guernsey by the Administrator of Income Tax. It is the intention of the directors to continue to operate the Company so that each year this tax-exempt status is maintained.

## Results and dividends
The results attributable to Ordinary Shareholders for the period are shown on page 28. The Company made a revenue return for the period of 12.33 pence (2011: 8.21 pence) per Ordinary Share and a capital return of 74.79 pence (2011: -10.07 pence capital return) per Ordinary Share.

The Company paid dividends during the year as follows:

| | **Payment date** | **Dividend per share (pence)** |
|---|---|---|
| First interim | 30 March 2012 | 3.00 |
| Second interim | 29 June 2012 | 3.00 |
| Third interim | 28 September 2012 | 3.00 |
| Fourth interim | 31 December 2012 | 3.00 |

## Directors
The directors in office are shown on page 13. Further details of the Directors' responsibilities are given on pages 18 to 23.

None of the directors nor any persons connected with them had a material interest in any of the Company's transactions, arrangements or agreements at the date of this report and none of the directors has or has had any interest in any transaction which is or was unusual in its nature or conditions or significant to the business of the Company, and which was effected by the Company during the reporting period.

At the date of this report, there are no outstanding loans or guarantees between the Company and any director.

## Substantial shareholdings

The following substantial interests in the Company's Ordinary Share capital as at the date of the report had been notified to the Company:

| | Voting rights | % of total voting rights |
|---|---|---|
| Cheviot Asset Management | 649,716 | 7.45% |
| Rathbone Brothers | 455,850 | 5.22% |
| Brewin Dolphin Limited | 453,563 | 5.20% |
| Charles Stanley Group plc | 427,525 | 4.90% |
| JP Morgan | 425,000 | 4.87% |
| J D McClure* | 286,980 | 3.083% |

*J D McClure is a director of Unicorn, one of the Company's Investment Advisers.

## Net Asset Value

The net asset value of the Company's Ordinary Shares, as at 31 December 2012 was 261.25 pence (2011: 186.12 pence) per share.

The net asset value for accounting purposes of the Company's ZDP Shares, as at 31 December 2012 was 104.14 pence (2011: 96.97 pence) per share.

## Management agreement

The Board is responsible for the determination of the Company's investment policy and has overall responsibility for the Company's day-to-day activities. The Company has, however, entered into a Management Agreement with Premier Asset Management (Guernsey) Limited (the "Manager"), a wholly-owned, Guernsey incorporated subsidiary of Premier Asset Management Limited. The Manager receives a management fee of 0.7% per annum of total assets, calculated monthly and payable quarterly in arrears, out of which it pays fees to the Investment Advisers. The Manager is also paid a shareholder communication and support fee, currently £3,100 for the twelve months from 1 April 2012 to 31 March 2013. The Manager is also potentially entitled to a performance fee of 15% of any excess of the Net Asset Value per Ordinary Share (together with any dividends paid by reference to the relevant period) over the benchmark NAV per Ordinary Share. No performance fee was paid or is payable for the year under review. The Management Agreement may be terminated by either party on 12 months' written notice.

Under separate Investment Adviser Agreements, the Manager has delegated certain of its duties and responsibilities to Premier and Unicorn, in relation to the Income Portfolio and Smaller Companies Portfolio respectively, as Investment Advisers who are responsible on behalf of the Manager for the identification and analysis of investments meeting the investment objectives and strategy of the Company. Premier and Unicorn are authorised and regulated by the FSA.

The Board keeps under review the performance of the Manager and the Investment Advisers. In the opinion of the directors the continuing appointment of the Manager on the terms agreed is in the interest of shareholders as a whole. The reasons for this view are that the investment performance of the Company is satisfactory relative to the markets in which the Company invests and because the fund management teams have experience and a proven track record in the chosen markets. This sub-section forms an integral part of the Financial Statements. Refer to Note 16.

## Administration agreement

Under the terms of the Management Agreement, the Manager is responsible for, amongst other things, providing administration and secretarial services to the Company. With the consent of the Company, the Manager has delegated the provision of certain administrative and secretarial services to Anson Fund Managers Limited (the "Administrator" and "Company Secretary") pursuant to an Administration Agreement. The Administrator carries out the general secretarial functions required by The Companies (Guernsey) Law, 2008 (as amended) and ensures that the Company complies with its continuing obligations as a company listed on the Official List of the London Stock Exchange. The Administrator also carries out the Company's general administrative functions such as the calculation of net asset value, calculating the performance of the Company's investments and the maintenance of accounting records. The Administration Agreement is terminable by either party on giving not less than three months' written notice.

## Payment of suppliers

It is the Company's payment policy to obtain the best possible terms for all business and, therefore, there is no consistent policy as to the terms used. The Company agrees with its suppliers the terms on which business will be transacted, and it is the Company's policy to abide by those terms. At 31 December 2012 all suppliers' invoices which had been received by that date had been settled.

## Segmental reporting

The Company has two reportable segments, being the Income Portfolio and the Smaller Companies Portfolio. Each of these portfolios is managed separately, entail different investment objectives and contain investments in different products. A more comprehensive disclosure can be found within Note 2 of the Notes to the Accounts.

## Corporate governance

### Statement of compliance with the UK Corporate Governance Code (the "Code")

Due to the Ordinary Shares having a premium listing on the LSE, the Company has to comply with Listing Rule 9.8.6(5) which requires the Company to apply the provisions of the Code to the extent that they are considered relevant to the Company. The directors place a high degree of importance on ensuring that high standards of corporate governance are maintained within the Company. The Code is available for download from the Financial Reporting Council's website www.frc.org.uk.

The Board has noted that the revised edition of the Code is effective for financial years commencing on or after 1 October 2012. As such, the Company will report against the revised Code in its annual financial report for the year ended 31 December 2013.

With effect from 1 January 2012 the Company was also required to comply with the Guernsey Financial Services Commission Financial Sector Code of Corporate Governance (the "Guernsey Code"). As the Company reports under the Code it is deemed to meet the Guernsey Code and the Board has undertaken to evaluate its corporate governance compliance on an on-going basis.

The Company has complied with the main principles of the Code, except as set out below.

The Code includes provisions relating to:

- the role of the chief executive;
- executive directors' remuneration; and
- the need for an internal audit function.

For the reasons set out in the preamble to the Code, the Board considers these provisions are not relevant to the Company. The Company has therefore not reported further in respect of these provisions. Other areas of non-compliance with the Code by the Company, and the reasons therefore, are as follows:

- There is no Senior Independent Director. This is not in accordance with provision A.4.1 of the Code but is felt to be appropriate for the size and nature of the Company.
- The non-executive directors of the Company do not meet without the Chairman present to appraise the Chairman's performance which is not in accordance with provision A.4.2. However, the Company has approved a Chairman Performance Evaluation Questionnaire during the period for completion by the directors on an annual basis to facilitate the review of the Chairman's performance.
- The Board did not undertake a formal performance evaluation of the Board, its committees or the individual directors during the year as required by provision B.6.1 and B.6.3 of the Code respectively. However, the Company has approved a Board and individual director Performance Evaluation Questionnaire during the period for review and completion on an annual basis.

As per the Company's Articles of Association, the directors are not subject to re-election by the Ordinary Shareholders nor are they appointed for specific terms as required by these provisions as this is not felt to be appropriate for the size and nature of the Company. However, the Board has determined, in order to facilitate good corporate governance practice, each director will offer themselves for re-election every 6 years.

## Board responsibilities

The Board comprises three non-executive directors, who meet at least quarterly to consider the affairs of the Company in a prescribed and structured manner. All directors are considered independent of the Manager for the purposes of the Code and listing rule 15.2.12A. Biographies of the directors appear on page 13 demonstrating the wide range of skills and experience they bring to the Board.

The directors, in the furtherance of their duties, may take independent professional advice at the Company's expense which is in accordance with provision B.5.1 of the Code. The directors also have access to the advice and services of the Company Secretary through its appointed representatives who are responsible to the Board for ensuring that the Board's procedures are followed and that applicable rules and regulations are complied with. To enable the Board to function effectively and allow directors to discharge their responsibilities, full and timely access is given to all relevant information.

None of the directors has a contract of service with the Company.

During the year ended 31 December 2012 the number of full scheduled Board meetings attended were as follows:

| | Quarterly Board meetings | Adhoc Board Meetings | Audit Committee Meetings |
|---|---|---|---|
| Helen Green | 4 (4) | 2 (2) | 3 (3) |
| Nigel Ward | 4 (4) | 2 (2) | 3 (3) |
| David Warr* | 2 (2) | – (–) | 1 (1) |
| John Boothman* | 3 (3) | 2 (2) | 2 (2) |

The figures in brackets indicate the number of meetings held in the period in respect of which the individual was a Board member.

*Note that at the Board meeting held 22 August 2012 John Boothman resigned as a director of the Company with immediate effect and David Warr was appointed as a non-executive Director with effect from 22 August 2012.

## Audit committee

In accordance with the Code an audit committee has been established consisting of Helen Green, David Warr and Nigel Ward. David Warr replaced Helen Green as Chairman of the Audit Committee with effect from 22 August 2012. The qualifications of the directors are included within the biographies on page 13. The committee meets at least twice a year and reviews, *inter alia*, the financial reporting process and the system of internal control and management of financial risks including understanding the current areas of greatest financial risk and how these are managed by the Manager, reviewing annual financial statements, assessing the fairness of preliminary and interim statements and disclosures and reviewing the external audit process. The committee is responsible for overseeing the Company's relationship with the external auditors, including making recommendations to the Board on the appointment of the external auditors and their remuneration. The committee considers the nature, scope and results of the auditor's work and reviews, and develops and implements policy on the supply of any non-audit services that are to be provided by the external auditors. During the year under review, the auditor provided non-audit services to the Company. The auditors were engaged to provide guidance to the Board on the implications of the Foreign Account Tax Compliance Act. The committee receives and reviews reports from the Manager and the Company's external auditors relating to the Company's annual report and financial statements. The committee focuses particularly on compliance with legal requirements, accounting standards and the Listing Rules and ensures that an effective system of internal financial and non-financial controls is maintained. The ultimate responsibility for reviewing and approving the annual report and financial statements remains with the Board.

The terms of reference of the audit committee are available from the Administrator on request.

During the year the audit committee met three times and of those meetings all directors were in attendance.

### Nomination committee

In accordance with the Code, a nomination committee was established during the period under review, consisting of Helen Green, David Warr and Nigel Ward. David Warr has been appointed Chairman. The qualifications of the directors are included within the biographies on page 13. The nomination committee shall meet at least once a year in accordance with the terms of reference and reviews, *inter alia*, the structure, size and composition of the Board and to make recommendations to the Board evaluating candidates from a wide range of backgrounds through open advertising. Whilst considering the composition of the Board, the nomination committee will be mindful of diversity, inclusiveness and meritocracy and, in considering a new candidate, the nomination committee will apply comparative analysis of candidates' qualifications and experience, applying pre-established clear, neutrally formulated and unambiguous criteria to determine the most suitable candidate sought for the specific position. Other duties of the nomination committee are to give full consideration to succession planning for directors, to regularly review the leadership needs of the non-executive directors, ensure non-executive directors receive a formal letter of appointment and to review the results of the Board's performance evaluation process.

The terms of reference of the nomination committee are available from the Administrator on request.

### Remuneration and Management Engagement ("RME") committee

In accordance with the Code, a RME committee was established during the period under review, consisting of Helen Green, David Warr and Nigel Ward. Nigel Ward has been appointed Chairman. The qualifications of the directors are included within the biographies on page 13. The RME committee shall meet at least once a year to determine and agree with the Board the framework for the remuneration of the Company's Chairman, directors and service providers, taking into account remuneration trends and all other factors which it deems necessary. The RME committee also reviews all contractual terms of third parties to ensure their compliance.

The terms of reference of the RME committee are available from the Administrator on request.

### Internal control and financial reporting

The Board is responsible for establishing and maintaining the Company's system of internal control in accordance with provision C.2 of the Code. Internal controls are designed to meet the particular needs of the Company and the risks to which it is exposed, and by their very nature provide reasonable, but not absolute, assurance against material misstatement or loss. The key procedures which have been established to provide effective internal control are as follows:

- Investment management is provided by Premier and Unicorn under the Investment Adviser Agreements. The Board is responsible for setting the overall investment policy and monitors the actions of the Investment Advisers at regular Board meetings. Both Premier and Unicorn provide the Board with updates at each quarterly board meeting and at any other time that the Board requests.

- Administration and company secretarial duties for the Company are performed by Anson Fund Managers Limited.
- Registrar duties are performed by Anson Registrars Limited.
- Custody of assets is undertaken by BNP Paribas Trust Company (Guernsey) Limited.
- The duties of investment management, accounting and the custody of assets are segregated. The procedures of the individual parties are designed to complement one another.
- The directors of the Company clearly define the duties and responsibilities of their agents and advisers. The appointment of agents and advisers is conducted by the Board after consideration of the quality of the parties involved; the Board monitors their on-going performance and contractual arrangements.
- Mandates for authorisation of investment transactions and expense payments are set out by the Board.
- The Board reviews detailed financial information produced by the Investment Advisers and the Administrator on a regular basis.

The Board is provided, on a quarterly basis, with a Compliance Report produced by a specialist Compliance and Legal department at Premier Asset Management (Guernsey) Limited. The monitoring programme ensures that all activities of Premier, for the year under review, have been in accordance with both internal procedures and with FSA principles for firms and individuals. The Compliance team also make regular external visits to both Unicorn and the Administrator, the latest visits being carried out in September 2012. The Secretary provides a report at each quarterly Board meeting which highlights any areas of non compliance with the Listing Rules and The Companies (Guernsey) Law, 2008. The Board has access, at all times, to all relevant compliance personnel.

The Company does not have an internal audit department. All the Company's management and administration functions are delegated to independent third parties and it is therefore felt there is no need for the Company to have an internal audit facility.

### Dialogue with shareholders

All holders of Ordinary Shares and ZDP Shares in the Company have the right to receive notice of, and attend, the general meetings of the Company, during which the Board and the Investment Advisers are available to discuss issues affecting the Company. This is in accordance with provision E.1 of the Code. Only Ordinary Shareholders carry full voting rights, holders of ZDP Shares are entitled to vote only on issues affecting their share class.

The primary responsibility for shareholder relations lies with the Manager. However, the directors are always available to enter into dialogue with shareholders and the Chairman is always willing to meet major shareholders as the Company believes such communication to be important.

During the period under review, the Company appointed Numis Securities Limited as the Company's Corporate Broker to replace Fairfax I.S Plc whose engagement was terminated with effect from 10 December 2012.

## General meeting

The notice of the Company's forthcoming general meeting to be held pursuant to section 199 of The Companies (Guernsey) Law, 2008 is set out on pages 55 and 56. Resolutions relating to the following items will be proposed at such forthcoming general meeting:

*Re-election of Director*

David John Warr was co-opted by the Board as a director with effect from 22 August 2012. As required under B.7.1 of the Code to which the Company complies with and in accordance with the Companies Articles of Association, Mr Warr is required to be re-elected by the shareholders at the first general meeting after his appointment. Having considered the performance and contribution made by Mr Warr during his appointment to the Board, the Board believes that Mr Warr performs effectively and with commitment to the role. As such, the Board recommends Mr Warr's election to the Board. Brief biographical details can be found on page 13.

Whilst there is no requirement under the Company's Articles of Association for directors to be subject to re-election by the Ordinary Shareholders at intervals of three years as required by provision B.2.3 of the Code, the Board has determined that in order to facilitate good corporate governance practice, each director will offer themselves for re-election every 6 years. As such, at the Company's General Meeting due to be held on 21 August 2013 Helen Green will retire and, being eligible, offers herself for re-election.

*Market purchases of the Company's Shares*

The Board will seek, in accordance with the Law, to renew the Company's authority to make market purchases of its Ordinary Shares and ZDP Shares.

## Going concern

The Company's principal activities are set out on page 15. The financial position of the Company is described on page 29. In addition, Note 18 to the Financial Statements includes the Company's objectives, policies and processes for managing its capital, its financial risk management objectives and its exposures to credit risk and liquidity risk.

The Board concluded that, after making enquiries, there is a reasonable expectation that the Company has adequate resources to continue its existence for the foreseeable future. Thus it continues to adopt the going concern basis of accounting in preparing the annual financial statements.

At the General Meeting of the Company held in August 2011, shareholders voted against the special resolution that, in accordance with Article 134(1), the Company should cease to continue as presently constituted. In accordance with the Company's Articles, shareholders will have the opportunity to vote on the Company's third continuation vote in August 2016.

## Statement of directors' responsibilities

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

The Companies (Guernsey) Law, 2008 (the "Law") requires the directors to prepare financial statements for each financial year. Under the Law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards and applicable law.

The financial statements are required by the Law to 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 estimates that are reasonable and prudent;
- state whether applicable accounting standards 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 proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Law. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

## Disclosure of information to auditors

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

## Auditor

KPMG Channel Islands Limited have expressed their willingness to continue in office as Auditor. A resolution proposing their reappointment will be submitted at the forthcoming general meeting to be held pursuant to section 199 of the Law.

Signed on behalf of the Board by:

| | |
|---|---|
| **Helen Green** | **Nigel Ward** |
| *Chair* | *Director* |

# Risk Factors

for the year ended 31 December 2012

The Board has an on-going process in place for identifying, evaluating and managing the significant risks faced by the Company. This process has been in place for the year under review and up to the date of the Annual Financial Report, is regularly reviewed by the Board and accords with the Turnbull guidance.

## Structure of the Company and gearing

The Company's business could be materially and adversely affected by a number of risks. External factors to the Company may either adversely or favourably affect the volatility and liquidity of the Smaller Companies and Income Portfolios, as well as their values. These can be caused by economic conditions, changes to tax laws, competition and a number of other factors.

Investors holding either Ordinary Shares or ZDP Shares should have carefully considered whether these investments, given the risks attached, are suitable for them. Investors in ZDP Shares should be aware that interest rate movements will affect the value of their investment. Further risks include the lower level of regulatory protection than applies to premium listed shares.

Holders of Ordinary Shares should be aware that the issue during 2011 of ZDP Shares to replace the existing bank borrowing facility increased the implicit level of gearing and thus exaggerated the likely impact of adverse movements in the value of the Company's investments. Furthermore, since the policy of the Company is not to amortise the increase in its ultimate liability to ZDP Shareholders, the amount eventually realised by Ordinary Shareholders on the liquidation or winding up of the Company will be adversely impacted by the prior redemption of the ZDP Shares.

## Risks associated with investments held in the Smaller Companies Portfolio

Investing in smaller companies, including AIM companies and unlisted companies, can carry greater risks than those usually associated with larger capitalised companies. Liquidity, in particular, can be lower in such shares with a risk of reducing the underlying asset value of the portfolio. Such companies, being less diversified, may be more vulnerable to weaknesses in the markets they serve, and may be less well placed than larger companies to secure financial support if required.

## Risks associated with investments held in the Income Portfolio

The Income Portfolio primarily contains fixed interest securities. Bond prices and interest rates are inversely correlated. Thus, when interest rates increase, the price of a bond with a fixed coupon will decline. Alternatively, when interest rates decline, the price of a bond with a fixed coupon will increase. Therefore, interest rate movements are carefully monitored by the Investment Adviser, but when interest rates rise or credit ratings decline losses are probable.

The Income Portfolio may contain higher yielding investment company shares (including shares of split capital investment trusts) and bonds (including reverse convertible bonds and contingent convertible bonds).

As a result of the underlying gearing in some investment company shares, any increase or decrease in the value of such shares might magnify movements in their net asset values and consequently affect the value of the Income Portfolio accordingly. In accordance with the Listing Rules, the Company makes monthly stock exchange announcements detailing its holdings in other UK listed investment companies which themselves do not have a stated investment policy to invest no more than 15% of their gross assets in other UK listed investment companies (including investment trusts).

## Dividend levels

Dividends paid on the Company's Ordinary Shares rely on receipt of interest payments and dividends from the securities in which the Company invests. The Company's revenue levels are monitored on a regular basis by the Board and the Investment Advisers.

## Currency risk

The majority of the Company's assets and all of its liabilities are denominated in sterling. To the extent that the Company has fixed interest investments denominated in foreign currency, this exposure is likely to be hedged back to sterling. Therefore, there is unlikely to be any significant risk.

## Market price risk

Since the Company invests in financial instruments, market price risk is inherent in these investments. In order to minimise this risk, a detailed analysis of the risk/reward relationship of each investee company is undertaken by the Investment Advisers prior to making investments.

## Interest rate risk

The Company's investment portfolio includes investments bearing interest at fixed rates.

## Liquidity risk

Liquidity risk is the risk that the Company will encounter in realising assets or otherwise raising funds to meet financial commitments.

## Discount volatility

Being a closed-end fund, the Company's shares may trade at a discount to their net asset value. The magnitude of this discount fluctuates daily and can vary significantly. Thus, for a given period of time, it is possible that the market price could decrease despite an increase in the Company's net asset value. The directors review the discount levels regularly. The Investment Advisers actively communicate with the Company's major shareholders and potential new investors, with the aim of managing discount levels.

# Independent Auditor's Report to the Members of Acorn Income Fund Limited

We have audited the financial statements of Acorn Income Fund Limited (the "Company") for the year ended 31 December 2012 which comprise the Statement of Comprehensive Income, Statement of Financial Position, Statement of Cash Flows, 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 as issued by the IASB.

This report is made solely to the Company's members, as a body, in accordance with section 262 of the Companies (Guernsey) Law, 2008. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of directors and auditor

As explained more fully in the Statement of Directors' Responsibilities set out on page 23 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 (APB's) Ethical Standards for Auditors.

## Scope of the audit of the financial statements

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

## Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 and of its profit for the year then ended;
- are in accordance with International Financial Reporting Standards as issued by the IASB; and
- comply with The Companies (Guernsey) Law, 2008.

# Independent Auditor's Report to the Members of Acorn Income Fund Limited (continued)

## Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where The Companies (Guernsey) Law, 2008 requires us to report to you if, in our opinion:

- the Company has not kept proper accounting records; or
- the financial statements are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations, which to the best of our knowledge and belief are necessary for the purpose of our audit.

Under the Listing Rules we are required to review the part 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. We have nothing to report in respect to this review.

Steven D Stormonth
for and on behalf of KPMG Channel Islands Limited
Chartered Accountants and Recognised Auditors

21 March 2013

# Statement of Comprehensive Income

for the year ended 31 December 2012

| | Notes | Year ended 31 Dec 2012 Revenue GBP | Capital GBP | Total GBP | Year ended 31 Dec 2011 Total GBP |
|---|---|---|---|---|---|
| Net gains/(losses) on financial assets designated as at fair value through profit or loss | 10 | – | 7,638,853 | 7,638,853 | (317,648) |
| Losses on derivative financial instruments | 4 | – | (27,605) | (27,605) | (314,432) |
| Investment income | 3 | 1,359,333 | – | 1,359,333 | 1,000,765 |
| Total income and gains | | 1,359,333 | 7,611,248 | 8,970,581 | 368,685 |
| Expenses | 5 | (284,472) | (226,672) | (511,144) | (409,543) |
| **Return on ordinary activities before finance costs and taxation** | | 1,074,861 | 7,384,576 | 8,459,437 | (40,858) |
| Interest payable and similar charges | 7 | 586 | (858,793) | (858,207) | (121,987) |
| **Return on ordinary activities before taxation** | | 1,075,447 | 6,525,783 | 7,601,230 | (162,845) |
| Taxation on ordinary activities | | – | – | – | – |
| Other comprehensive income | | – | – | – | – |
| **Total comprehensive income for the year attributable to Ordinary Shareholders** | | 1,075,447 | 6,525,783 | 7,601,230 | (162,845) |

| | | Pence | Pence | Pence | Pence |
|---|---|---|---|---|---|
| **Return per Ordinary Share** | 9 | 12.33 | 74.79 | 87.12 | (1.86) |
| **Dividend per Ordinary Share** | 8 | 12.00 | 0.00 | 12.00 | 7.00 |
| **Return per ZDP Share** | 9 | – | 0.07 | 0.07 | 0.06 |

The supplementary revenue return and capital return columns have been prepared in accordance with the Statement of Recommended Practice ("SORP") issued by the Association of Investment Companies ("AIC").

In arriving at the results for the financial year, all amounts above relate to continuing operations.

No operations were acquired or discontinued in the year.

The notes on pages 32 to 53 form an integral part of the financial statements.

# Statement of Financial Position

as at 31 December 2012

| | Notes | 31 Dec 2012 GBP | 31 Dec 2011 GBP |
|---|---|---|---|
| **NON-CURRENT ASSETS** | | | |
| Financial assets designated as at fair value through profit or loss | 10 | 34,358,936 | 22,042,663 |
| **CURRENT ASSETS** | | | |
| Receivables | 11 | 418,464 | 361,730 |
| Cash and cash equivalents | | 618,376 | 5,829,513 |
| Derivative financial assets | 18 | 707 | 23,165 |
| | | 1,037,547 | 6,214,408 |
| **TOTAL ASSETS** | | 35,396,483 | 28,257,071 |
| **CURRENT LIABILITIES** | | | |
| Derivative financial liabilities | 18 | – | 24,178 |
| Payables – due within one year | 12 | 106,361 | 357,578 |
| **NON-CURRENT LIABILITIES** | | | |
| ZDP Shares | 13 | 12,496,984 | 11,636,432 |
| **TOTAL LIABILITIES** | | 12,603,344 | 12,018,188 |
| **NET ASSETS** | | 22,793,138 | 16,238,883 |
| **EQUITY** | | | |
| Share capital | 14 | 89,398 | 89,398 |
| Share premium | | 79,173 | 79,173 |
| Treasury shares | 15 | (303,211) | (303,211) |
| Revenue reserve | | 297,363 | 268,891 |
| Special reserve | | 10,000,000 | 10,000,000 |
| Capital reserve | | 12,630,415 | 6,104,632 |
| **TOTAL EQUITY** | | 22,793,138 | 16,238,883 |
| | | Pence | Pence |
| **Net asset value per Ordinary Share (per IFRS and Articles)** | | 261.25 | 186.12 |
| **Net asset value per ZDP Share (per IFRS)** | | 104.14 | 96.97 |
| **Net asset value per ZDP Share (per Articles)** | | 106.71 | 100.17 |

The financial statements on pages 28 to 53 were approved by the Board of Directors and authorised for issue on 21 March 2013 and signed on its behalf by:

**Helen Green**
*Chair*

**Nigel Ward**
*Director*

The notes on pages 32 to 53 form an integral part of the financial statements.

# Statement of Cash Flows

for the year ended 31 December 2012

| | Notes | Year ended 31 Dec 2012 GBP | Year ended 31 Dec 2011 GBP |
|---|---|---|---|
| **Operating activities** | | | |
| Return on ordinary activities before taxation | | 7,601,230 | (162,845) |
| Net (gains)/losses on financial assets designated as at fair value through profit or loss | 10 | (7,638,853) | 317,648 |
| Investment income | 3 | (1,359,333) | (1,000,765) |
| Interest expense | | 858,207 | 121,987 |
| (Increase)/Decrease in derivative financial assets | | 22,458 | (23,165) |
| Decrease in derivative financial liabilities | 18 | (24,178) | (18,386) |
| Increase/(Decrease) in payables and appropriations | 12 | (251,217) | 287,600 |
| Decrease in receivables excluding accrued investment income | 11 | 54,496 | 16,461 |
| **Net cash flow from operating activities before investment income** | | (737,190) | (461,465) |
| Investment income received | | 1,248,102 | 930,624 |
| **Net cash flow from operating activities before taxation** | | 510,912 | 469,160 |
| Tax paid | | – | – |
| **Net cash flow from operating activities after taxation** | | 510,912 | 469,160 |
| **Investing activities** | | | |
| Purchase of financial assets | 10 | (21,500,190) | (7,576,479) |
| Sale of financial assets | | 16,822,771 | 5,929,161 |
| **Net cash flow from investing activities** | | (4,677,419) | (1,647,318) |
| **Financing activities** | | | |
| Equity dividends paid | 8 | (1,046,975) | (611,610) |
| Drawdown of bank loan | | – | 1,650,000 |
| Repayment of bank loan | | – | (6,000,000) |
| Purchase of own shares | 15 | – | (96,193) |
| Bank loan interest paid | | 2,345 | (99,553) |
| Proceeds from issue of ZDP Shares | | – | 12,000,000 |
| Cost of issue of ZDP Shares | | – | (386,002) |
| **Net cash flow from financing activities** | | (1,044,630) | 6,456,642 |
| **Increase/(Decrease) in cash and cash equivalents** | | (5,211,137) | 5,278,483 |
| Cash and cash equivalents at beginning of year | | 5,829,513 | 551,030 |
| **Cash and cash equivalents at end of year** | | 618,376 | 5,829,513 |

The notes on pages 32 to 53 form an integral part of the financial statements.

# Statement of Changes in Equity

as at 31 December 2012

| | Share Capital 31 Dec 2012 GBP | Share Premium 31 Dec 2012 GBP | Treasury Reserve 31 Dec 2012 GBP | Revenue Reserve 31 Dec 2012 GBP | Special Reserve 31 Dec 2012 GBP | Capital Reserve 31 Dec 2012 GBP | Total 31 Dec 2012 GBP |
|---|---|---|---|---|---|---|---|
| Balances as at 1 January 2012 | 89,398 | 79,173 | (303,211) | 268,891 | 10,000,000 | 6,104,632 | 16,238,883 |
| Total comprehensive income for the year attributable to shareholders | – | – | – | 1,075,447 | – | 6,525,783 | 7,601,230 |
| Dividends | – | – | – | (1,046,975) | – | – | (1,046,975) |
| Treasury shares acquired | – | – | – | – | – | – | – |
| Transfer between reserves | – | – | – | – | – | – | – |
| Balances as at 31 December 2012 | 89,398 | 79,173 | (303,211) | 297,363 | 10,000,000 | 12,630,415 | 22,793,138 |

| | Share Capital 31 Dec 2011 GBP | Share Premium 31 Dec 2011 GBP | Treasury Reserve 31 Dec 2011 GBP | Revenue Reserve 31 Dec 2011 GBP | Special Reserve 31 Dec 2011 GBP | Capital Reserve 31 Dec 2011 GBP | Total 31 Dec 2011 GBP |
|---|---|---|---|---|---|---|---|
| Balances as at 1 January 2011 | 89,398 | 79,173 | (207,018) | 1,363,079 | 10,000,000 | 5,784,899 | 17,109,531 |
| Total comprehensive income for the year attributable to shareholders | – | – | – | 717,422 | – | (880,267) | (162,845) |
| Dividends | – | – | – | (611,610) | – | – | (611,610) |
| Treasury shares acquired | – | – | (96,193) | – | – | – | (96,193) |
| Transfer between reserves | – | – | – | (1,200,000) | – | 1,200,000 | – |
| Balances as at 31 December 2011 | 89,398 | 79,173 | (303,211) | 268,891 | 10,000,000 | 6,104,632 | 16,238,883 |

The notes on pages 32 to 53 form an integral part of the financial statements.

## 1 ACCOUNTING POLICIES

### (a) Basis of preparation

The financial statements, which give a true and fair view, have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB"), the AIC's SORP (as revised in January 2009) where this is consistent with the requirements of IFRS and all in compliance with The Companies (Guernsey) Law, 2008. All accounting policies adopted for the period are consistent with IFRS issued by the IASB. The financial statements have been prepared on an historical cost basis except for the measurement at fair value of financial assets designated as at fair value through profit or loss and derivative financial instruments.

The following Standards or Interpretations have been adopted in the current year. Their adoption has not had any impact on the amounts reported in these Financial Statements and it is not expected to have any impact on future financial periods:

IAS 1 *Presentation of Financial Statements* (amendments to revise the way other comprehensive income is presented) effective for annual periods beginning on or after 1 July 2012.

The following Standards or Interpretations have been issued by the IASB but not yet adopted by the Company:

IFRS 1 – *First-time Adoption of International Financial Reporting Standards* (amendments resulting from annual improvements) effective for annual periods beginning on or after 1 January 2013.

IFRS 7 *Financial Instruments: Disclosures* (amendments related to the offsetting of assets and liabilities) effective annual periods beginning on or after 1 January 2015.

IFRS 9 *Financial Instruments – Classification and Measurement of financial liabilities* to incorporate requirements for de-recognition of financial assets and financial liabilities as well as modifies relief from restating comparative periods and their associated disclosures. This is effective for annual periods beginning on or after 1 January 2015.

IFRS 13 *Fair Value Measurement* was published in May 2011 and is effective for annual periods beginning on or after 1 January 2013. The IFRS sets out a single framework for measuring fair value including definitions, disclosures and details regarding the 'fair value hierarchy.'

IAS 1 *Presentation of Financial Statements* (annual amendments) effective for annual periods beginning on or after 1 January 2013.

IAS 32 *Financial Instruments: Presentation* (amendments relating to the offsetting of assets and liabilities) effective for annual periods beginning on or after 1 January 2014.

IAS 32 *Financial Instruments: Presentation* (annual improvements) effective for annual periods beginning on or after 1 January 2014.

The directors have considered the above and are of the opinion that these Standards and Interpretations are not expected to have an impact on the Company's financial statements except for the presentation of additional disclosures and changes to the presentation of components of the financial statements. These items will be applied in the first financial period for which they are required.

## 1 ACCOUNTING POLICIES (CONTINUED)

### (b) Use of estimates and judgements

The preparation of the financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an on going basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Management use estimates and judgements in allocating expenses between Revenue and Capital and in ascertaining the risk disclosures contained in Note 18.

### (c) Ordinary share capital

Ordinary Shares are classified as equity. Incremental costs directly attributable to the issue of Ordinary Shares are recognised as a deduction from equity.

### (d) Zero Dividend Preference shares

Under IAS 32, the Zero Dividend Preference ("ZDP") Shares are classified as financial liabilities and are held at amortised cost. Appropriation for the period in respect of ZDP Shares is included in the Statement of Comprehensive Income as a finance cost and is calculated using the effective interest rate method ("EIR"). The costs of issue of the ZDP Shares are being amortised over the period until the ZDP Shares will be redeemed.

### (e) Taxation

The Company has been granted exemption under the Income Tax (Exempt Bodies) (Guernsey) Ordinance, 1989 from Guernsey Income Tax, and has elected to remain exempt following changes to in the Guernsey tax regime. The Company pays an annual fee of £600.

### (f) Treasury shares

Treasury shares are classified as a deduction from equity and recorded for the consideration paid.

### (g) Capital reserve

The following are accounted for in this reserve:

- gains and losses on the realisation of investments;
- expenses charged to this account in accordance with the policy below;
- increases and decreases in the valuation of the investments held at the year end; and
- unrealised exchange differences of a capital nature.

## 1 ACCOUNTING POLICIES (CONTINUED)

### (h) Expenses

All expenses are accounted for on an accruals basis. Expenses are charged to the capital reserve where a connection with the maintenance or enhancement of the value of the investments can be demonstrated.

75% of the Company's management fee and financing costs are charged to the capital reserve in line with the Board's expected long-term split of returns between income and capital gains from the investment portfolio.

100% of any performance fee, commissions paid and the appropriation in respect of ZDP Shares is charged to the capital account.

All other expenses are charged through the revenue account.

### (i) Investment income

Interest income and distributions receivable are accounted for on an accruals basis. Interest income relates only to interest on bank balances. Bond income is accounted for on the effective interest rate "EIR" basis. Dividends are recognised on the ex-dividend date. All investment income is treated as a revenue item in the Statement of Comprehensive Income.

### (j) Foreign currency translation

The currency of the primary economic environment in which the Company operates (the functional currency) is Great British Pounds (GBP) which is also the presentational currency.

Transactions denominated in foreign currencies are translated into GBP at the rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities, other than investments, denominated in foreign currencies at the reporting date are translated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the Statement of Comprehensive Income. Foreign exchange differences relating to investments are taken to the capital reserve. Realised and unrealised foreign exchange differences on non-capital assets or liabilities are taken to the Statement of Comprehensive Income in the period in which they arise.

### (k) Cash and cash equivalents

Cash and cash equivalents are defined as cash in hand, demand deposits and short term, highly liquid investments readily convertible to known amounts of cash and subject to an insignificant risk of changes in value. For the purposes of the Statement of Cash Flows, cash and cash equivalents consist of cash, deposits at bank and money market deposits.

## 1 ACCOUNTING POLICIES (CONTINUED)

### (l) Investments

All investments have been designated as financial assets at "fair value through profit or loss". Investments are initially recognised on the date of purchase at fair value, with transaction costs recognised in the Statement of Comprehensive Income. Unrealised gains and losses on movement in fair value of investments are recognised in the Statement of Comprehensive Income. Investments are derecognised on the date of sale. Gains and losses on the sale of investments will be taken to the Statement of Comprehensive Income in the period in which they arise. For investments actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices as at the close of business on the reporting date.

### (m) Derivatives

Derivatives consist of forward exchange contracts and long gilt futures contracts, which are stated at market value, with the resulting net realised and unrealised gains and losses being reflected in the Statement of Comprehensive Income.

### (n) Trade date accounting

All "regular way" purchases and sales of financial assets are recognised on the "trade date", i.e. the date that the entity commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of the asset within the timeframe generally established by regulation or convention in the market place.

### (o) Segmental reporting

The Company retains two Investment Advisers, Unicorn Asset Management Limited and Premier Fund Managers Limited for the Smaller Companies Portfolio and Income Portfolio respectively. As the Board reviews the performance of each portfolio separately and decides on the allocation of resources based on this performance, the Board has determined that the Company has two reportable segments (2011: two).

The Board is charged with setting the Company's investment strategy in accordance with the Prospectus. They have delegated the day to day implementation of this strategy to its Investment Advisers but retain responsibility to ensure that adequate resources of the Company are directed in accordance with their decisions. The investment decisions of the Investment Advisers are reviewed on a regular basis to ensure compliance with the policies and legal responsibilities of the Board. The Investment Advisers have been given full authority to act on behalf of the Company, including the authority to purchase and sell securities and other investments on behalf of the Company and to carry out other actions as appropriate to give effect thereto. Whilst the Investment Advisers may make the investment decisions on a day to day basis regarding the allocation of funds to different investments, any changes to the investment strategy or major allocation decisions have to be approved by the Board, even though they may be proposed by the Investment Advisers. The Board, therefore, retains full responsibility as to the major allocation decisions made on an on going basis. The Investment Advisers will always act under the terms of the Prospectus which cannot be radically changed without approval of the Board and the shareholders.

## 1 ACCOUNTING POLICIES (CONTINUED)

### (o) Segmental reporting (continued)

The key measure of performance used by the Board to assess the Company's performance and to allocate resources is the total return on the Company's net asset value, as calculated under IFRS, and therefore no reconciliation is required between the measure of profit or loss used by the Board and that contained in the financial statements.

The schedule of principal investments held as at the period end are presented in the Investment Advisers' Report.

### (p) Going concern

The Company has adequate financial resources and as a consequence, the directors believe the Company is well placed to manage its business risks successfully despite the current economic climate. In reaching this conclusion, the directors have considered the liquidity of the Company's portfolio of investments as well as its cash position, income and expense flows. In addition, during 2011 the Company's passed its continuation vote and is not subject to a further continuation vote until 2016.

## 2 OPERATING SEGMENTS

The Company has two reportable segments, being the Income Portfolio and the Smaller Companies Portfolio. Each of these portfolios is managed separately as they entail different investment objectives and strategies and contain investments in different products.

For each of the portfolios, the Board reviews internal management reports on a quarterly basis. The objectives and principal investment products of the respective reportable segments are as follows:

| **Segment** | **Investment objectives and principal investments products** |
|---|---|
| Income Portfolio | To maximise income through investments in sterling denominated fixed interest securities including corporate bonds, preference and permanent interest bearing shares, convertibles, reverse convertibles, debentures and other similar securities. |
| Smaller Companies Portfolio | To maximise income and capital growth through investments in UK equities with a market capitalisation of under £1 billion. |

Information regarding the results of each reportable segment follows. Performance is measured based on the increase in value of each portfolio, as included in the internal management reports that are reviewed by the Board.

Segment information is measured on the same basis as those used in the preparation of the Company's financial statements.

## 2 OPERATING SEGMENTS (CONTINUED)

| | Income Portfolio GBP | Smaller Companies Portfolio GBP | Unallocated GBP | Total GBP |
|---|---|---|---|---|
| **2012** | | | | |
| External revenues: | | | | |
| Net gains on financial assets designated as at fair value through profit or loss | 959,870 | 6,678,983 | – | 7,638,853 |
| Losses on derivative financial instruments | (102,799) | – | 75,194 | (27,605) |
| Investment income: | | | | |
| Bank interest | – | – | 2,995 | 2,995 |
| Dividend income | 118,272 | 899,155 | – | 1,017,427 |
| Bond income | 338,911 | – | – | 338,911 |
| Total income and gains | 1,314,254 | 7,578,138 | 78,189 | 8,970,581 |
| Expenses | – | – | (511,144) | (511,144) |
| Interest payable and similar charges | – | – | (858,207) | (858,207) |
| Total comprehensive income for the year attributable to shareholders | 1,314,254 | 7,578,138 | (1,291,162) | 7,601,230 |

| | Income Portfolio GBP | Smaller Companies Portfolio GBP | Unallocated GBP | Total GBP |
|---|---|---|---|---|
| **2012** | | | | |
| Financial assets designated as at fair value through profit or loss | 7,096,762 | 27,262,174 | – | 34,358,936 |
| Receivables | 270,533 | 144,225 | 3,706 | 418,464 |
| Derivative financial assets | – | – | 707 | 707 |
| Cash and cash equivalents | 303,270 | 177,913 | 137,192 | 618,375 |
| Total assets | 7,670,565 | 27,584,312 | 141,605 | 35,396,482 |
| Derivative financial liabilities | – | – | – | – |
| Payables | – | – | 106,361 | 106,361 |
| Total liabilities | – | – | 106,361 | 106,361 |

## 2 OPERATING SEGMENTS (CONTINUED)

| | Income Portfolio GBP | Smaller Companies Portfolio GBP | Unallocated GBP | Total GBP |
|---|---|---|---|---|
| **2011** | | | | |
| External revenues: | | | | |
| Net gains/(losses) on financial assets designated as at fair value through profit or loss | (299,774) | (17,874) | – | (317,648) |
| Losses on derivative financial instruments | (349,682) | – | 35,250 | (314,432) |
| Investment income: | | | | |
| Bank interest | – | – | 1,280 | 1,280 |
| Dividend income | 66,189 | 666,712 | – | 732,901 |
| Bond income | 266,584 | – | – | 266,584 |
| Total income and gains/(losses) | (316,683) | 648,838 | 36,530 | 368,685 |
| Expenses | – | – | (409,543) | (409,543) |
| Interest payable and similar charges | – | – | (121,987) | (121,987) |
| Total comprehensive income for the year attributable to shareholders | (316,683) | 648,838 | (495,000) | (162,845) |

| | Income Portfolio GBP | Smaller Companies Portfolio GBP | Unallocated GBP | Total GBP |
|---|---|---|---|---|
| **2011** | | | | |
| Financial assets designated as at fair value through profit or loss | 5,327,783 | 16,714,880 | – | 22,042,663 |
| Receivables | 227,747 | 97,308 | 36,675 | 361,730 |
| Cash and cash equivalents | 1,038,855 | 4,542,956 | 247,702 | 5,829,513 |
| Derivative financial assets | – | – | 23,165 | 23,165 |
| Total assets | 6,594,385 | 21,355,144 | 307,542 | 28,257,071 |
| Derivative financial liabilities | (24,178) | – | – | (24,178) |
| Payables | (208,559) | – | (11,785,451) | (11,994,010) |
| Total liabilities | (232,737) | – | (11,785,451) | (12,018,188) |

## 2 OPERATING SEGMENTS (CONTINUED)

### Geographical information

In presenting information on the basis of geographical segments, segment revenue and segment assets are based on the domicile countries of the investees and counterparties to derivative transactions.

| | UK GBP | Guernsey GBP | Jersey GBP | Other Europe GBP | Rest of the World GBP | Australia GBP | Total GBP |
|---|---|---|---|---|---|---|---|
| **31 Dec 2012** | | | | | | | |
| **External revenues** | | | | | | | |
| Total Revenue | 1,104,983 | 105,906 | 24,063 | 100,793 | 20,593 | – | 1,356,338 |

| | UK GBP | Guernsey GBP | Jersey GBP | Other Europe GBP | Rest of the World GBP | Australia GBP | Total GBP |
|---|---|---|---|---|---|---|---|
| **31 Dec 2011** | | | | | | | |
| **External revenues** | | | | | | | |
| Total Revenue | 800,745 | 76,516 | 23,750 | 80,287 | 12,264 | 5,922 | 999,485 |

The Company did not hold any non-current assets during the year other than financial instruments (2011: £nil).

### Major customers

The Company regards its shareholders as customers. There were no shareholders with a holding greater than 10% at the period end.

## 3 INVESTMENT INCOME

| | Year ended 31 Dec 2012 GBP | Year ended 31 Dec 2011 GBP |
|---|---|---|
| Bank interest | 2,995 | 1,280 |
| Dividend income | 1,017,427 | 732,901 |
| Bond income | 338,911 | 266,584 |
| | 1,359,333 | 1,000,765 |

## 4 LOSSES ON DERIVATIVE FINANCIAL INSTRUMENTS

| | Year ended 31 Dec 2012 GBP | Year ended 31 Dec 2011 GBP |
|---|---|---|
| Unrealised (loss)/gain on forward foreign currency contracts | (54,486) | 43,379 |
| Realised gain/(loss) on forward foreign currency contracts | 129,680 | (8,129) |
| Appreciation/(depreciation) on fair value of derivative financial assets | 24,178 | (14,121) |
| Realised (losses) on derivative financial assets | (126,977) | (335,561) |
| | (27,605) | (314,432) |

## 5 EXPENSES

| | Revenue GBP | Year ended 31 Dec 2012 Capital GBP | Total GBP |
|---|---|---|---|
| Manager's fee* | 56,644 | 169,931 | 226,575 |
| Administrator's fee | 59,585 | – | 59,585 |
| Registrar's fee | 11,671 | – | 11,671 |
| Directors' fees | 54,358 | – | 54,358 |
| Custody fees | 15,506 | – | 15,506 |
| Audit fees | 23,054 | – | 23,054 |
| Directors' and Officers' insurance | 6,940 | – | 6,940 |
| Annual fees | 16,285 | – | 16,285 |
| Bank charges | 1,506 | – | 1,506 |
| Commission paid | – | 56,741 | 56,741 |
| Broker fees | 12,938 | – | 12,938 |
| Sundry costs | 13,205 | – | 13,205 |
| Legal and professional fees | 2,600 | – | 2,600 |
| Loss on foreign exchange | 10,180 | – | 10,180 |
| | 284,472 | 226,672 | 511,144 |

*The Company has entered into a Management Agreement with Premier Asset Management (Guernsey) Limited, a wholly-owned, Guernsey incorporated subsidiary of Premier Asset Management Limited. The Manager receives a management fee of 0.7% per annum of total assets, calculated monthly and payable quarterly in arrears, out of which it pays fees to the Investment Advisers. The Manager is also paid a shareholder communication and support fee, currently £3,100 for the twelve months from 1 April 2012 to 31 March 2013. The Manager is also potentially entitled to a performance fee of 15% of any excess of the Net Asset Value per Ordinary Share (together with any dividends paid by reference to the relevant period) over the benchmark NAV per Ordinary Share. No performance fee was paid or is payable for the year under review. The Management Agreement may be terminated by either party on 12 months' written notice.

| | Revenue GBP | Year ended 31 Dec 2011 Capital GBP | Total GBP |
|---|---|---|---|
| Manager's fee | 41,159 | 123,475 | 164,634 |
| Administrator's fee | 58,289 | – | 58,289 |
| Registrar's fee | 5,019 | – | 5,019 |
| Directors' fees | 47,387 | – | 47,387 |
| Custody fees | 14,735 | – | 14,735 |
| Audit fees | 22,067 | – | 22,067 |
| Directors' and Officers' insurance | 12,154 | – | 12,154 |
| Annual fees | 15,039 | – | 15,039 |
| Bank charges | 4,872 | – | 4,872 |
| Commission paid | – | 33,222 | 33,222 |
| Sundry costs | 13,140 | – | 13,140 |
| Legal and professional fees | 11,680 | – | 11,680 |
| Loss on foreign exchange | 7,305 | – | 7,305 |
| | 252,846 | 156,697 | 409,543 |

## 6 DIRECTORS' REMUNERATION

Under their terms of appointment, each Director is paid a fee of £17,500 per annum by the Company, except for the Chairman, who receives £22,500 per annum.

## 7 INTEREST PAYABLE AND SIMILAR CHARGES

| | Year ended 31 Dec 2012 | | | Year ended 31 Dec 2011 | | |
|---|---|---|---|---|---|---|
| | Revenue GBP | Capital GBP | Total GBP | Revenue GBP | Capital GBP | Total GBP |
| Bank loan interest | (586) | (1,759) | (2,345) | 24,888 | 74,665 | 99,553 |
| Appropriation in respect of ZDP Shares | – | 784,800 | 784,800 | – | 20,400 | 20,400 |
| Amortisation of ZDP issue costs | – | 75,752 | 75,752 | – | 2,034 | 2,034 |
| | (586) | 858,793 | 858,207 | 24,888 | 97,099 | 121,987 |

## 8 DIVIDENDS IN RESPECT OF ORDINARY SHARES

| | Year ended 31 Dec 2012 GBP | Year ended 31 Dec 2012 Pence per share |
|---|---|---|
| First interim payment | 261,743 | 3.00 |
| Second interim payment | 261,744 | 3.00 |
| Third interim payment | 261,744 | 3.00 |
| Fourth interim payment | 261,744 | 3.00 |
| | 1,046,975 | 12.00 |

| | Year ended 31 Dec 2011 GBP | Year ended 31 Dec 2011 Pence per share |
|---|---|---|
| First interim payment | 153,559 | 1.75 |
| Second interim payment | 152,684 | 1.75 |
| Third interim payment | 152,684 | 1.75 |
| Fourth interim payment | 152,683 | 1.75 |
| | 611,611 | 7.00 |

## 9 EARNINGS PER SHARE

### Ordinary Shares

The total return per Ordinary Share is based on the total return on ordinary activities for the year attributable to Ordinary shareholders of £7,601,230 (2011: -£162,845) and on 8,724,790 (2011: 8,742,735) shares, being the weighted average number of shares in issue during the year. There are no dilutive instruments and therefore basic and diluted gain per share are identical.

## 9 EARNINGS PER SHARE (CONTINUED)

### Ordinary Shares (continued)

The revenue return per Ordinary Share is based on the revenue return on ordinary activities for the year attributable to Ordinary shareholders of £1,075,447 (2011: £717,422) and on 8,724,790 (2011: 8,742,735) shares, being the weighted average number of shares in issue during the year. There are no dilutive instruments and therefore basic and diluted gain per share are identical.

The capital return per Ordinary Share is based on the capital return on ordinary activities for the year attributable to Ordinary shareholders of £6,525,783 (2011: -£880,267) and on 8,724,790 (2011: 8,742,735) shares, being the weighted average number of shares in issue during the year. There are no dilutive instruments and therefore basic and diluted gain per share are identical.

### ZDP Shares

The return per ZDP Share is based on the appropriation in respect of ZDP Shares and the amortisation of ZDP Share issue costs totalling £860,552 (2011: £22,434) and on 12,000,000 (2011: 361,644) shares, being the weighted average number of ZDP Shares in issue during the year.

## 10 FINANCIAL ASSETS DESIGNATED AS AT FAIR VALUE THROUGH PROFIT OR LOSS

| | 31 Dec 2012 GBP | 31 Dec 2011 GBP |
|---|---|---|
| **Investments** | | |
| Opening portfolio cost | 17,493,826 | 13,777,724 |
| Unrealised appreciation on valuation brought forward | 4,548,837 | 6,935,269 |
| Opening valuation | 22,042,663 | 20,712,993 |
| Movements in the year | | |
| Purchases at cost | 21,500,190 | 7,576,479 |
| Sales | | |
| – proceeds | (16,822,771) | (5,929,161) |
| – realised gains on sales | 1,540,631 | 2,068,784 |
| Unrealised appreciation/(depreciation) on valuation for the year | 6,098,222 | (2,386,432) |
| Fair value of investments at 31 December 2012 | 34,358,936 | 22,042,663 |
| Closing book cost | 23,711,877 | 17,493,826 |
| Closing unrealised appreciation | 10,647,059 | 4,548,837 |
| | 34,358,936 | 22,042,663 |
| Realised gains on sales | 1,540,631 | 2,068,784 |
| Increase/(decrease) in unrealised appreciation | 6,098,222 | (2,386,432) |
| Net gains/(losses) on financial assets designated as at fair value through profit or loss | 7,638,853 | (317,648) |

## 10 FINANCIAL ASSETS DESIGNATED AS AT FAIR VALUE THROUGH PROFIT OR LOSS (CONTINUED)

As at 31 December 2012, the closing fair value of investments comprises £27,807,487 (2011: £17,709,268) of equity shares and £6,551,449 (2011: £4,333,395) of fixed income securities.

IFRS 7 requires the fair value of investments to be disclosed by the source of inputs, using a three-level hierarchy as detailed below:

Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);

Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) (Level 2);

Inputs for the asset or liability that not based on observable market data (unobservable inputs) (Level 3).

The Investments held by the Company have been classified as Level 1. This is in accordance with the fair value hierarchy.

Details of the value of each classification are listed in the table below. Values are based on the market value of the investment as at the reporting date:

**Financial assets designated as at fair value through profit or loss**

| | 31 Dec 2012 Market Value % | 31 Dec 2012 Market Value GBP | 31 Dec 2011 Market Value % | 31 Dec 2011 Market Value GBP |
|---|---|---|---|---|
| Level 1 | 100 | 34,358,936 | 100 | 22,042,663 |
| Total | 100 | 34,358,936 | 100 | 22,042,663 |

**Derivative financial assets and liabilities designated as at fair value through profit or loss**

| | 31 Dec 2012 Market Value % | 31 Dec 2012 Market Value GBP | 31 Dec 2011 Market Value % | 31 Dec 2011 Market Value GBP |
|---|---|---|---|---|
| Level 2 derivative financial assets | 100 | 707 | 100 | 23,165 |
| Level 2 derivative financial liabilities | 100 | – | 100 | 24,178 |

There have been no transfers between levels of the fair value hierarchy during the year under review.

The derivative financial instruments held by the Company have been classified as Level 2. This is in accordance with the fair value hierarchy. The Company uses widely recognised valuation models for determining fair value of derivative financial instruments that use only observable market data and require little management judgement and estimation.

## 11 RECEIVABLES

| | 31 Dec 2012 GBP | 31 Dec 2011 GBP |
|---|---|---|
| Prepayments | 3,706 | 2,977 |
| Accrued income | 314,408 | 203,178 |
| Sundry receivables | 100,350 | 155,575 |
| | 418,464 | 361,730 |

## 12 PAYABLES

(amounts falling due within one year)

| | 31 Dec 2012 GBP | 31 Dec 2011 GBP |
|---|---|---|
| Accrued expenses | 26,066 | 107,698 |
| Sundry payables | – | 208,559 |
| Trade creditors | 80,295 | 41,321 |
| | 106,361 | 357,578 |

## 13 ZDP SHARES

| | 31 Dec 2012 GBP | 31 Dec 2011 GBP |
|---|---|---|
| 12,000,000 ZDP Shares issued 21 December 2011 | 12,000,000 | 12,000,000 |
| Appropriation in respect of ZDP Shares | 805,200 | 20,400 |
| ZDP value (calculated in accordance with the Articles) | 12,805,200 | 12,020,400 |
| ZDP issue costs | (383,968) | (386,002) |
| Issue costs amortised during period | 75,752 | 2,034 |
| ZDP value (calculated in accordance with IFRS) | 12,496,984 | 11,636,432 |

The fair value of the ZDP Shares is considered to be the same as the value calculated in accordance with IFRS.

ZDP Shares carry no entitlement to income distributions to be made by the Company. The ZDP Shares will not pay dividends but will have a final capital entitlement at the end of their life on 31 January 2017 of 138 pence. It should be noted that the predetermined capital entitlement of a ZDP Share is not guaranteed and is dependent upon the Company's gross assets being sufficient on 31 January 2017 to meet the final capital entitlement of the ZDP Shares. If the Company had been wound up on 31 December 2012, the ZDP Shares would have had an entitlement of 106.71 pence each. The ZDP Shares have the right to receive notice of and attend, but shall not have the right to vote at, any general meeting.

Under the Articles of Association, the Company is obliged to redeem all of the ZDP Shares on 31 January 2017 (if such redemption has not already been effected).

The number of authorised ZDP Shares is 50,000,000.

## 14 SHARE CAPITAL

| | GBP |
|---|---|
| **Authorised** | |
| Ordinary Shares of 1 pence each | 10,000,000 |

| | | Number of shares |
|---|---|---|
| **Issued** | | |
| **The issue of Ordinary Shares took place as follows:** | | |
| Ordinary Shares | 11 February 2009 | 29,600,002 |
| Tender offer | 17 January 2007 | (20,660,212) |
| Purchase of Treasury shares – Year ended 31 December 2011 | | (215,000) |
| Number of shares in issue at 1 January 2012 and 31 December 2012 | | 8,724,790 |
| Issued capital as at 31 December 2012 | | 89,398 |

Ordinary Shares carry rights to dividends and the holders have the right to vote at general meetings of the Company. ZDP Shares carry no rights to receive dividends and holders only have the ability to vote on any resolutions affecting their class of shares. The ZDP Shares will be repaid on 31 January 2017.

## 15 TREASURY SHARES

| | 31 Dec 2012 GBP | 31 Dec 2011 GBP |
|---|---|---|
| Balance as at 1 January 2012 | (303,211) | (207,018) |
| Acquired during the period | – | (96,193) |
| Balance as at 31 December 2012 | (303,211) | (303,211) |

The Treasury shares reserve represents 215,000 Ordinary Shares purchased in the market at various prices ranging from £1.23 to £1.92 and held by the Company in treasury. No cancellations or purchases of Shares took place during the year under review.

## 16 RELATED PARTIES

Premier Asset Management (Guernsey) Limited is the Company's Manager and operates under the terms of the management agreement in force which gives it complete control over the Company's investment portfolio.

£226,575 (2011: £164,634) of costs were incurred by the Company with this related party in the year, of which £62,382 (2011: £42,466) was due to this related party as at 31 December 2012.

Directors' remuneration is disclosed in Note 6.

## 17 FINANCIAL INSTRUMENTS

The Company's main financial instruments comprise:

(a) Cash and cash equivalents that arise directly from the Company's operations;

(b) Investments in listed entities and derivative financial assets;

(c) ZDP Shares; and

(d) Derivative financial liabilities.

## 18 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The following table details the categories of financial assets and liabilities held by the Company at the reporting date:

| | 31 Dec 2012 GBP | 31 Dec 2011 GBP |
|---|---|---|
| **Financial assets** | | |
| Financial assets at fair value through profit or loss | 34,358,936 | 22,042,663 |
| Derivative financial assets | 707 | 23,165 |
| **Total financial assets at fair value through profit or loss** | 34,359,643 | 22,065,828 |
| Loans and receivables | 1,036,839 | 6,191,243 |
| **Total assets** | 35,396,482 | 28,257,071 |
| **Financial liabilities** | | |
| Financial liabilities at fair value through profit or loss: | | |
| Accrued expenses | 106,361 | 357,578 |
| Derivative financial liabilities | – | 24,178 |
| **Total financial liabilities at fair value through profit or loss** | 106,361 | 381,756 |
| **Financial liabilities measured at amortised cost** | 12,496,984 | 11,636,432 |
| **Total liabilities excluding net assets attributable to holders of Ordinary Shares** | 12,603,344 | 12,018,188 |

Loans and receivables presented above represents cash and cash equivalents, balances due from brokers and other receivables as detailed in the Statement of Financial Position.

Financial liabilities measured at amortised cost presented above represents accrued expenses and ZDP Shares as detailed in the Statement of Financial Position.

Derivative financial assets presented above represent forward foreign exchange contracts. Long gilts exist but are valued at zero.

## 18 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

The main risks arising from the Company's financial instruments are market price risk, credit risk, liquidity risk, interest rate risk and foreign exchange risk. The Board regularly review and agrees policies for managing each of these risks and these are summarised below:

### (a) Market price risk

Market price risk arises mainly from uncertainty about future prices of financial instruments held. It represents the potential loss the Company might suffer through holding market positions in the face of price movements. The Investment Advisers actively monitor market prices and report to the Board as to the appropriateness of the prices used for valuation purposes. The Investment Advisers also attempt to minimise market price risk by undertaking a detailed analysis of the risk/reward relationship of each investee company prior to any investment being made.

Details of the Company's Investment Objective and Policy are given inside the front cover of this Report.

*Price sensitivity*

The following details the Company's sensitivity to a 15% increase and decrease in the market prices, with 15% being the sensitivity rate used when reporting price risk internally to key management personnel and representing management's assessment of the possible change in market prices.

At 31 December 2012, if market prices had been 15% higher with all the other variables held constant, the return attributable to shareholders for the year would have been £5,153,840 (2011: £3,306,399) greater, due to the increase in the fair value of financial assets at fair value through profit or loss. This would represent an increase in Net Assets of 22.61% (2011: 20.36%).

If market prices had been 15% lower with all the other variables held constant, the net return attributable to shareholders for the year would have been £5,153,840 (2011: £3,306,399) lower, due to the decrease in the fair value of financial assets at fair value through profit or loss. This would represent a decrease in Net Assets of 22.61% (2011: 20.36%).

### (b) Credit risk

Credit risk is the risk that an issuer or counterparty will be unable or unwilling to meet a commitment that it has entered into with the Company. The directors receive financial information on a regular basis which is used to identify and monitor risk. It is Company policy not to invest more than 20% of the gross assets of the Company in the securities of any one company or group at the time the investment is made.

The Company has no significant concentration of credit risk, with exposure spread over a large number of counterparties. At 31 December 2012 the Company's largest exposure to a single investment was £1,576,479 (2011: £1,420,813), 4.45% (2011: 5.03%) of total assets.

## 18 FINANCIAL RISK MANAGEMENT OBJECTIVE AND POLICIES (CONTINUED)

### (b) Credit risk (continued)

Investors should be aware that the prospective returns to Ordinary Shareholders mirror the returns under the Quoted Securities held or entered into by the Company and that any default by an issuer of any such Quoted Security held by the Company would have a consequential adverse effect on the ability of the Company to pay some or all of the entitlement to Ordinary Shareholders. Such a default might, for example, arise on the insolvency of an issuer of a Quoted Security.

The Company's financial assets exposed to credit risk are as follows:

| | 31 Dec 2012 GBP | 31 Dec 2011 GBP |
|---|---|---|
| Financial assets designated as at fair value through profit or loss (fixed income securities only) | 6,551,549 | 4,333,395 |
| Cash and cash equivalents | 618,376 | 5,829,513 |
| Interest, dividends and other receivables | 418,464 | 361,730 |
| | 7,588,389 | 10,524,638 |

The credit ratings of the bonds in the income portfolio), as rated by Moody's Investor Services Inc ("Moodys") were:

| Rating | 31 Dec 2012 | 31 Dec 2011 |
|---|---|---|
| Aaa | 1.16% | 9.60% |
| Aa | 4.09% | 1.67% |
| A | 15.30% | 17.64% |
| Baa | 24.46% | 22.46% |
| Ba | 5.58% | 7.08% |
| B | 2.22% | 0.00% |
| WR | 0.00% | 0.00% |
| No rating available | 47.19% | 41.55% |

The cash and cash equivalents were held with BNP Paribas, which at the time of signing this report held a credit rating, as rated by Moody's, of A2.

### (c) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in realising assets or otherwise raising funds to meet financial commitments. The Company's main financial commitments are its on-going operating expenses and the settlement of the obligation upon maturity of the ZDP Shares on 31 January 2017. The ZDP liability will be settled through realisation of the Company's investment portfolio.

## 18 FINANCIAL RISK MANAGEMENT OBJECTIVE AND POLICIES (CONTINUED)

### (c) Liquidity risk (continued)

The Investment Advisers ensure that the Company has sufficient liquid resources available to fulfil its operational plans and to meet its financial obligations as they fall due. This is monitored by carrying out a solvency calculation on a quarterly basis by reference to management accounts and revenue projections. The Board will approve, if appropriate, a Solvency Certificate resolution prior to declaring any interim dividend distributions.

The ZDP Shares will not pay dividends but will have a final capital entitlement at the end of their life on 31 January 2017 of 138 pence. It should be noted that the predetermined capital entitlement of a ZDP Share is not guaranteed and is dependent upon the Company's gross assets being sufficient on 31 January 2017 to meet the final capital entitlement of the ZDP Shares.

The Board intend to monitor the financial position of the Company to ensure that it has sufficient liquid resources available to fulfil its obligation upon maturity of the ZDP Shares.

The table below details the residual contractual maturities of financial liabilities:

**As at 31 December 2012:**

| | 1-3 months GBP | Up to 1 year GBP | 2-5 years GBP |
|---|---|---|---|
| *Financial liabilities including derivatives* | | | |
| Payables – due within one year | 106,361 | – | – |
| Derivative financial instruments | – | – | – |
| ZDP Share entitlement | – | – | 16,560,000 |
| | 106,361 | – | 16,560,000 |

**As at 31 December 2011:**

| | 1-3 months GBP | Up to 1 year GBP | 2-5 years GBP |
|---|---|---|---|
| *Financial liabilities including derivatives* | | | |
| Payables – due within one year | 357,578 | – | – |
| Derivative financial instruments | 24,178 | – | – |
| ZDP Share entitlement | – | – | 16,560,000 |
| | 381,756 | – | 16,560,000 |

### (d) Interest rate risk

The Company could hedge interest rate risk using various different methods.

The following table details the Company's exposure to interest rate risks. It includes the Company's assets and liabilities at fair values, categorised by the earlier of contractual re-pricing or maturity date measured by the carrying value of the assets and liabilities.

## 18 FINANCIAL RISK MANAGEMENT OBJECTIVE AND POLICIES (CONTINUED)

### (d) Interest rate risk (continued)

**As at 31 December 2012:**

| | Less than 1 month GBP | Fixed interest GBP | Non-interest bearing GBP | Total GBP |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Financial assets at fair value through profit or loss on initial recognition | – | 6,551,549 | 27,807,387 | 34,358,936 |
| Cash and cash equivalents | 618,375 | – | – | 618,375 |
| Interest, dividends and other receivables | – | – | 418,464 | 418,464 |
| Derivative financial instruments | – | – | 707 | 707 |
| **Total financial assets** | 618,375 | 6,551,549 | 28,226,558 | 35,396,482 |
| **Financial liabilities** | | | | |
| Derivative financial instruments | – | – | – | – |
| Payables | – | – | 106,361 | 106,361 |
| ZDP Share entitlement | – | 12,496,983 | – | 12,496,983 |
| **Total financial liabilities** | – | 12,496,983 | 106,361 | 12,603,344 |
| **Total interest sensitivity gap** | 618,375 | (5,945,434) | | |

**As at 31 December 2011:**

| | Less than 1 month GBP | Fixed interest GBP | Non-interest bearing GBP | Total GBP |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Financial assets at fair value through profit or loss on initial recognition | – | 4,333,395 | 17,709,268 | 22,042,663 |
| Cash and cash equivalents | 5,829,513 | – | – | 5,829,513 |
| Interest, dividends and other receivables | – | – | 361,730 | 361,730 |
| Derivative financial instruments | – | – | 23,165 | 23,165 |
| **Total financial assets** | 5,829,513 | 4,333,395 | 18,094,163 | 28,257,071 |
| **Financial liabilities** | | | | |
| Derivative financial instruments | – | – | 24,178 | 24,178 |
| Payables | – | – | 357,578 | 357,578 |
| ZDP Share entitlement | – | 11,636,432 | – | 11,636,432 |
| **Total financial liabilities** | – | 11,636,432 | 381,756 | 12,018,188 |
| **Total interest sensitivity gap** | 5,829,513 | (7,303,037) | | |

## 18 FINANCIAL RISK MANAGEMENT OBJECTIVE AND POLICIES (CONTINUED)

### (d) Interest rate risk (continued)

Interest rate sensitivity takes account of the effect of interest rate movements on cash balances, loan amounts and fixed interest securities. Interest rate risk does not affect the cash flows of the fixed interest securities but does affect the fair value and as such this sensitivity has been reflected in the market price risk disclosures at Note 18a.

### Interest rate sensitivity

If interest rates had been 25 basis points higher and all other variables were held constant, the Company's return on income attributable to Ordinary Shareholders for the year ended 31 December 2012 would have increased by approximately £1,546 (2011: £14,574) or 0% (2011: 0.05%) of Total Assets due to an increase in the amount of interest receivable on the bank balances.

If interest rates had been 25 basis points lower and all other variables were held constant, the Company's return on income attributable to shareholders for the year ended 31 December 2012 would have decreased by approximately £1,546 (2011: £14,574) or 0% (2011: 0.05%) of Total Assets due to a decrease in the amount of interest receivable on the bank balances.

### (e) Foreign exchange risk

Forward currency transactions are used to hedge the foreign currency exposure in bonds, other investments and cash balances held within the portfolio. The purpose of the hedge is to protect the Company's assets from a decline in value that might arise from the depreciation of a foreign currency against Sterling.

At 31 December 2012, the Company's holdings in derivatives translated into GBP were as specified below:

| Type of contract | Expiration | Underlying | Notional amount of contracts outstanding | Fair value assets/ (liabilities) GBP |
|---|---|---|---|---|
| Forward | March 2013 | Sold USD | 1,000,000.00 | 5,229 |
| Forward | March 2013 | Sold EUR | 1,455,000.00 | (4,522) |
| | | | | 707 |

## 18 FINANCIAL RISK MANAGEMENT OBJECTIVE AND POLICIES (CONTINUED)

### (e) Foreign exchange risk (continued)

At 31 December 2011, the Company's holdings in forward currency contracts translated into GBP were as specified below:

| Type of contract | Expiration | Underlying | Notional amount of contracts outstanding | Fair value assets/ (liabilities) GBP |
|---|---|---|---|---|
| Forward | March 2012 | Sold EUR | 250,000 | 228 |
| Forward | March 2012 | Sold EUR | 200,000 | 538 |
| Forward | March 2012 | Sold EUR | 1,367,000 | 25,739 |
| Forward | March 2012 | Sold USD | 630,000 | (2,336) |
| Forward | March 2012 | Sold USD | 185,000 | (1,004) |
| | | | | 23,165 |

Exchange rate exposures are managed by minimising the amount of foreign currency held at any one time and entering into forward exchange contracts.

The following table sets out the Company's total exposure to foreign currency risk and the net exposure to foreign currencies of the monetary assets and liabilities:

**31 December 2012**

| | Monetary Assets GBP | Monetary Liabilities GBP | Forward FX Contracts GBP | Net Exposure GBP |
|---|---|---|---|---|
| Euro | 1,380,666 | – | (1,176,773) | 203,893 |
| US Dollar | 740,262 | – | (620,424) | 119,838 |
| Australian Dollar | 14,527 | – | – | 14,527 |

**31 December 2011**

| | Monetary Assets GBP | Monetary Liabilities GBP | Forward FX Contracts GBP | Net Exposure GBP |
|---|---|---|---|---|
| Euro | 1,733,908 | (208,559) | (1,542,314) | (16,965) |
| US Dollar | 536,790 | – | (521,012) | 15,778 |
| Australian Dollar | 14,543 | – | – | 14,543 |

Amounts in the above table are based on the carrying value of monetary assets and liabilities and the underlying principal amount of forward currency contracts.

## 18 FINANCIAL RISK MANAGEMENT OBJECTIVE AND POLICIES (CONTINUED)

### (f) Capital management

The principal investment objectives of the Company are to provide shareholders with a high income and also the opportunity for income and capital growth by investing primarily in smaller capitalised United Kingdom companies admitted to the Official List of the United Kingdom Listing Authority and traded on the London Stock Exchange or traded on AIM.

The Company's portfolio is invested in equities and high income and fixed interest and other income-bearing securities in order to achieve its investment objectives. It is the aim of the Company to provide both income and capital growth predominantly through investment of approximately 70% of the portfolio in smaller capitalised United Kingdom companies. The Company also aims to further enhance income for shareholders by investing approximately 30% of its assets in high yielding securities which will be predominantly fixed income securities (including corporate bonds, preference and permanent interest bearing shares, convertible and reverse convertible bonds and debentures) but may include up to 15% of the portfolio (measured at time of acquisition) in high yielding investment company shares.

As the Company's Ordinary Shares are traded on the London Stock Exchange, the Ordinary Shares may trade at a discount to their Net Asset Value per Share on occasion. However, the Directors and the manager monitor the discount on a regular basis and can use share buy backs to manage the discount.

The Company monitors capital on the basis of the carrying amount of equity as presented on the face of the statement of financial position. Capital for the reporting periods under review is summarised as follows:

| | GBP |
|---|---|
| Distributable reserves | 10,297,363 |
| Share capital and share premium | 168,571 |
| Non distributable reserves | 12,630,415 |
| Treasury shares | (303,211) |
| Total | 22,793,138 |

The distributable reserves comprise the revenue reserve and the special reserve. The non distributable reserves comprise the capital reserve. The special reserve was created on the cancellation of part of the Company's share premium account. The directors have resolved that the capital reserve is a non distributable reserve.

# Directors and Advisers

Registered in Guernsey No. 34778

| | |
|---|---|
| **Directors** | Helen Foster Green (Chairman)<br>John Nigel Ward<br>David John Warr (appointed 22 August 2012)<br>John Boothman (resigned 22 August 2012) |
| **Manager** | Premier Asset Management (Guernsey) Limited<br>PO Box 405<br>Anson Place, Mill Court<br>La Charroterie<br>St Peter Port<br>Guernsey GY1 3GF |
| **Investment Adviser – Smaller Companies Portfolio** | Unicorn Asset Management Limited<br>Preacher's Court<br>The Charterhouse<br>Charterhouse Square<br>London EC1M 6AU |
| **Investment Adviser – Income Portfolio** | Premier Fund Managers Limited<br>Eastgate Court<br>High Street<br>Guildford GU1 3DE |
| **Administrator and Secretary** | Anson Fund Managers Limited<br>PO Box 405<br>Anson Place, Mill Court<br>La Charroterie, St Peter Port<br>Guernsey GY1 3GF |
| **Registrar** | Anson Registrars Limited<br>PO Box 426<br>Anson Place<br>Mill Court, La Charroterie<br>St Peter Port<br>Guernsey GY1 3GF |
| **Custodian** | BNP Paribas Trust Company (Guernsey) Limited<br>BNP Paribas House<br>St Julian's Avenue<br>St Peter Port<br>Guernsey GY1 3WE |
| **Corporate Broker** | Numis Securities Limited<br>10 Paternoster Square<br>London EC4M 7LT |
| **Independent Auditors** | KPMG Channel Islands Limited<br>PO Box 20<br>20 New Street<br>St Peter Port<br>Guernsey GY1 4AN |
| **Registered Office** | Anson Place<br>Mill Court<br>La Charroterie<br>St Peter Port<br>Guernsey GY1 1EJ |

# Notice of General Meeting

Registered in Guernsey No. 34778

NOTICE IS HEREBY GIVEN that the GENERAL MEETING of the voting Members of Acorn Income Fund Limited (the "Company") will be held at Anson Place, Mill Court, La Charroterie, St Peter Port, Guernsey, Channel Islands on Wednesday 21 August 2013 at 11.00 a.m. You will be asked to consider and vote on the resolutions below:

**ORDINARY BUSINESS:**

1. To receive the Annual Financial Report for the year ended 31 December 2012.
2. To reappoint KPMG Channel Islands Limited as Auditor to the Company, to hold office from the conclusion of this meeting until the conclusion of the next general meeting to be held in 2014 under section 199 of the Companies (Guernsey) Law, 2008, as amended (the "Law"), and to authorise the directors to determine their remuneration.
3. To re-elect Helen Foster Green as a director.
4. To re-elect David John Warr as a director.

**SPECIAL BUSINESS TO BE PROPOSED AS AN ORDINARY RESOLUTION:**

5. THAT, the Company be and is hereby generally and unconditionally authorised in accordance with the Law to make one or more market purchases (as defined in section 316 of the Law) of Zero Dividend Preference ("ZDP") Shares PROVIDED THAT:
    - i) the maximum aggregate number of ZDP Shares hereby authorised to be purchased shall be 14.99 per cent. of the issued ZDP Shares in issue immediately following completion of the Placing;
    - ii) the minimum price payable by the Company for each ZDP Share shall be £0.01;
    - iii) the maximum price payable by the Company for each ZDP Share shall be the higher of (i) an amount equal to 105 per cent. of the average of the middle market quotations for a ZDP Share as derived from the London Stock Exchange for the five business days immediately preceding the day on which the ZDP Shares are purchased and (ii) the higher of the price of the last independent trade and highest bid on the London Stock Exchange when the purchase is carried out; and
    - iv) unless previously varied, revoked or renewed, the authority hereby conferred shall expire at the conclusion of the next annual general meeting of the Company to be held in 2014 under section 199 of the Law, save that the Company may, prior to such expiry, enter into a contract to purchase ZDP Shares under such authority and may make a purchase of ZDP Shares pursuant to any such contract as if the authority conferred hereby had not expired.
6. THAT the Company be and hereby is generally and unconditionally authorised in accordance with the Law to make one or more market acquisitions of Ordinary Shares PROVIDED THAT:
    - (i) the maximum aggregate number of Ordinary Shares hereby authorised to be purchased shall be 14.99 per cent. of the issued Ordinary Shares in issue on the date this resolution is passed;
    - (ii) the minimum price payable by the Company for each Ordinary Share shall be £0.01;
    - (iii) the maximum price payable by the Company for each Ordinary Share shall be the higher of (a) an amount equal to 105 per cent. of the average of the middle market quotation for an Ordinary Share as derived from The London Stock Exchange for the five business days immediately preceding the day on which the Ordinary Shares re-purchased and (b) the higher of the price of the last independent trade and highest bid on the London Stock Exchange when the purchase is carried out; and
    - (iv) unless previously varied, revoked or renewed, the authority hereby conferred shall expire at the conclusion of the next general meeting of the Company to be held in 2014 under section 199 of the Law, save that the Company may, prior to such expiry, enter into a contract to purchase Ordinary Shares under such authority and may make a purchase of Ordinary Shares pursuant to any such contract.

***BY ORDER OF THE BOARD***

Anson Fund Managers Limited
Secretary

21 March 2013

***Registered Office:***

Anson Place
Mill Court
La Charroterie
St Peter Port
Guernsey GY1 1EJ
Channel Islands

**Notes:**

- Ordinary Resolution: To be passed this type of resolution requires a simple majority of the votes cast by those shareholders voting in person or by proxy at the meeting to be voted in favour of the resolution.
- A member entitled to attend and vote at the meeting is entitled to appoint one or more proxies to speak and vote instead of them. A proxy need not be a member of the Company. Completion and return of the form of proxy will not preclude members from attending or voting at the meeting, if they so wish.
- More than one proxy may be appointed provided each proxy is appointed to exercise the rights attached to different shares.
- To be valid the Form of Proxy, together with the power of attorney or other authority, if any, under which it is executed (or a notarially certified copy of such power of authority) must be deposited with the Company's agent, for this purpose being, Anson Registrars Limited, Anson Place, Mill Court, La Charroterie, St Peter Port, Guernsey, C.I. GY1 1EJ not less than 48 hours before the time for holding the meeting. A Form of Proxy is enclosed with this Notice.
- All persons recorded on the register of shareholders as holding shares in the Company as at 5.00 p.m. on 20 August 2013 or, if the general meeting is adjourned, as at 48 hours before the time of any adjourned general meeting, shall be entitled to attend and vote (either in person or by proxy) at the general meeting and shall be entitled to one vote per share held.
- Where there are joint registered holders of any shares such persons shall not have the right of voting individually in respect of such shares but shall elect one of their number to represent them and to vote whether in person or by proxy in their name. In default of such election the person whose name stands first on the register of shareholders shall alone be entitled to vote. Where there are joint participants in respect of any share such persons shall not have the right of voting individually in respect of such share but shall elect one of their number to represent them and to vote whether in person or by proxy in their name. In default of such election the participant whose interests are first notified to the Company shall alone be entitled to vote.
- On a poll votes may be given either personally or by proxy and a shareholder entitled to more than one vote need not use all his votes or cast all the votes he uses in the same way.
- Any corporation which is a shareholder may by resolution of its directors or other governing body authorise such person as it thinks fit to act as its representative at this meeting. Any person so authorised shall be entitled to exercise on behalf of the corporation which he represents the same powers (other than to appoint a proxy) as that corporation could exercise if it were an individual shareholder.

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