The Henderson Smaller Companies Investment Trust plc

Report and Financial Statements for the year ended 31 May 2010

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HGI9226/2010

The Henderson Smaller Companies Investment Trust plc

The objective of The Henderson Smaller Companies Investment Trust plc is to maximise shareholders' total returns by investing mainly in smaller companies that are quoted in the United Kingdom. Our portfolio of investments is managed by a team of specialists at Henderson Global Investors. At 31 May 2010 there were 114 holdings with a market value of £227 million. As an investment trust, we are exempt from tax on the capital gains arising on the investments.

Investment selection
The investment selection process seeks, by rigorous research, to identify high-quality smaller companies with strong growth potential. Generally new investments are made in constituents of the benchmark index. Investments may continue to be held when the underlying companies grow out of the smaller companies sector but strong selling disciplines are applied regardless of the size of the entity.

Benchmark
Hoare Govett Smaller Companies Index (excluding investment companies).*

Manager
The Board has appointed Henderson Global Investors to manage the investments and to provide the related administrative services.

Independent board
The directors, who are independent of the Manager, meet regularly to consider investment strategy and to monitor the performance of the Company.

Website
Information about the Company can be found on the website www.hendersonsmallercompanies.com

*prior to 1 June 2003 the benchmark was the FTSE SmallCap Index (excluding investment companies)

Financial Highlights

	31 May 2010	31 May 2009
Total net assets	**£208 million**	£156 million
Net asset value per ordinary share	**277.1p**	202.1p
Net asset value per ordinary share on an alternative basis*	**269.7p**	196.9p
Market price per ordinary share	**216.0p**	167.0p
Total return per ordinary share	**79.3p**	(115.4)p
Revenue return per ordinary share	**4.6p**	6.3p
Dividend per ordinary share	**3.6p**	3.0p
Special dividend per ordinary share	**–**	2.6p
Total dividend per ordinary share	**3.6p**	5.6p
Gearing†	**9.5%**	11.4%

*Calculated by deducting from the net assets the debt at its market value, as disclosed in note 20 on page 54.
†Defined here as the total market value of the Group's investments less shareholders' funds as a percentage of shareholders' funds.

Performance: comparative total return figures for periods ended 31 May 2010

	1 year %	**2 years %**	**3 years %**	**5 years %**	**10 years %**
The Henderson Smaller Companies Investment Trust plc:					
net asset value per share * (1)	40.1	(9.8)	(27.4)	34.3	(31.3)
The Henderson Smaller Companies Investment Trust plc: share price (1)	33.0	(10.4)	(29.8)	35.5	(31.8)
Hoare Govett Smaller Companies Index (excluding investment companies) (2)	29.6	4.4	(17.8)	41.9	84.6
FTSE SmallCap Index (excluding investment companies) (2)	20.9	(11.9)	(38.8)	(6.7)	(5.4)
FTSE All-Share Index (2)	22.9	(6.1)	(12.8)	28.6	23.2

Source: (1) AIC (except the net asset value per share return over one year);
(2) Datastream.

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

Historical Record

Year end	**Market price per ordinary share in pence**	**Net asset value per ordinary share in pence**	**Revenue earnings per ordinary share in pence**	**Final dividend per ordinary share in pence**	**Special dividend per ordinary share in pence†**
31 May 2000	341.5	423.8	1.14	0.50	–
31 May 2001	278.0	328.9	(0.34)	0.50	–
31 May 2002	150.5	181.1	(0.77)	0.50	–
31 May 2003	96.0	121.8	0.20	0.50	–
31 May 2004	134.75	172.1	1.17	1.00	–
31 May 2005	169.5	214.5*	1.44*	1.15	–
31 May 2006	232.75	280.4*	1.83*	1.35	–
31 May 2007	323.5	392.1	2.12	1.70	–
31 May 2008	252.0	317.6	4.64	2.20†	1.60
31 May 2009	167.0	202.1	6.30	3.00†	2.60
31 May 2010	**216.0**	**277.1**	**4.59**	**3.60**	**–**

*The figures for 2006 (and the figures for subsequent years) have been calculated in accordance with International Financial Reporting Standards ("IFRS") and the figure for 2005 was restated on first time adoption of IFRS. The figures for the earlier years have not been restated.
†In 2008 and 2009 the revenue earnings included the write-back of VAT borne on management fees in certain periods between 1990 and 2007 and the simple interest receivable on those refunds. Most of the amounts recognised were distributed by way of special dividends.

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Warning to Shareholders

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

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

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

Chairman's Statement

Dudley Fishburn

Our performance in the year ended 31 May 2010 was strong, a welcome recovery from the previous year. On a total return basis our net asset value per share rose 40.1%, against 29.6% for the benchmark index. This degree of outperformance has continued since the year end. The greatest contributor to these results has been strong stock selection, not least a recovery in the market ratings of companies that our fund manager, Neil Hermon, identified as sound long-term investments. Such are the rewards of diligent research and conviction, although we still have some ground to make up to re-establish our five-year record. Other positive factors included our gearing, where our short-term borrowing facility has been used to good effect as a supplement to our fixed borrowings of £20 million. A full attribution analysis is given on page 16 of this Annual Report.

Revenue and dividend

The revenue return per share was 4.6p, compared with 6.3p for the previous year when there was a substantial VAT refund. Leaving this refund aside, the underlying revenue return per share grew to 4.2p this year from 3.9p in 2009. The investment income on a per share basis fell marginally but the income from sub-underwriting has been buoyant. We expect to see resumed dividend growth from many of our investments to the benefit of the results in future years. We propose a final dividend for the year of 3.6p per share (2009: 3.0p). This is subject to shareholder approval at the Annual General Meeting in September.

Share buy-backs

During the year we bought back 2.5 million shares, equivalent to about 3% of those in issue at 31 May 2009, at an average discount (calculated by valuing the debenture stock at par) of about 21%. Most of these shares were bought back at the start of our financial year. The Board continues to monitor the discount closely. It has been encouraging to note a growing interest in the shares from new investors.

Outlook

The stock market has moved ahead strongly over the past year, albeit subject to a high degree of volatility as sentiment about the vigour of the recovery fluctuates. Nevertheless, valuations are reasonable and companies' profitability, cash flows and balance sheets are generally in good order, in marked contrast to the public finances of much of the world. On balance we are positive about the medium term outlook for equities.

Continuation

Our shareholders are asked every three years to vote for the continuation of the Company and a resolution to this effect will be put to the Annual General Meeting in September. Henderson Smaller Companies Investment Trust has shown again that active investment management, well-executed within the transparent structure of an investment trust company, can offer investors an attractive means of adding value to their portfolio. We are therefore recommending shareholders to vote for the Company to continue.

Board composition

Sally Davis will retire as a director at the conclusion of the Annual General Meeting in September. She has served on the Board for nine years, for the last seven as Chairman of the Audit Committee. We are very grateful to her and we shall miss her insightful contributions, reflecting her experience as a senior executive at BT Group plc.

I am delighted to welcome Beatrice Hollond, who was appointed to the Board on 23 July 2010 and will stand for election at the Annual General Meeting. She has a wide experience of investment matters and will succeed Sally Davis as Chairman of the Audit Committee. She brings another independent and enquiring mind to the Board.

Articles of Association

We propose to adopt revised Articles of Association and a resolution to this effect will be put to the Annual General Meeting in September. The revised Articles, summarised in the separate circular to shareholders, incorporate the changes required to bring the Company's constitution fully into line with the latest UK company law.

AGM

Our Annual General Meeting will be held at 11.30 am on Friday 24 September 2010 at the Registered Office, 201 Bishopsgate, London EC2M 3AE. The Notice of Meeting is set out in the accompanying circular to shareholders.

The Board recommends that the shareholders vote in favour of all the resolutions to be put to the Meeting, as the directors intend to do in respect of their own holdings. Even if you are unable to attend in person, I hope that you will support the resolutions by completing and returning the enclosed form of proxy.

J Dudley Fishburn
Chairman
3 August 2010

Fund Manager's Review

Neil Hermon

Analysis of the portfolio by sector	31 May 2010 %	31 May 2009 %
Support Services	**20.0**	19.5
Electronic & Electrical Equipment	**9.7**	7.8
Media	**8.0**	6.6
Software & Computer Services	**7.5**	8.0
Financial Services	**6.7**	5.5
Real Estate	**5.5**	5.8
Aerospace & Defence	**5.3**	4.2
Chemicals	**4.9**	3.4
Industrial Engineering	**4.7**	3.7
General Retailers	**3.9**	3.4
Oil & Gas Producers	**3.7**	4.7
Household Goods & Home Construction	**3.6**	5.7
Construction & Materials	**3.4**	5.4
Travel & Leisure	**3.1**	4.8
Technology Hardware & Equipment	**3.1**	2.3
Health Care Equipment & Services	**2.1**	3.3
Oil Equipment, Services & Distribution	**1.4**	1.5
Industrial Metals & Mining	**1.4**	1.9
Mining	**1.4**	0.8
Pharmaceuticals & Biotechnology	**0.6**	0.5
Life Insurance	**0.0**	0.7
Industrial Transportation	**0.0**	0.5
	100.0	100.0

Market – year in review

The year has been one of stabilisation and recovery for both equity markets and the global economy. Signs that the global economy was no longer declining led to a very sharp rally in equity markets from depressed levels. Investors' appetite for risk assets increased as confidence grew that the worst was behind us. Smaller companies outperformed significantly in the early part of this rally since by composition smaller companies are more economically sensitive than larger companies. Additionally, smaller companies were trading at a significant valuation gap to larger companies.

After the initial rally equity markets have continued to move higher, albeit at a slower pace and with periods of modest declines. The economic statistics have proved generally positive and reflect a global economy that is gradually recovering. Corporate earnings have proved remarkably robust, aided by swift management action to cut costs. However, markets have remained volatile in the face of macro headwinds.

Fund performance

The Trust had a good year in performance terms – rising in absolute terms and significantly out-performing on a relative basis. The net asset value rose 40.1%, on a total return basis. This compares to a gain of 29.6% (total return) from the Hoare Govett Smaller Companies Index (excluding investment companies) and 20.9% (total return) from the FTSE SmallCap Index (excluding investment companies). The outperformance came from a combination of underlying positive portfolio performance and gearing in the Trust. Share buy-backs were an additional small positive to performance. The year under review is the sixth year of outperformance of our benchmark, the Hoare Govett Smaller Companies Index (excluding investment companies), in the last seven years. See also the table on page 16.

Fund Manager's Review

continued

Attribution analysis

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

Principal contributors

Top five contributors to relative performance	12 month return %	Relative contribution %
Informa	+61.7	1.0
WSP	+70.8	0.9
Senior	+240.2	0.7
Victrex	+93.2	0.7
Domino Printing Sciences	+87.0	0.7

Informa is a leading business to business information group. Its activities include the provision of academic journals, books, data services, trade exhibitions, conferences and training services. It is also the largest holding in the Trust's portfolio. The company produced a very resilient profit performance in 2009, helped by aggressive cost cutting. Additionally, the balance sheet has been strengthened and the company is set for a return to growth in coming years. Given its low valuation, we believe the share price is set for further gains.

WSP is an international engineering consultant, principally in the built environment. Although market conditions were tough, profits have held up well as the company has adjusted its cost base to match revenues. 2010 is likely to be a trough year for earnings and the company will benefit in future years from its international diversification (70% of revenues are from outside the UK) and we believe the shares have significant further potential to re-rate from these levels.

Senior manufactures specialist engineering products for the automotive, industrial and aerospace industries. Impressive cost reduction and cash generation during the downturn meant the company was well placed to benefit from the upswing in its markets during the latter part of 2009 and early 2010. With commercial aerospace markets continuing to recover and Senior supplying key growth programmes, the future looks bright for the business.

Victrex is a speciality chemicals company. Its principal product is PEEK, a high performance thermoplastic. Demand for PEEK, which is used in a broad range of manufacturing industries, suffered badly in the industrial recession of late 2008 and early 2009. However, demand has recovered strongly and its medical implant business, Invibio, has continued to see robust growth. The weakness of sterling has been an additional benefit with Victrex being a major exporter. Rising demand for PEEK and Invibio's strong prospects means the company is set for further strong growth.

Domino Printing Sciences is a manufacturer of industrial printing equipment. It is one of the leaders in its global market and a major exporter. As with many other UK companies, management responded quickly and aggressively to the downturn and took significant costs out of the business. As demand recovered profits have seen a sharp recovery. Combined with a strong balance sheet, a well respected management team and a strong new product pipeline, we believe the shares will continue to outperform.

Principal detractors

Top five detractors from relative performance	12 month return %	Relative contribution %
Balfour Beatty	-10.7	-0.8
New World Resources*	+147.7	-0.6
Mouchel	-25.4	-0.5
Southern Cross Healthcare	-66.5	-0.5
Arriva*	+79.1	-0.4

*Included in the benchmark index but not owned by the Trust.

Balfour Beatty is an international engineering and contracting business. It has undergone a strategic shift in the last few years, with expansion into the US and into higher value consulting work, mostly through acquisition. The share price performed poorly in the last year due to concern over UK public sector spending cutbacks. We acknowledge these fears have substance but believe the international diversification of the group, the strong balance sheet, conservative accounting and excellent management team mean the company is well placed for more difficult markets. Additionally, the valuation of the company looks extremely low, especially considering the value of its investment portfolio and net cash balance.

The core business of **New World Resources** is coal mining and coke production. As the global economy recovered the price of its products increased and the profitability of the business recovered sharply. The Trust had no holding in this company and the rapid rise in its share price cost us relative performance.

Fund Manager's Review

continued

Mouchel is a professional support service company providing highways management, local authority outsourcing and water consultancy services. This year has been a traumatic one for Mouchel. Profitability has been under pressure from a lack of new contract wins, difficult trading conditions in public sector consulting and bad debt issues in the Middle East. The company did receive a bid from VT Group but before this was completed VT was acquired by Babcock. We think the valuation of Mouchel looks very attractive at these depressed levels and the company is vulnerable to corporate activity.

Southern Cross operates nursing homes. The industry has experienced difficult trading conditions as local authority spending constraints have put both fee rates and occupancy under pressure. Given the high operational gearing inherent in Southern Cross's leased model, profitability has decreased. The outlook for the industry remains under a cloud but the valuation now placed on the business looks ridiculously low and any positive change in sentiment could see the share price rise significantly.

Arriva provides transportation services throughout Europe with its operations including bus, train and commuter coach services. Although profitability is under pressure, the share price rose sharply after Deutsche Bahn made an agreed offer for the company at a significant premium. The Trust had no holding in this company.

Portfolio activity

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

A feature of the year was the large amount of equity issuance by UK corporates. The lack of bank finance and the need to reduce borrowings in a difficult economic environment meant the stock market was called upon to re-finance stretched corporate balance sheets. Many of these fund-raisings were done at significant discounts, providing attractive entry points. In the year we participated in equity offerings from **Capital and Regional**, the retail property investor, **e2v technologies**, the tubes and sensor manufacturer, **Intermediate Capital**, the mezzanine finance provider, and **Laird**, the electronics group.

In the year we have added a number of new positions to our portfolio. We increased our exposure to the resources sector. We targeted companies which own a world class asset, have a strong management team and a near term plan to get to commercial production. Acquisitions in this area included **Avocet Mining**, which owns a large gold deposit in Burkina Faso, **Kalahari Minerals**, which owns a significant stake in a uranium project in Namibia, and **Kenmare Resources**, which has a titanium dioxide deposit in Mozambique. We also increased our position in the consultant engineer sector with the acquisition of positions in **Hyder Consulting** and **Scott Wilson**. We feel this area is undervalued by the market and will recover quickly into an economic recovery. The position in Scott Wilson has already paid off handsomely, with competing take-over offers from two American companies pushing the share price up over 250% in June 2010.

Other new additions to our portfolio included:

John Menzies – a newspaper and magazine distribution business as well as a leading provider of ground and baggage handling services to the aviation industry. The news distribution business is mature but stable and generates significant cash. The aviation services business is operating in a growth market as well as seeing rapid recovery from the difficulties of 2009. The company has exceeded market forecasts repeatedly throughout the last year but is still trading on a very low valuation.

Spirent Communications – the group specialises in telecommunication testing systems. Spirent is a market leader, has high margins, strong cash generation and balance sheet and operates in a growth market. The explosion of data services and the number of smart phones is putting pressure on telecom networks and Spirent is well placed to benefit from these trends.

To balance the additions to our portfolio we have disposed of positions in companies which we felt were set for poor price performance. In particular, sales were made where we felt the share price had become over-valued and did not reflect the company's prospects. These included **Big Yellow**, the self storage company, **Morgan Sindall**, the UK construction company, and **Savills**, the property agent. We also disposed of our holding in **Ricardo**, the automotive consultant, where we believe profitability will remain under pressure as its end customers, the automotive manufacturers, continue to struggle. We also disposed of our holding in **Talvivaara Mining**, the Finnish nickel producer, as its relatively innovative

Fund Manager's Review

continued

production process continued to see teething problems.

IPO (initial public offering) and takeover activity was relatively quiet but did see a pick up from almost non-existent levels in the previous year. In the portfolio takeover bids were received for **Care UK**, the nursing home and domiciliary care business, from Bridgepoint, **Just Retirement**, the enhanced annuity company, from Primera, **Powerleague**, the 5-a-side football centre company, from Patron Capital and **Venture Production**, the North Sea oil and gas business from Centrica. Deals announced but not yet completed at the year end are the takeovers of **VT Group** by Babcock, **Chloride** by Emerson and **BSS Group** by Travis Perkins.

We participated in three IPOs in the year. These were:

CPP – the credit card and protection group which has an excellent long term growth record and strong international growth prospects.

Digital Barriers – a shell company looking to acquire assets in the digital security market. The attraction of the company is the management team, who previously built Detica into a £400 million plus business with an excellent growth record before it was acquired by BAE Systems.

LXB Properties – a company formed to take advantage of distressed valuations in the retail warehouse property sector. Again, the attraction was the strong management team who had previously had great success at Grantchester.

Portfolio outlook

The following table shows the Trust's key stock positions versus the Hoare Govett Smaller Companies Index (excluding investment companies) at the end of May 2010.

Top ten active positions at 31 May 2010	Active Weight %	Holding %	Index Weight %
Informa	3.8	3.8	0.0
WSP	3.2	3.4	0.2
Carillion	2.0	2.0	0.0
Victrex	1.9	2.6	0.7
Domino Printing Sciences	1.9	2.2	0.3
Spectris	1.7	2.4	0.7
Bellway	1.7	2.3	0.6
WS Atkins	1.5	2.0	0.5
Balfour Beatty	1.5	1.5	0.0
Intermediate Capital	1.4	2.2	0.8

Brief descriptions of Informa, WSP, Victrex, Domino Printing Sciences and Balfour Beatty have been included earlier. A brief description of the remaining largest active positions follows:

Carillion is a diversified construction and support services group with its major operations in the UK, Middle East and Canada. The company has undergone a very successful transformation over the last five years with rapid growth in its outsourcing activities and a staged reduction in its UK construction activities to a point where they only account for 10% of group profits. The increasing trend to outsource services by both the public and private sectors leaves Carillion well placed for future growth.

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

Bellway is a leading UK housebuilder. Although the outlook for the housing market is more uncertain, the long term prognosis is strong with a structural undersupply of new housing in the UK. The company is well managed, has a robust balance sheet, a long and secure land bank and good regional diversification. Trading at a large discount to net assets, the shares look attractive on a long term basis.

WS Atkins is an engineering consultancy business. It is the largest operator in the UK and is number one in most of its markets. The company is well placed to benefit from the growing power needs and environmental issues prevalent in the UK. The company has significant net cash and is looking to diversify internationally. Any acquisition would be significantly earnings enhancing.

Intermediate Capital is a leading provider of mezzanine finance to LBO markets. It also owns a highly successful mezzanine and credit fund management operation. After a difficult 2009 when the company required an equity issue to re-finance its balance sheet, prospects look much brighter. Its portfolio of investments is performing well, the company is looking to grow its loan book and the fund management business has an ambition to double in five years. The valuation looks very appealing, trading at a large discount to net assets.

Fund Manager's Review

continued

Market outlook

As referred to in the opening segment of the review, the last year has been one of stabilisation and recovery for both equity markets and the global economy. In 2010 though, markets have been more volatile. Although economic statistics have been supportive, there are significant concerns over the state of public finances in peripheral Europe and the viability of the euro. Additionally, there are fears about over-heating in the Chinese property market and the impact on the economy of the powerhouse of world economic growth.

The UK economy has made a modest recovery from recession. However, the need to rein in public spending and reduce the massive public sector deficit will necessitate large cuts in government spending. This will dampen economic recovery and lead to problems for public sector focused businesses. The strength of the UK consumer and housing market will be tested in this environment.

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

In conclusion, the year under review has been a good one for the equity market and even more so for the Trust. Performance was strong and our portfolio companies, in general, have weathered the downturn in good order. Our investments are generally trading well, are soundly financed and attractively valued. Additionally the small cap market continues to throw up exciting growth opportunities in which the Trust can invest.

Neil Hermon
Fund Manager
3 August 2010

Investment Portfolio

at 31 May 2010

Company	Main activity	Valuation as at 31 May 2010 £'000	% of portfolio
Informa	*business to business information*	**8,694**	3.83
WSP	*engineering consultancy*	**7,820**	3.44
Victrex	*speciality chemicals*	**5,905**	2.60
Spectris	*electronic control and process instrumentation*	**5,343**	2.35
Croda	*speciality chemicals*	**5,143**	2.26
Bellway	*house building*	**5,125**	2.25
Intermediate Capital	*mezzanine finance*	**4,942**	2.17
Domino Printing Sciences	*industrial printing equipment*	**4,900**	2.16
Carillion	*international contractor and outsourcer*	**4,589**	2.02
WS Atkins	*engineering consultancy*	**4,502**	1.98
10 largest		56,963	25.06
Melrose	*diversified engineering*	3,873	1.70
Rotork	*process control solutions*	3,833	1.69
Chemring	*defence products*	3,804	1.67
VT Group	*defence outsourcer*	3,562	1.57
Premier Oil	*oil & gas*	3,498	1.54
Interserve	*international contractor*	3,460	1.52
Balfour Beatty	*international contractor*	3,420	1.51
Grainger	*residential property investor*	3,380	1.49
BSS Group	*builders merchant*	3,234	1.42
Senior	*aerospace and automotive products*	3,210	1.41
20 largest		92,237	40.58
Ultra Electronic	*specialised defence contractor*	3,142	1.38
e2v technologies	*electronic components*	3,107	1.37
Paragon	*buy to let mortgage provider*	3,056	1.34
Restaurant Group	*restaurants*	3,004	1.32
Fidessa	*financial software*	2,896	1.27
Charter	*engineering*	2,884	1.27
LSL Property Services	*estate agent and surveyor*	2,685	1.18
Euromoney Institutional Investor	*business to business information*	2,675	1.18
CSR	*semi conductors*	2,673	1.18
Northgate	*commercial vehicle hire*	2,664	1.17
30 largest		121,023	53.24
Laird	*electronic products*	2,516	1.11
Chloride	*engineering power solutions*	2,507	1.10
Bluebay Asset Management	*credit asset manager*	2,487	1.10
Aveva Group	*design software*	2,346	1.03
Synergy Healthcare	*healthcare support services*	2,304	1.01
Halfords	*retailer of automotive parts*	2,258	0.99
Shaftesbury	*West End property investor*	2,243	0.99
Phoenix	*IT services*	2,185	0.96
John Menzies	*news distributor and aviation services*	2,152	0.95
Oxford Instruments	*advanced instrumentation equipment*	2,072	0.91
40 largest		144,093	63.39

Investment Portfolio

at 31 May 2010 continued

Company	Main activity	Valuation as at 31 May 2010 £'000	% of portfolio
Spirent Communications	*telecoms testing*	2,060	0.91
Chime Communications	*public relations and media services*	1,995	0.88
Greene King	*pub operator*	1,983	0.87
Capital & Regional	*retail property investor*	1,905	0.84
GlobeOp Financial Services	*hedge fund administrator*	1,896	0.83
International Ferro Metals	*ferrochrome producer*	1,871	0.82
Costain	*contractor*	1,855	0.81
SIG	*builders merchant*	1,838	0.81
*RWS	*patent translation services*	1,828	0.80
Eaga	*carbon services*	1,814	0.80
50 largest		163,138	71.76
Keller	*ground engineering*	1,806	0.80
Meggitt	*aerospace products*	1,803	0.79
Mouchel	*support services*	1,800	0.79
ITE Group	*exhibition organiser*	1,708	0.75
*Rockhopper Exploration	*oil & gas explorer*	1,703	0.75
Renishaw	*precision measuring and calibration equipment*	1,604	0.71
NCC Group	*IT security*	1,587	0.70
Aberdeen Asset Management	*fund manager*	1,579	0.70
Babcock International	*defence outsourcer*	1,577	0.69
Debenhams	*department stores*	1,567	0.69
60 largest		179,872	79.13
RM	*education software*	1,496	0.66
Dunelm	*homewares retailer*	1,444	0.63
Persimmon	*UK housebuilder*	1,428	0.63
Anite	*telecom software*	1,395	0.61
Psion	*hand held electronic products*	1,377	0.61
CPP Group	*credit card and identity protector insurance*	1,326	0.58
*Kentz	*oil & gas contractor*	1,304	0.57
Hyder Consulting	*engineering consultancy*	1,209	0.53
*Shed Media	*television programming*	1,195	0.53
*Valiant Petroleum	*oil & gas explorer*	1,175	0.52
70 largest		193,221	85.00
Telecity Group	*internet infrastructure*	1,149	0.50
Chrysalis	*music royalties*	1,133	0.50
*Playtech	*internet gaming software*	1,115	0.49
Ted Baker	*clothing retailer*	1,059	0.47
*Majestic Wine	*wine warehouse*	1,026	0.45
Kofax	*electronic capture software*	1,020	0.45
Rathbone Brothers	*private client asset management*	996	0.44
Hochschild Mining	*silver miner*	988	0.43
*Caretech Holdings	*residential care services*	967	0.43
*Digital Barriers	*digital security*	958	0.42
80 largest		203,632	89.58

Investment Portfolio

at 31 May 2010 continued

Company	Main activity	Valuation as at 31 May 2010 £'000	% of portfolio
*Abcam	*internet retailer of antibodies*	950	0.42
Intec Telecom Systems	*telecom billing software*	948	0.42
Wellstream Holdings	*flexible pipes for oil & gas*	948	0.42
Taylor Wimpey	*house builder*	933	0.41
John Wood	*oil & gas services*	918	0.40
Pace	*set top box provider*	909	0.40
*Xcite Energy	*oil & gas explorer*	875	0.39
Speedy Hire	*tool hire*	870	0.38
*LXB Retail Properties	*retail property investor*	869	0.38
Hansteen	*industrial property investor*	864	0.38
90 largest		212,716	93.58
*Goals Soccer Centres	*five-a-side soccer centres*	847	0.37
Gem Diamonds	*diamond producer*	814	0.36
Headlam	*floor covering distributor*	795	0.35
*London Mining	*iron ore mining*	789	0.35
Heritage Oil	*oil & gas explorer*	784	0.34
Consort Medical	*healthcare products*	776	0.34
*Avocet Mining	*gold mining*	762	0.33
*CVS Group	*veterinary retailer*	740	0.33
*Next Fifteen Communications	*PR and media services*	715	0.31
Scott Wilson	*engineering consultancy*	680	0.30
100 largest		220,418	96.96
Norcros	*shower and tile manufacturer*	677	0.30
Southern Cross Healthcare	*nursing homes*	652	0.29
Kenmare Resources	*titanium dioxide mining*	635	0.28
*Kalahari Minerals	*uranium mining*	599	0.26
*The Clapham House Group	*restaurants*	570	0.25
Minerva	*property developer*	564	0.25
Tribal	*health and education support services*	559	0.25
*Carluccio's	*restaurants*	550	0.24
Topps Tiles	*tile retailer*	520	0.23
*Desire Petroleum	*oil & gas explorer*	400	0.17
110 largest		226,144	99.48
*Numis Corporation	*investment bank*	361	0.16
JJB Sports	*sports retailing*	347	0.15
*Proximagen	*biotechnology*	322	0.14
*Critical Information	*shell company*	149	0.07
Total investments		**227,323**	**100.00**

There were no convertible or fixed interest securities at either 31 May 2010 or 31 May 2009.

*quoted on the Alternative Investment Market.

Directors


Dudley Fishburn


Sally Davis


James Nelson


Keith Percy


Mary Ann Sieghart


Beatrice Hollond

Dudley Fishburn (Chairman) joined the Board in 1996. He is an independent director of Philip Morris International Inc and a former director of HSBC Bank plc. He was for nine years a Member of Parliament and is a former Treasurer of the National Trust and a former executive editor of The Economist.

Sally Davis joined the Board in 2001 and became Chairman of the Audit Committee in 2003. She is CEO, BT Wholesale, one of the four operating divisions of BT Group plc. A former Vice President of Bell Atlantic and NYNEX, she is a Fellow of University College London. She is also a director of Logitech International S.A., a Swiss company quoted on NASDAQ. She will retire from the Board at the conclusion of the Annual General Meeting on 24 September 2010.

James Nelson joined the Board in 2002. He is the Company's Senior Independent Director. He was formerly an executive partner of Graphite Capital and is a former chairman of the BVCA. He is a director of Intermediate Capital Group PLC.

Keith Percy joined the Board in 2006. He is Chairman of Brunner Investment Trust plc and a director of JPMorgan Japanese Investment Trust plc, Standard Life Equity Income Trust plc and The Children's Mutual.

Mary Ann Sieghart joined the Board in July 2008. She was Assistant Editor of The Times from 1998 to 2007. She is also a former City Editor and Lex columnist. She sits on the Council of Tate Modern and the Advisory Council of Into University and is a Trustee of the Radcliffe Trust and Vice-President of the National Association for Gifted Children. She writes a weekly column for The Independent.

Beatrice Hollond joined the Board on 23 July 2010 and will become Chairman of the Audit Committee on 24 September 2010. She is deputy chairman of Millbank Financial Services, an independent family office, and chairman of Millbank Investment Management Limited, its investment management subsidiary. She is also a director of Keystone Investment Trust plc, ORA Capital Partners Plc and Oldfield & Co. (London) Limited. Among other appointments she is a trustee of the Esmée Fairbairn Foundation and Chairman of the Investment Committee, and an Advisory Fellow, of Pembroke College, Oxford.

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

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

Management


Neil Hermon


Geoffrey Rice

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

Geoffrey Rice ACIS has acted as company secretary since 1998. He is an authorised representative of Henderson Secretarial Services Limited, the corporate company secretary.

Directors' Report

The directors present the audited financial statements of the Group and their report for the year ended 31 May 2010. The Group comprises The Henderson Smaller Companies Investment Trust plc ("the Company") and its wholly owned subsidiary undertaking, Henderson Smaller Companies Finance Limited ("the Subsidiary").

Business Review

The business review seeks primarily to provide information about the Company's business, its principal risks and uncertainties and its results for the year ended 31 May 2010. It should be read in conjunction with the Chairman's Statement on page 3 and the Fund Manager's Review on pages 4 to 8, which reviews the investment activity in the year and the outlook for the portfolio.

a) Status

The Company is incorporated in England and Wales and domiciled in the United Kingdom. It is an investment company as defined in section 833 of the Companies Act 2006 and operates as an investment trust in accordance with section 1158 of the Corporation Tax Act 2010 (formerly section 842 of the Income and Corporation Taxes Act 1988). HM Revenue & Customs approval of the Company's status as an investment trust has been received in respect of the year ended 31 May 2009, although approval for that year is subject to review should there be any subsequent enquiry under Corporation Tax Self Assessment. The Company will continue to seek approval under section 1158 of the Corporation Tax Act 2010 each year.

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

b) Investment objective

The Company's investment objective is to maximise shareholders' total returns by investing mainly in smaller companies that are quoted in the United Kingdom. The strategy is to use rigorous research to identify high-quality smaller companies with strong growth potential. Generally, new investments are made in constituents of the benchmark index but they may continue to be held when the underlying companies grow out of the smaller companies sector. The benchmark is the Hoare Govett Smaller Companies Index (excluding investment companies).

c) Investment policy

The Company's portfolio is managed within a framework of investment limits and restrictions determined by the Board, the primary purpose of which is to spread and mitigate investment risk. It is intended that the Company will continue to be managed so as to satisfy each year the conditions for approval by HM Revenue & Customs as an investment trust.

Diversification

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

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

Asset Allocation

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

Gearing

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

General

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

Directors' Report

continued

d) Principal activity

The principal activity of the Company is to pursue its objective by operating as an investment trust company. The investment trust company structure allows the shareholders, whether institutions or private investors, to access a diversified portfolio of investments that is professionally managed. The principal activity remained unchanged throughout the year ended 31 May 2010.

e) Strategy

The Company has appointed Henderson Global Investors Limited ("Henderson") to manage the investments and to provide the related administrative services. Henderson provides a specialist fund manager whose role is to pursue the Company's objective within parameters determined by the Board. These parameters reflect investment policy and the Board's assessment of the risks facing the Company, including the importance of retaining the Company's taxation status as an investment trust. As an investment company the Company invests its shareholders' funds in the securities of other companies. In addition it has the ability to borrow money (termed "gearing") in order to increase the funds available for investment. It does this by means of both fixed borrowings (its £20 million issue of 10½ per cent debenture stock, repayable in 2016) and short term borrowings (drawn down from a facility provided by ING Bank N.V., London Branch with a current capacity of £5 million). In the event that the investment outlook becomes unfavourable, the Company may reduce its gearing to nil. However, it would expect the shareholders' funds to remain invested in all but unusual circumstances.

f) Performance measurement and key performance indicators

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

Performance measured against the benchmark

The Board reviews, at each of its meetings, the performance of the portfolio, the net asset value per share and the share price and compares them with the performance of the Company's benchmark (the Hoare Govett Smaller Companies Index (excluding investment companies)).

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

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

Performance measured against the Company's peer group

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

Total expense ratio ("TER")

The TER is a measure of the total expenses incurred by the Company. The Board reviews the TER and monitors the Company's expenses.

g) Principal risks and uncertainties

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

A fuller description of the principal risks and uncertainties follows.

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

Investment activity and strategy

An inappropriate investment strategy (for example, in terms of asset allocation or the level of gearing) may lead to underperformance against the Company's benchmark index and

Directors' Report
continued

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

Portfolio and market
Market risk arises from uncertainty about the future prices of the Company's investments. This is commented on in note 16 on pages 49 to 52.

Accounting, legal and regulatory
In order to qualify as an investment trust the Company must comply with section 1158 of the Corporation Tax Act 2010 (formerly section 842 of the Income and Corporation Taxes Act 1988) ("section 1158"), to which reference is made on page 13 under the heading 'Status'. A breach of section 1158 could result in the Company losing investment trust status and, as a consequence, capital gains realised within the Company's portfolio would be subject to Corporation Tax. The section 1158 criteria are monitored by the Manager and the results are reported to the directors at each Board meeting. The Company must comply with the provisions of the Companies Act 2006 ("the Companies Act"), and, as the Company's shares are listed for trading on the London Stock Exchange, the Company must comply with the UK Listing Authority's Listing Rules and Disclosure and Transparency Rules ("UKLA Rules"). A breach of the Companies Act could result in the Company and/or the directors being fined or becoming the subject of criminal proceedings. Breach of the UKLA Rules could result in the suspension of the Company's shares which would in turn lead to a breach of section 1158. The Board relies on its company secretary and its professional advisers to ensure compliance with the Companies Act and UKLA Rules.

Corporate governance and shareholder relations
Details of the Company's compliance with corporate governance best practice, including information on relations with shareholders, are set out in the Corporate Governance Statement on pages 19 to 23.

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

Financial instruments and the management of risk
By its nature as an investment trust, the Company is exposed in varying degrees to market risk (comprising market price risk, currency risk and interest rate risk), liquidity risk and credit and counterparty risk. An analysis of these financial risks and the Company's policies for managing them are set out in note 16 on pages 49 to 52.

h) Financial review
Capital
At 31 May 2010 the Company had in issue 74,906,796 ordinary shares of 25p each. The market price per share at that date was 216.0p, giving the Company a market capitalisation of £161.8 million. Equity shareholders' funds totalled £207.5 million, the net asset value being 277.1p per share. Accordingly, the market price per share stood at a discount of 22.0% to the net asset value. The Company seeks annually shareholder authority to buy back its shares in the market for cancellation. During the year the Company bought back 2,463,500 of its ordinary shares, representing 3.2% of the ordinary shares in issue at 31 May 2009. These purchases were made at an average discount of 21.4%; they cost £4.1 million excluding stamp duty and were funded from the realised capital reserves.

Performance
The Company had a strong year in terms of both absolute and relative performance. The stock market rose over the year and, because of good stock selection and, to a lesser degree, its

Directors' Report

continued

gearing, the Company outperformed its benchmark, the Hoare Govett Smaller Companies Index (excluding investment companies) on a total return basis. The following table sets out, with comparatives, key indicators of performance:

	At 31 May 2010	At 31 May 2009	% change
Shareholders' funds	**£207,533,000**	£156,349,000	+32.7
Net asset value per share	**277.1p**	202.1p	+37.1
Market price per share	**216.0p**	167.0p	+29.3
	Year ended 31 May 2010	Year ended 31 May 2009	% change
Revenue return per share	**4.59p**	6.30p	
Capital return per share	**74.70p**	(121.71)p	
Total return per share	**79.29p**	(115.41)p	
Dividend per share	**3.60p**	3.00p	+20.0
Special dividend per share	**–**	2.60p	

On a total return basis the benchmark index returned 29.6% over the year ended 31 May 2010. By comparison the Company's net asset value total return was 40.1%.

Performance attribution

	Note	Year ended 31 May 2010
Net asset value per share total return		40.1
Benchmark total return	1	29.6
Relative performance		**10.5**
Made up:		
Stock selection		7.5
Gearing		2.8
Share buy-backs		0.6
Expenses		(0.6)
Write-back of VAT and related interest		0.2
		10.5

Notes:

1. The benchmark is the Hoare Govett Smaller Companies Index (excluding investment companies).
2. Source: Henderson Global Investors Limited. The table sets out the Manager's understanding of the movement, relative to the benchmark, between the net asset value per share at 31 May 2009 (202.1p) and the net asset value per share at 31 May 2010 (277.1p).

Assets

The Group's net assets increased during the year from £156.3 million to £207.5 million. The net asset value per ordinary share increased during the year from 202.1p to 277.1p. The main reason for this increase was the rise in the market value of the Company's investments.

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

Costs

The Company's most significant items of expenditure are the costs of borrowing money for investment (the costs of gearing) and the management and, if applicable, performance fees payable to the Manager. Other expenses include investment transaction costs, the directors' fees and insurance, the fees of professional advisers and regulators, marketing, and the production and issue of reports to shareholders. In the year under review borrowing costs totalled £2,129,000, the management fee totalled £679,000 and other expenses totalled £373,000. These figures include VAT where applicable. No performance fee is payable in respect of the year because, although the Company outperformed its benchmark index and both the share price and the net asset value rose, the value of the outperformance was not sufficient to clear the negative balance brought forward (see page 24). During the year a further amount of £44,000 was recognised in respect of the recovery of VAT borne on investment management fees in past years. The recovery in the prior year was £1,150,000. The transaction costs, which include stamp duty and totalled £209,000, are included within the purchase costs or netted against the sales proceeds of investments.

The total expense ratio ("TER") is a measure of the Company's running costs. The definition used for the figures below is "the total of the management fees and other administrative expenses as a percentage of the average of shareholders' funds at the beginning and end of the year". This definition excludes borrowing costs and transaction costs (and, in respect of both the year under review and the prior year, the write back of VAT) but includes any performance fee. For the year ended 31 May 2010 the TER is 0.58% (2009: 0.51%).

Revenue and dividend

The Company's investment income and other revenue totalled £6,588,000 (2009: £7,218,000). After deducting expenses the revenue profit for the year was £3,449,000 (2009: £4,936,000).

The Board seeks to increase each year the dividend per ordinary share that it puts to the shareholders for approval. The amount available for distribution represents the investment income of the Company less all borrowing costs, management fees and administrative expenses (except the performance fee).

Directors' Report

continued

The difference between the totals of income and expenditure may vary from year to year because the Company's most significant costs are not related at all closely to the investment income. Accordingly, it is not possible to be certain that a progressive dividend policy can be maintained.

In respect of the year under review the directors recommend a final dividend of 3.60p per ordinary share (2009: 3.00p). Subject to approval at the Annual General Meeting, the final dividend will be paid on 8 October 2010 to shareholders on the register of members on 17 September 2010.

Donations

During the year the Company made charitable donations of £5,000 (2009: £5,000). No political donations were made (2009: £nil).

Payment of creditors

It remains the Company's policy for the forthcoming financial year to obtain the best terms for all business and therefore there is no single policy as to the terms used. In general the Company agrees with its suppliers the terms on which business will take place and it is the Company's policy to abide by such terms. There were no trade creditors at 31 May 2010 (2009: none).

i) Going concern

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

j) Future developments

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

Directors

a) The directors

The directors of the Company, as shown on page 12, are Mrs S M Davis, Mr J D Fishburn, Mr J J Nelson, Mr K E Percy, Ms M A Sieghart and Mrs B Hollond. All served throughout the year under review, with the exception of Mrs Hollond who was appointed on 23 July 2010. Mrs Davis will retire from the Board at the conclusion of the Annual General Meeting on 24 September 2010.

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

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

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

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

The directors have reviewed their independence in the context of the Combined Code and by reference to the AIC's Code of Corporate Governance. The directors have had no material

Directors' Report
continued

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

b) Directors' interests

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

	31 May 2010 Ordinary shares of 25p	1 June 2009 Ordinary shares of 25p
With beneficial interest:		
S M Davis	**11,184**	10,894
J D Fishburn	**19,551**	17,551
J J Nelson	**45,000**	45,000
K E Percy	**4,700**	4,000
M A Sieghart	**500**	500

Since the year end, Ms Sieghart has increased her holding to 1,176 shares. No director had an interest in the preference or debenture stocks of the Company. There were no other changes in the directors' interests between the year end and 3 August 2010.

c) Directors' fees

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

d) Directors' conflicts of interest

Directors have a duty to avoid situations where they have, or could have, a direct or indirect interest that conflicts, or possibly could conflict, with the Company's interests. With effect from 1 October 2008, the Companies Act 2006 (the "Act") has allowed directors of public companies to authorise such conflicts and potential conflicts, where appropriate, but only if the articles of association contain a provision to this effect. The Act also allows the articles of association to contain other provisions for dealing with directors' conflicts of interest to avoid a breach of duty. There are two circumstances in which a conflict of interest can be permitted: either the situation cannot reasonably be regarded as likely to give rise to a conflict of interest or the matter has been authorised in advance by the directors. The Company's Articles of Association, which were adopted by shareholders on 26 September 2008, give the directors the relevant authority required to deal with conflicts of interest. Each of the directors has provided a statement of all conflicts of interest and potential conflicts of interest, if any, applicable to the Company. A register of conflicts of interest has been compiled and approved by the Board. The directors have also all undertaken to notify the Chairman as soon as they become aware of any new potential conflicts of interest that need to be approved by the Board and added to the Register, which is reviewed annually by the Board. It has also been agreed that directors will advise the Chairman and the company secretary in advance of any proposed external appointment and new directors will be asked to submit a list of potential situations falling within the conflicts of interest provisions of the Act in advance of joining the Board. The Chairman will then determine whether the relevant appointment causes a conflict or potential conflict of interest and should therefore be considered by the Board. Only directors who have no interest in the matter being considered would be able to participate in the Board approval process. In deciding whether to approve a conflict of interest, directors will act in a way they consider, in good faith, will be most likely to promote the Company's success. The Board can impose limits or conditions when giving authorisation if the directors consider this to be appropriate. The Board believes that its powers of authorisation of conflicts have operated effectively since they were introduced on 1 October 2008. The Board also confirms that its procedures for the approval of conflicts of interest have been followed by all the directors.

e) Directors' indemnity

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

Directors' Report

continued

Corporate Governance Statement

a) Background

The UK Listing Authority requires all listed companies to disclose how they have applied the principles and complied with the provisions of The Combined Code on Corporate Governance ("the Code"). (The Code is accessible at www.frc.co.uk.)

Throughout the year under review the Code in force was The Combined Code on Corporate Governance issued by the Financial Reporting Council in June 2008. In addition, the AIC Code of Corporate Governance, issued by the Association of Investment Companies in March 2009 ("the AIC Code"), applies to the Company. (The AIC Code, and the related Corporate Governance Guide for Investment Companies, are accessible at www.theaic.co.uk.)

b) Statement of compliance

The directors consider that the Company has complied during the year ended 31 May 2010 with all the relevant provisions set out in the Code. The directors consider that the Company has complied throughout the year ended 31 May 2010 with the AIC Code.

c) Application of the Principles of the Code

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

d) The Board of directors

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

The Board currently consists of six non-executive directors, all of whom the directors consider to be independent of the Company's Manager (Henderson Global Investors Limited). Their biographical details, set out on page 12, demonstrate a breadth of investment, commercial and professional experience with an international perspective. The number of directors will reduce back to five when Mrs Davis retires at the conclusion of the Annual General Meeting in September.

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

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

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

Directors' Report

continued

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

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

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

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

e) Board committees

The Board has established Audit, Management Engagement and Nomination Committees with defined terms of reference and duties. All three committees comprise non-executive directors appointed by the Board; the Board also appoints the Chairman of each of the Committees. The membership of these Committees is set out on page 12. A record of the meetings held during the year is set out on page 21.

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

Audit Committee

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

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

Directors' Report

continued

Management Engagement Committee

The Management Engagement Committee is responsible for the regular review of the terms of the management contract with the Manager. The Management Engagement Committee did not meet formally during the year. The details of the management arrangements and the Board's review of them is set out on page 24.

Nomination Committee

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

The Nomination Committee met formally once during the year to carry out this duty. It determined that the director to be appointed to replace Mrs Davis should add diversity to the skills and experience of the Board and be able to contribute from a fresh perspective to the Board's strategic leadership of the Company and its scrutiny of the Manager. It determined also that the new director should have the capacity and experience necessary to chair the Audit Committee in due course. Accordingly, the Board appointed a headhunter to identify candidates with a record of success in business or the professions rather than with any specific experience or expertise in investment or investment trust matters.
Mrs Hollond was appointed to the Board on 23 July 2010.

f) Board attendance

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

	Board	Audit Committee	Nomination Committee
Number of meetings	4	2	1
J D Fishburn	4	2*	1
S M Davis	4	2	1
J J Nelson	4	2	1
K E Percy	4	2	1
M A Sieghart	4	2	1

All the above directors attended the Annual General Meeting.

*Mr Fishburn stood down from the Audit Committee in 2007 but has attended its meetings by invitation.

g) Board remuneration

The Board as a whole considers the directors' remuneration; therefore it has not appointed a separate remuneration committee for this purpose. Because the Company is an investment trust company and all its directors are non-executive, the Company is not required to comply with the provisions of the Code in respect of the remuneration of executive directors. The directors' fees are detailed in the Directors' Remuneration Report on pages 26 and 27. The directors have undertaken to use part of their fees, after statutory deductions, to purchase shares in the Company.

h) Share capital

The Company's share capital comprises:

a) *ordinary shares of 25p nominal value each ("shares")*
The voting rights of the shares on a poll are one vote for each share held. At 31 May 2009 there were 77,370,296 shares in issue. During the year 2,463,500 shares (representing 3.2% of the number in issue at the beginning of the year) were bought back and cancelled. At 31 May 2010 the number of shares in issue, and thus the number of voting rights, was 74,906,796.

The Company's Articles of Association permit the Company to purchase its own shares and to fund such purchases from its accumulated realised capital reserves. At the Annual General Meeting in October 2009 a special resolution was passed giving the Company authority, until the conclusion of the Annual General Meeting in 2010, to make market purchases for cancellation of the Company's own ordinary shares up to a maximum of 11,251,538 shares (being 14.99% of the issued ordinary share capital as at 2 October 2009). As at 31 May 2010 the Company had valid authority, outstanding until the conclusion of the Annual General Meeting in 2010, to make market purchases for cancellation of 11,098,038 shares. A fresh buy-back authority will be sought at the Annual General Meeting in September. Shares are not bought back unless the result is an increase in the net asset value per ordinary share.

b) *preference stock units of £1 each ("preference stock units")*
The preference stockholders have no rights to attend and vote at general meetings (except where the dividend is six months in arrears or on a resolution to wind up the Company). At 31 May 2009 there were 4,257 preference

Directors' Report

continued

stock units in issue. No preference stock units were bought back during the year. Therefore, at 31 May 2010 the number of preference stock units in issue was 4,257. A fresh buy-back authority will be sought at the Annual General Meeting in September.

Further details on the preference stock units are given in note 15 on pages 48 and 49.

There have been no changes to the share capital or voting rights of the Company since 31 May 2010.

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

i) Substantial share interests

As at 3 August 2010 the following had declared an interest in 3% or more of the voting rights of the Company:

Shareholder	% of voting rights
M & G Investment Management Limited (direct)	11.48
Newton Investment Management Limited (indirect)	10.51
The Standard Life Investments Group (direct 6.62%; indirect 0.67%)	7.29
Royal London Asset Management Limited (direct)	6.96
East Riding of Yorkshire Council (direct)	6.27
1607 Capital Partners LLC (category not stated)	5.78
Legal & General Investment Management Limited (direct)	3.89

The above percentages are calculated by applying the shareholdings as notified to the Company to the issued share capital as at 3 August 2010 (the shareholdings being the voting rights).

The Board is aware that, as at 31 May 2010, 3.3% of the issued share capital was held on behalf of participants in the Halifax Share Dealing Products (run by Halifax Share Dealing Limited ("HSDL") which is now part of Lloyds Banking Group) who transferred from the products formerly managed by Henderson Global Investors Limited ("Henderson") or who have subsequently been introduced via Henderson. In accordance with the arrangements made between HSDL and Henderson, these participants in the Halifax Share Dealing Products are given the opportunity to instruct the nominee company of HSDL to exercise the voting rights appertaining to their shares in respect of all general meetings of the Company. HSDL has undertaken to instruct its nominee company to exercise the voting rights of any such shares held through the Halifax Share Dealing Products that have not been exercised by the individual participants in them. It will do so by voting for or against all resolutions to be put at all general meetings of the Company (or by withholding votes on such resolutions) pro rata to the aggregate voting instructions for each resolution received from those participants who have chosen to exercise their voting rights.

j) Relations with shareholders

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

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

The Board considers that the annual general meeting should provide an effective forum for individual investors to communicate with the directors. The annual general meeting is chaired by the Chairman of the Board. All the other directors, including the Chairman of the Audit Committee, expect to be present. Details of the proxy votes received in respect of each resolution are made available to shareholders and shown on the Henderson website. Representatives of the Manager make a presentation to the meeting. The Company has adopted a nominee share code which is set out on page 56.

k) Accountability and audit

The directors' statement of responsibilities in respect of the accounts is set out on page 28. The responsibilities of the independent auditors are set out on pages 29 and 30. The directors' statement that the business is a going concern is set out on page 17.

The Board has delegated contractually to external agents, including the Manager, the management of the investment portfolio, the custodial services (which include the

Directors' Report
continued

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

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

l) Internal control

The Manager has established an internal control framework to provide reasonable assurance on the effectiveness of the internal controls operated on behalf of its clients. The effectiveness of the internal controls is assessed by the Manager's internal audit and compliance and risk departments on an ongoing basis.

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

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

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

m) Environmental and human rights policy and the exercise of voting powers

The Code emphasises that the way in which institutional investors use their power to influence the standards of corporate governance is of fundamental importance and their readiness to do this turns on the degree to which they see it as their responsibility as owners, and in the interest of those whose money they are investing, to bring about changes in companies when necessary.

In this regard, the Company's Manager follows a responsible investment policy covering the UK requirements of the Code in full. The Manager votes with this policy in mind and enjoys the benefits of having its own socially responsible investment and corporate engagement teams. The Board has approved a corporate governance voting policy for the United Kingdom which accords with current best practice whilst maintaining a primary focus on financial returns.

Related Parties

The contracts with the Manager and the Custodian are the only related party arrangements currently in place. Other than fees payable in the ordinary course of business, there have

Directors' Report

continued

been no material transactions with these related parties that have affected the financial position or performance of the Company during the year under review.

Manager

Investment management, accounting, administrative and company secretarial services are provided to the Company (and were provided during the year under review) by subsidiaries of Henderson Group plc ("Henderson"). BNP Paribas Securities Services (formerly its subsidiary company, BNP Paribas Fund Services UK Limited) provides, on behalf of Henderson, accounting and investment administration services to the Company.

The management agreement between the Company and Henderson provides for the payment of a composite annual management fee, calculated as a percentage of the value of the assets under management. The management fee is calculated quarterly as a percentage of the value of the assets under management on the last day of the quarter preceding the quarter in respect of which the calculation is made. Assets under management for the purpose of calculating the management fee exclude any holdings in funds managed by Henderson. The management fee is payable quarterly in advance. During the year ended 31 May 2010 the percentage fee rate was 0.0875 per cent per quarter (0.35 per cent per annum) (2009: the same).

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

No performance fee is payable in respect of the year ended 31 May 2010 because, although the Company outperformed its benchmark index and both the share price and the net asset value per share were higher at the end of the year than at the start of the year, the value of the outperformance was not sufficient to clear the negative Historic Amount brought forward. The Historic Amount brought forward at 1 June 2009 amounted to a deficit of £26,661,000. The Historic Amount carried forward at 31 May 2010 amounted to a deficit of £10,758,219.

The management agreement provides for a formal review every three years of the fee arrangements with the Manager. In July 2008 the Board and Henderson concluded the triennial review due as at 31 May 2008. Certain changes to the performance fee arrangements were agreed between the parties but withdrawn following meetings with some of the larger shareholders.

The notice period under the management agreement between Henderson and the Company is six months, the amount of any compensation payable by the Company to be pro rata to any notice given. No compensation is payable if six months' notice of termination is given. In the event that the continuation vote to be put to the Annual General Meeting on 24 September 2010, or a continuation vote put to a subsequent annual general meeting, is not passed, no compensation will be payable on the subsequent termination of the contract.

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

Directors' Report
continued

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

Annual General Meeting
The next Annual General Meeting will be held at 11.30 am on Friday 24 September 2010 at the Company's Registered Office, 201 Bishopsgate, London EC2M 3AE. The Notice of Meeting is set out in the accompanying circular to shareholders.

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

Articles of Association
Those sections of the Companies Act 2006 that had not been applied earlier came into force on 1 October 2009. In addition, the Companies (Shareholders' Rights) Regulations 2009 were issued last year, applying the requirements of the Shareholder Rights' Directive with effect from 3 August 2009. The Articles of Association have been revised to reflect these changes, including the transfer of the provisions of the Memorandum of Association to the Articles of Association. A special resolution to this effect will be put to the Annual General Meeting in September. The resolution is set out in the Notice of Meeting that is being sent to shareholders as an accompanying circular to this Annual Report. A summary of the changes to the Articles of Association is set out in the circular.

Life of the Company
The Board announced on 27 September 2002 that it proposed to introduce regular continuation votes for the Company. Accordingly, a continuation vote was put to the annual general meeting of the Company in September 2004 and a similar resolution was put to the annual general meeting in September 2007. Thereafter in 2010, and at every subsequent third annual general meeting, an ordinary resolution will be put asking the shareholders to approve the continuation of the Company as an investment trust. The resolution is set out in the Notice of Meeting that is being sent to shareholders as an accompanying circular to this Annual Report.

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

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

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

By order of the Board
G S Rice
For and on behalf of Henderson Secretarial Services Limited, Secretary
3 August 2010

Directors' Remuneration Report

Introduction

The Directors' Remuneration Report ("the Report") is prepared in accordance with the Companies Act 2006 ("the Act") in respect of the year ended 31 May 2010. An ordinary resolution to receive and approve the Report will be put to the Annual General Meeting on 24 September 2010. The Act requires the auditors to report to the Company's members on certain parts of the Report and to state whether in their opinion those parts of the Report have been properly prepared in accordance with the Act. Therefore the Report has been divided into separate sections for audited and unaudited information.

UNAUDITED INFORMATION

Consideration by the directors of matters relating to directors' remuneration

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

Statement of the Company's policy on directors' remuneration

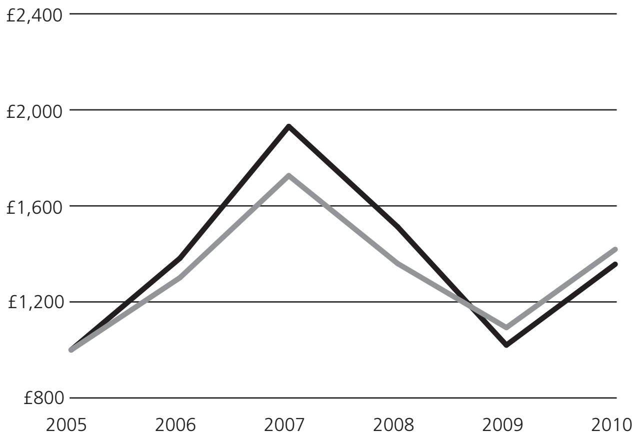
The Board consists entirely of non-executive directors who meet at least four times a year to deal with the important aspects of the Company's affairs. New directors are appointed with the expectation that they will serve for a period of three years. Directors' appointments are reviewed formally every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

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

The Company's Articles of Association limit the fees payable to the directors to £150,000 per annum. The directors' fees were increased, with effect from 1 January 2010, as follows: the Chairman from £27,500 to £28,000 per annum, the Chairman of the Audit Committee from £17,000 to £21,000 per annum and the other directors from £16,000 to £18,000 per annum. The policy is to review the fee rates from time to time, although such review will not necessarily result in any change to them. The fees had last been increased with effect from 1 January 2006.

Directors' and officers' liability insurance cover is held by the Company in respect of the directors.

Performance graph



Henderson Smaller Companies share price total return, assuming the investment of £1,000 on 31 May 2005 and the reinvestment of all dividends (excluding dealing expenses)

Hoare Govett Smaller Companies Index (excluding investment companies), assuming the notional investment of £1,000 into the Index on 31 May 2005 and the reinvestment of all income (excluding dealing expenses)

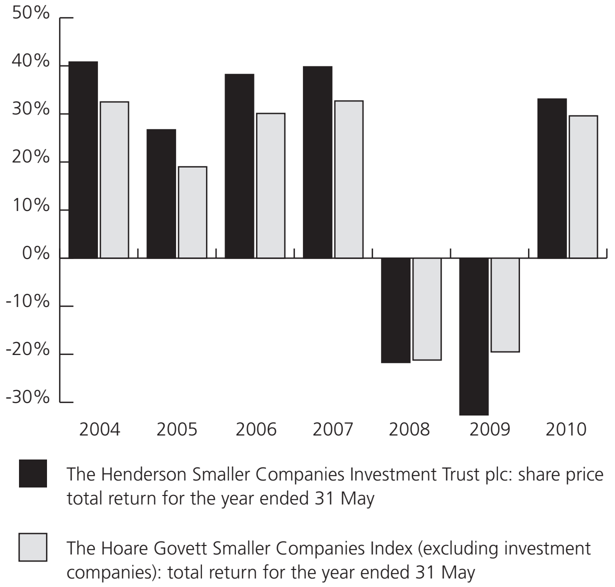
(Source: Datastream).

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

Directors' Remuneration Report

continued

The information given in the graph on page 26, which is set out in the format required by the Act, may be more readily understood in the form of a bar chart. The bar chart below compares the performance of the Company's share price to the performance of the benchmark index in each of the seven years up to 31 May 2010. Neil Hermon was appointed Fund Manager in November 2002. Therefore the bar chart covers the seven full financial years to date of his management.



AUDITED INFORMATION

Amount of each director's emoluments

The fees payable in respect of each of the directors who served during the year, and during 2009, were as follows:

	2010 £	2009 £
S M Davis	**18,667**	17,000
J D Fishburn	**27,708**	27,500
J J Nelson	**16,833**	16,000
K E Percy	**16,833**	16,000
M A Sieghart (i)	**16,833**	12,288
J M P Taylor (ii)	**–**	6,826
TOTAL	**96,874**	95,614

Notes:

(i) Ms Sieghart was appointed to the Board on 18 July 2008.

(ii) Mr Taylor retired from the Board on 26 September 2008.

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

By order of the Board

G S Rice

For and on behalf of Henderson Secretarial Services Limited, Secretary

3 August 2010

Statement of Directors' Responsibilities

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

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these financial statements, the directors are required to:

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Statement under DTR 4.1.12

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

- the Group financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Group; and
- the directors' report in this Annual Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

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

For and on behalf of the Board
J D Fishburn
Chairman
3 August 2010

Independent Auditors' Report

to the members of The Henderson Smaller Companies Investment Trust plc

We have audited the financial statements of The Henderson Smaller Companies Investment Trust plc for the year ended 31 May 2010 which comprise the Consolidated Statement of Comprehensive Income, the Consolidated and Parent Company Statements of Changes in Equity, the Consolidated and Parent Company Balance Sheets, the Consolidated and Parent Company Cash Flow Statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

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

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 May 2010 and of the Group's profit and the Group's and Parent Company's cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or

Independent Auditors' Report
continued

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, set out on page 17, in relation to going concern; and
- the parts of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Brian Taylor (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
3 August 2010

Consolidated Statement of Comprehensive Income

for the year ended 31 May 2010

Notes		Year ended 31 May 2010 Revenue return £'000	Year ended 31 May 2010 Capital return £'000	Year ended 31 May 2010 Total £'000	Year ended 31 May 2009 Revenue return £'000	Year ended 31 May 2009 Capital return £'000	Year ended 31 May 2009 Total £'000
2	Investment income	**5,961**	**–**	**5,961**	6,271	–	6,271
3	Other income	**627**	**–**	**627**	947	–	947
10(c)	Gains/(losses) on investments held at fair value through profit or loss	**–**	**56,091**	**56,091**	–	(95,301)	(95,301)
	Total income/(loss)	**6,588**	**56,091**	**62,679**	7,218	(95,301)	(88,083)
	Expenses						
4	Management and performance fees	**(679)**	**–**	**(679)**	(687)	–	(687)
4	Write-back of VAT	**44**	**–**	**44**	1,150	–	1,150
5	Other expenses	**(373)**	**–**	**(373)**	(360)	–	(360)
	Profit/(loss) before finance costs and taxation	**5,580**	**56,091**	**61,671**	7,321	(95,301)	(87,980)
6	Finance costs	**(2,129)**	**–**	**(2,129)**	(2,376)	–	(2,376)
	Profit/(loss) before taxation	**3,451**	**56,091**	**59,542**	4,945	(95,301)	(90,356)
7	Taxation	**(2)**	**–**	**(2)**	(9)	–	(9)
	Net profit/(loss) for the year and total comprehensive income	**3,449**	**56,091**	**59,540**	4,936	(95,301)	(90,365)
8	**Earnings/(loss) per ordinary share**	**4.59p**	**74.70p**	**79.29p**	6.30p	(121.71)p	(115.41)p

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

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

The Group does not have any Other Comprehensive Income and hence the net profit/(loss), as disclosed above, is the same as the Group's Total Comprehensive Income.

All items in the above statement derive from continuing operations.

The net profit for the year of the Company was £59,540,000 (2009: loss of £90,365,000).

All income is attributable to the equity holders of The Henderson Smaller Companies Investment Trust plc, the parent company. There are no minority interests.

The notes on pages 35 to 55 form part of these financial statements.

Consolidated and Parent Company Statements of Changes in Equity

for the year ended 31 May 2010

Notes		Consolidated Year ended 31 May 2010 Called up share capital £'000	Capital redemption reserve £'000	Capital reserves £'000	Revenue reserve £'000	Total £'000
	Total equity at 31 May 2009	**19,343**	**26,078**	**99,930**	**10,998**	**156,349**
	Total comprehensive income:					
	Profit for the year	**–**	**–**	**56,091**	**3,449**	**59,540**
	Transactions with owners, recorded directly to equity:					
9	Ordinary dividends paid	**–**	**–**	**–**	**(4,205)**	**(4,205)**
17	Buy-backs of ordinary shares	**(616)**	**616**	**(4,151)**	**–**	**(4,151)**
	Total equity at 31 May 2010	**18,727**	**26,694**	**151,870**	**10,242**	**207,533**

Notes		Consolidated Year ended 31 May 2009 Called up share capital £'000	Capital redemption reserve £'000	Capital reserves £'000	Revenue reserve £'000	Total £'000
	Total equity at 31 May 2008	20,113	25,303	200,986	9,069	255,471
	Total comprehensive income:					
	(Loss)/profit for the year	–	–	(95,301)	4,936	(90,365)
	Transactions with owners, recorded directly to equity:					
9	Ordinary dividends paid	–	–	–	(3,007)	(3,007)
17	Buy-backs of ordinary shares	(770)	770	(5,750)	–	(5,750)
	Buy-back of preference stock (in 2008)	–	5	(5)	–	–
	Total equity at 31 May 2009	19,343	26,078	99,930	10,998	156,349

Notes		Company Year ended 31 May 2010 Called up share capital £'000	Capital redemption reserve £'000	Capital reserves £'000	Revenue reserve £'000	Total £'000
	Total equity at 31 May 2009	**19,343**	**26,078**	**102,194**	**8,734**	**156,349**
	Total comprehensive income:					
	Profit for the year	**–**	**–**	**56,090**	**3,450**	**59,540**
	Transactions with owners, recorded directly to equity:					
9	Ordinary dividends paid	**–**	**–**	**–**	**(4,205)**	**(4,205)**
17	Buy-backs of ordinary shares	**(616)**	**616**	**(4,151)**	**–**	**(4,151)**
	Total equity at 31 May 2010	**18,727**	**26,694**	**154,133**	**7,979**	**207,533**

Notes		Company Year ended 31 May 2009 Called up share capital £'000	Capital redemption reserve £'000	Capital reserves £'000	Revenue reserve £'000	Total £'000
	Total equity at 31 May 2008	20,113	25,303	203,251	6,804	255,471
	Total comprehensive income:					
	(Loss)/profit for the year	–	–	(95,302)	4,937	(90,365)
	Transactions with owners, recorded directly to equity:					
9	Ordinary dividends paid	–	–	–	(3,007)	(3,007)
17	Buy-backs of ordinary shares	(770)	770	(5,750)	–	(5,750)
	Buy-back of preference stock (in 2008)	–	5	(5)	–	–
	Total equity at 31 May 2009	19,343	26,078	102,194	8,734	156,349

The notes on pages 35 to 55 form part of these financial statements.

Consolidated and Parent Company Balance Sheets

at 31 May 2010

Notes		**Consolidated 2010 £'000**	Consolidated 2009 £'000	**Company 2010 £'000**	Company 2009 £'000
	Non current assets				
10	Investments held at fair value through profit or loss	**227,323**	174,232	**229,586**	176,496
	Current assets				
13	Other receivables	**1,431**	2,854	**1,431**	2,854
	Cash and cash equivalents	**1,097**	234	**1,097**	234
		2,528	3,088	**2,528**	3,088
	Total assets	**229,851**	177,320	**232,114**	179,584
	Current liabilities				
14	Other payables	**(311)**	(967)	**(2,574)**	(3,231)
16(viii)	Bank loans	**(2,003)**	–	**(2,003)**	–
		(2,314)	(967)	**(4,577)**	(3,231)
	Total assets less current liabilities	**227,537**	176,353	**227,537**	176,353
	Non current liabilities				
15	Financial liabilities	**(20,004)**	(20,004)	**(20,004)**	(20,004)
	Net assets	**207,533**	156,349	**207,533**	156,349
	Equity attributable to equity shareholders				
17	Called up share capital	**18,727**	19,343	**18,727**	19,343
18	Capital redemption reserve	**26,694**	26,078	**26,694**	26,078
	Retained earnings				
18	Capital reserves	**151,870**	99,930	**154,133**	102,194
19	Revenue reserve	**10,242**	10,998	**7,979**	8,734
	Total equity	**207,533**	156,349	**207,533**	156,349
20	**Net asset value per ordinary share**	**277.1p**	202.1p	**277.1p**	202.1p

These financial statements were approved by the Board of directors on 3 August 2010 and signed on their behalf by:

J D Fishburn

The notes on pages 35 to 55 form part of these financial statements.

Consolidated and Parent Company Cash Flow Statements

for the year ended 31 May 2010

	Year ended 31 May 2010		Year ended 31 May 2009	
	Consolidated £'000	**Company £'000**	Consolidated £'000	Company £'000
Operating activities				
Profit/(loss) before taxation	**59,542**	**59,542**	(90,356)	(90,356)
Add: interest payable	**2,129**	**2,129**	2,376	2,376
Less: (gains)/losses on investments held at fair value through profit or loss	**(56,091)**	**(56,090)**	95,301	95,302
Add: net sales of investments held at fair value through profit or loss	**3,000**	**3,000**	17,286	17,286
Decrease in other receivables	**846**	**846**	893	893
Increase in amounts due from brokers	**(51)**	**(51)**	(443)	(443)
Decrease in accrued income	**622**	**622**	–	–
Increase/(decrease) in other payables	**112**	**111**	(106)	(107)
Decrease in amounts due to brokers	**(773)**	**(773)**	(727)	(727)
Taxation on investment income	**4**	**4**	(23)	(23)
Net cash inflow from operating activities before interest and taxation	**9,340**	**9,340**	24,201	24,201
Interest paid	**(2,124)**	**(2,124)**	(2,382)	(2,382)
Net cash inflow from operating activities	**7,216**	**7,216**	21,819	21,819
Financing activities				
Equity dividends paid	**(4,205)**	**(4,205)**	(3,007)	(3,007)
Buy-backs of ordinary shares	**(4,151)**	**(4,151)**	(5,750)	(5,750)
Drawdown/(repayment) of bank loans	**2,003**	**2,003**	(13,500)	(13,500)
Net cash outflow from financing	**(6,353)**	**(6,353)**	(22,257)	(22,257)
Increase/(decrease) in cash and cash equivalents	**863**	**863**	(438)	(438)
Cash and cash equivalents at the start of the year	**234**	**234**	672	672
Cash and cash equivalents at the end of the year	**1,097**	**1,097**	234	234

The notes on pages 35 to 55 form part of these financial statements.

Notes to the Financial Statements

1 Accounting policies

(a) Basis of preparation

The consolidated and parent company financial statements for the year ended 31 May 2010 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. These comprise standards and interpretations approved by the International Accounting Standards Board ("IASB"), together with interpretations of the International Accounting Standards and Standing Interpretations Committee approved by the International Accounting Standards Committee ("IASC") that remain in effect, to the extent that IFRS have been adopted by the European Union.

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

Accounting Standards

(i) Standards, amendments and interpretations that become effective in the current financial year that have been adopted by the Group:

- IAS 1 (revised) *Presentation of Financial Statements* The revised standard requires the separate presentation of changes in equity attributable to the owners (equity shareholders) and other non-owner changes. All non-owner changes in equity are required to be shown in a performance statement, but entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the income statement and statement of comprehensive income). The Group has applied IAS 1 (revised) from 1 June 2009 and has elected to present solely a statement of comprehensive income. Where an entity restates or reclassifies comparative information, it is also required to present a restated balance sheet as at the beginning of the comparative period. The adoption of this revised standard has not resulted in a significant change to the presentation of the Group's performance statement, as the Group has no elements of other comprehensive income not previously included in its Income Statement.

- IAS 39 (amendment) *Financial Instruments: Recognition and measurement* The amendment was part of the IASB's annual improvements project published in May 2008. The amendment permits an entity to reclassify particular financial assets in some circumstances, and the definition of financial asset or financial liability at fair value through profit or loss as it relates to items that are held for trading was amended. Adoption did not have a significant impact on the Group's financial statements.

- IFRS 7 (amendment) *Financial Instruments: Disclosures* Introduced new disclosure requirements whereby financial instruments must be categorised under a three-level fair value hierarchy. A reconciliation is also required for any investments categorised as Level 3. The additional disclosures resulting from this amendment have been included in note 10 on page 46. The amendments to IFRS 7 also introduce some additional disclosures on liquidity risk which are included in note 16.

- IAS 32 (amendment) *Financial Instruments: Presentation* and IAS 1 (amendment) *Presentation of financial statements – Puttable financial instruments and obligations arising on liquidation* The amendment provides exemptions from financial liability classification for (a) puttable financial instruments that meet certain conditions; and (b) certain instruments or components of instruments that impose on the entity an obligation to deliver to another party a pro-rata share of the net assets of the entity only on liquidation as equity. Adoption did not have any impact on the Group's financial statements.

Notes to the Financial Statements

continued

1 Accounting policies (continued)

- IFRS 8 *Operating Segments* Replaces IAS 14 and aligns segment reporting with the requirements of the US standard SFAS 131. The new standard requires a 'management approach' under which segment information is presented on the same basis as that used for internal reporting purposes. The adoption of this standard has no impact on disclosures within the Group's financial statements as the Group has only one operating segment and operates only in the United Kingdom.
- IAS 23 (amendment) *Borrowing Costs* Requires an entity to capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. This is not currently relevant to the Group, which has no qualifying assets.
- *Improvements to IFRS* were issued in May 2008 and April 2009 and comprise numerous amendments to IFRS that result in accounting changes for presentation, recognition or measurement purposes as well as terminology or editorial amendments related to a variety of individual standards. Most of the amendments are effective for annual periods beginning on or after 1 January 2009 and 1 January 2010 respectively, with earlier application permitted. No material changes to accounting policies have been made (or, where relevant, are expected) as a result of these amendments.

(ii) Standards, amendments and interpretations to existing standards that become effective in future accounting periods and have not been adopted early by the Group:

- IAS 27 (revised) *Consolidated and Separate Financial Statements* (effective for financial periods beginning on or after 1 July 2009). Introduces significant changes to the accounting for transactions with non-controlling interests (minority interests), the accounting for a loss of control and the presentation of non-controlling interests in consolidated financial statements. The revised standard is not expected to have a significant effect on the Group's financial statements.
- IAS 39 (amendment) *Financial Instruments: Recognition and Measurement* (effective for financial periods beginning on or after 1 July 2009). Adoption is unlikely to have a significant effect on the Group's financial statements.
- IAS 24 (revised) *Related Party Disclosures* (effective for financial periods beginning on or after 1 January 2011, subject to EU endorsement). Revises definition of related parties. Adoption is unlikely to have a significant effect on the Group's financial statements.

(iii) Standards, amendments and interpretations to existing standards that become effective in future accounting periods and are not relevant to the Group's operations:

- IFRS 1 (amendment) *First-time Adoption of International Financial Reporting Standards*
- IFRS 5 (amendment) *Non-current Assets Held for Sale and Discontinued Operations*
- IFRS 9 (new) *Financial Instruments: Classification and Measurement*
- IAS 17 (amendment) *Leases*
- IAS 28 (amendment) *Investments in Associates* (effective for periods beginning on or after 1 July 2009). Consequential amendments arising from revisions to IFRS 3.
- IAS 32 (amendment) *Financial Instruments: Presentation* Amendments relating to the classification of rights issues.
- IFRS 1 (amendments) *Additional Exemptions for First-time Adopters* (effective for periods beginning on or after 1 January 2010)
- IFRS 2 (amendments) *Group Cash-settled Share-based Payment Transactions* (effective for periods beginning on or after 1 January 2010)
- IFRS 3 (revised) *Business Combinations* (effective for periods beginning on or after 1 July 2009).

Notes to the Financial Statements

continued

1 Accounting policies (continued)

(b) Basis of consolidation

The Group financial statements consolidate the financial statements of the Company and of its sole wholly owned subsidiary undertaking, Henderson Smaller Companies Finance Limited. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. The inter-group balances and transactions are eliminated on consolidation. The investment in the subsidiary is recognised at fair value in the financial statements of the Company.

(c) Going concern

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

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

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

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

(e) Presentation of the Statement of Comprehensive Income

In order to better reflect the activities of an investment trust company, and in accordance with guidance issued by the Association of Investment Companies ("the AIC"), supplementary information which analyses the Statement of Comprehensive Income between items of a revenue and capital nature has been presented alongside the Statement of Comprehensive Income. In accordance with the Company's status as a UK investment company under section 833 of the Companies Act 2006, net capital returns may not be distributed by way of dividend. Additionally, the net revenue is the measure the directors believe appropriate in assessing the Group's compliance with certain requirements set out in section 1158 of the Corporation Tax Act 2010 (formerly section 842 of the Income and Corporation Taxes Act 1988).

Notes to the Financial Statements

continued

1 Accounting policies (continued)

(f) Income

Dividends receivable on equity shares are recognised as revenue for the year on an ex-dividend basis. Special dividends are treated as revenue return or as capital return, depending on the facts of each individual case. Income from fixed interest debt securities is recognised using the effective interest rate method. The trading profits of the subsidiary undertaking, which represent realised gains and losses on the sale of current asset investments, are dealt with in the revenue column of the Statement of Comprehensive Income as a revenue item. Bank deposit interest is accounted for on an accruals basis.

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

(g) Expenses

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

Purchase and sale transaction costs for the year ended 31 May 2010 were £145,000 and £64,000 respectively (2009: transaction costs of purchases £126,000; transaction costs of sales £55,000). These comprise mainly stamp duty and commission.

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

(h) Taxation

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

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

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

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

Notes to the Financial Statements

continued

1 Accounting policies (continued)

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

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

(i) Foreign currency

For the purposes of the consolidated financial statements, the results and financial position of each entity is expressed in pounds sterling, which is the functional currency of the Company and of its subsidiary and the presentational currency of the Group. Sterling is the functional currency because it is the currency of the primary economic environment in which the Company and its subsidiary operate.

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

(j) Cash and cash equivalents

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

(k) Borrowings

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

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

(l) Operating segments

The Group has adopted IFRS 8 *Operating Segments* for the first time, replacing the previous reporting under IAS 14 *Segment Reporting*. Under IFRS 8, operating segments are considered to be components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The directors meet regularly to consider investment strategy and to monitor the Company's performance but the Fund Manager, who has been appointed to manage the Company's investments, attends all Board meetings at which investment strategy and performance are discussed.

The directors consider that the Group has one operating segment, being the Parent Company's activity of investing in shares and securities primarily for capital appreciation in accordance with the Company's published investment objective. Its wholly owned subsidiary, Henderson Smaller Companies Finance Limited, exists to trade in securities to enhance the Group's returns but has not entered into any such transactions in recent years. The Group operates within the United Kingdom.

Notes to the Financial Statements

continued

1 Accounting policies (continued)

(m) Dividends payable to shareholders

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

(n) Capital reserves

Capital reserve arising on investments sold

The following are accounted for in this reserve:

– gains and losses on the disposals of investments;

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

– realised foreign exchange differences of a capital nature; and

– costs of repurchasing ordinary share capital.

Capital reserve arising on revaluation of investments held

The following are accounted for in this reserve:

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

– unrealised foreign exchange differences of a capital nature.

2 Investment income

	2010 £'000	2009 £'000
Franked income from companies listed or quoted in the United Kingdom:		
Dividends	**5,761**	5,736
Special dividends	**122**	39
Unfranked income from companies listed or quoted in the United Kingdom:		
Dividends	**44**	365
Property income distributions	**34**	108
Stock dividends	**–**	23
Total investment income	**5,961**	6,271

All investment income for the Group is from UK investments.

3 Other income

	2010 £'000	2009 £'000
Bank interest	**4**	22
Interest on the refund of VAT	**236**	749
Underwriting income (allocated to revenue)*	**387**	176
	627	947

*A further £4,000 (2009: £13,000) of income in respect of shares taken up has been allocated to capital.

Notes to the Financial Statements

continued

4	**Management and performance fees**	**2010 Revenue return £'000**	**2010 Capital return £'000**	**2010 Total £'000**	2009 Revenue return £'000	2009 Capital return £'000	2009 Total £'000
	Management fee	**679**	**–**	**679**	687	–	687
	Write-back of VAT	**(44)**	**–**	**(44)**	(1,150)	–	(1,150)
		635	**–**	**635**	(463)	–	(463)

No performance fee was payable in repsect of the year (2009: none). A summary of the management agreement is given on page 24 in the Directors' Report.

VAT on management fees

In 2004 the Association of Investment Companies (the "AIC"), together with JPMorgan Claverhouse Investment Trust plc, launched a case against HM Revenue & Customs ("HMRC") to challenge whether Value Added Tax ("VAT") should have been charged on fees paid for management services provided to investment trust companies. On 28 June 2007 the European Court of Justice delivered its judgement on the case in favour of the AIC.

Since then HMRC has accepted that the provision of investment management services to investment trust companies is VAT exempt and has acknowledged its liability to pay claims in respect of VAT borne by investment companies in respect of much, but not all, of the period from 1 January 1990 to the point in 2007 from which VAT ceased to be applied to investment management fees. Accordingly, the Manager (Henderson Global Investors Limited) has been able, on behalf of the Company, to reclaim from HMRC the VAT borne, together with simple interest thereon.

An aggregate amount of £2,055,000, in respect of the VAT on investment management fees borne by the Company in the period from October 2000 to September 2007, was written back in the years ended 31 May 2008 and 2009, in accordance with an agreement reached between the Manager and the Company. An aggregate amount of £844,000, in respect of the period from 1 January 1990 to 4 December 1996, was written back in the year ended 31 May 2009 and a further £44,000 has been recognised in the year ended 31 May 2010. These amounts have been received in full by the Company. The write-backs of VAT have been allocated between revenue return and capital return according to the allocation of the amounts originally paid. The £44,000 recognised in the year has been allocated wholly to the revenue return (year ended 31 May 2009: £1,150,000).

The Company has also received from the Manager the interest paid by HMRC on the amounts of VAT recovered. Interest of £749,000 was recognised in the year ended 31 May 2009 and a further £236,000 has been recognised in the year ended 31 May 2010. These amounts are included in other income.

There remain outstanding claims relating to the period 1996 to 2000 and claims for compound interest from 1990 onwards. No amounts have been recognised in respect of these claims as it is uncertain whether any further amounts will be recovered.

Notes to the Financial Statements

continued

5	**Other expenses**	**2010 £'000**	2009 £'000
	Directors' fees (see the directors' remuneration report on pages 26 and 27)	**97**	96
	Remuneration for audit of the parent company and the consolidated financial statements (including £23,000 (2009: £26,000) relating to the parent undertaking and £1,000 (2009: £1,000) to the subsidiary)	**24**	27
	Payable to PricewaterhouseCoopers LLP for tax advisory services relating to a VAT restitution action project	**40**	–
	Other professional fees	**45**	122
	FSA and London Stock Exchange fees	**12**	21
	Registration costs	**13**	11
	Annual and half year reports and shareholder circulars: printing and distribution	**14**	33
	Insurances	**22**	22
	AIC subscriptions	**20**	28
	Custody and other bank charges	**21**	19
	Bank facilities: non-utilisation commissions	**10**	(41)
	Charitable donations	**5**	5
	Other expenses payable to the management company*	**18**	(10)
	Share price listings in newspapers	**8**	9
	Other expenses	**24**	18
		373	360

*Other expenses payable to the management company ("Henderson") relate to the employment of additional marketing staff by Henderson and, formerly, to the marketing and administration of Itshenderson (formerly the Henderson Investment Trust Share Plan).

6	**Finance costs**	**2010 £'000**	2009 £'000
	Bank overdraft and loan interest	**29**	276
	Interest on debentures that are repayable wholly or partly after five years	**2,100**	2,100
		2,129	2,376

Notes to the Financial Statements

continued

7 Taxation

(a) Analysis of charge for the year

	2010 Revenue return £'000	2010 Capital return £'000	2010 Total £'000	2009 Revenue return £'000	2009 Capital return £'000	2009 Total £'000
Overseas tax suffered	**2**	**–**	**2**	9	–	9
Current and total tax charge for the year	**2**	**–**	**2**	9	–	9

(b) Factors affecting the tax charge for the year

UK corporation tax at 28% (2009: 28%)

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

The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 28% (2009: 28%) for the year ended 31 May 2010.

The differences are explained below.

	2010 Revenue return £'000	2010 Capital return £'000	2010 Total £'000	2009 Revenue return £'000	2009 Capital return £'000	2009 Total £'000
Net profit/(loss) on ordinary activities before taxation	**3,451**	**56,091**	**59,542**	4,945	(95,301)	(90,356)
Corporation tax at 28% (2009: 28%)	**967**	**15,705**	**16,672**	1,385	(26,684)	(25,299)
Effects of:						
Non-taxable UK dividends	**(1,647)**	**–**	**(1,647)**	(1,624)	–	(1,624)
Non-taxable overseas dividends	**(28)**	**–**	**(28)**	–	–	–
Income taxable in different years	**17**	**–**	**17**	(17)	–	(17)
Excess management expenses and loan deficits	**691**	**–**	**691**	260	–	260
Overseas withholding tax suffered	**2**	**–**	**2**	9	–	9
Disallowable expenses	**–**	**–**	**–**	(4)	–	(4)
Other capital returns (e.g. investment (gains)/losses)	**–**	**(15,705)**	**(15,705)**	–	26,684	26,684
Tax charge	**2**	**–**	**2**	9	–	9

Notes to the Financial Statements

continued

7 Taxation (continued)

(c) Provision for deferred taxation

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

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

(d) Factors that may affect future tax charges

The Company has not recognised a deferred tax asset of £12,272,000 (2009: £11,573,000) arising as a result of having unutilised management expenses and deficits on loan relationships, and eligible unrelieved foreign tax of £nil (2009: £9,000). These expenses will only be utilised if the tax treatment of the Company's income and capital gains changes or if the Company's investment profile changes.

8 Earnings/(loss) per ordinary share

The earnings/(loss) per ordinary share figure is based on the net gains for the year of £59,540,000 (2009: losses of £90,365,000) and on 75,089,586 (2009: 78,298,336) ordinary shares, being the weighted average number of ordinary shares in issue during the year.

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

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

	2010 £'000	2009 £'000
Net revenue profit	**3,449**	4,936
Net capital earnings/(losses)	**56,091**	(95,301)
Net total earnings/(losses)	**59,540**	(90,365)
Weighted average number of ordinary shares in issue during the year	**75,089,586**	78,298,336

	Pence	Pence
Revenue earnings per ordinary share	**4.59**	6.30
Capital earnings/(losses) per ordinary share	**74.70**	(121.71)
Total earnings/(losses) per ordinary share	**79.29**	(115.41)

Notes to the Financial Statements

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9	Dividends	2010 £'000	2009 £'000
	Amounts recognised as distributions to equity holders in the year:		
	Final dividend for the year ended 31 May 2009 of 3.00p (2008: 2.20p per ordinary share)	**2,252**	1,741
	Special dividend for the year ended 31 May 2009 of 2.60p (2008: 1.60p per ordinary share)	**1,953**	1,266
		4,205	3,007

The final dividend of 3.00p per ordinary share and the special dividend of 2.60p per ordinary share in respect of the year ended 31 May 2009 were paid on 9 October 2009 to shareholders on the register of members at the close of business on 11 September 2009. The dividends paid amounted to £4,205,000 in total.

Subject to approval at the Annual General Meeting, the proposed final dividend of 3.60p per ordinary share will be paid on 8 October 2010 to shareholders on the register of members at the close of business on 17 September 2010.

The proposed final dividend for the year ended 31 May 2010 has not been included as a liability in these financial statements. Under IFRS, the final dividend is not recognised until approved by the shareholders.

The total dividends payable in respect of the financial year which form the basis of the test under section 1158 of the Corporation Tax Act 2010 (formerly section 842 of the Income and Corporation Taxes Act 1988) are set out below:

	2010 £'000
Revenue available for distribution by way of dividends for the year	**3,449**
Proposed final dividend for the year ended 31 May 2010: 3.60p (based on the 74,906,796 shares in issue at 3 August 2010)	**(2,697)**
Undistributed revenue for section 1158 purposes*	**752**

*Undistributed revenue comprises 12.6% of the income from investments of £5,961,000 (see note 2).

10	Investments held at fair value (a) Group	£'000
	Cost at 1 June 2009	**195,646**
	Investment holding losses at 1 June 2009	**(21,414)**
	Valuation at 1 June 2009	**174,232**
	Movements in the year:	
	Acquisitions at cost	**41,534**
	Disposals at cost	**(42,478)**
	Movement in investment holding gains	**54,035**
	Valuation at 31 May 2010	**227,323**
	Cost at 31 May 2010	**194,702**
	Investment holding gains	**32,621**
	Valuation at 31 May 2010	**227,323**

Notes to the Financial Statements

continued

10 Investments held at fair value (continued)

Included in the total investments are (i) unlisted investments that are quoted on the Alternative Investment Market with an aggregate valuation of £20,769,000 (2009: £15,262,000) and (ii) unlisted investments that are unquoted and shown at the directors' fair valuation of £nil (2009: £119,000).

At 31 May 2010 no convertible or fixed interest securities were held in the portfolio (2009: nil).

Analysis of investments at fair value:

	2010 £'000	2009 £'000
Listed:		
United Kingdom	**206,554**	158,851
Unlisted:		
United Kingdom (quoted on the Alternative Investment Market)	**20,769**	15,381
	227,323	174,232

All the investments are listed or quoted in the United Kingdom but a few of the investments are in companies that are incorporated overseas. There were no unquoted investments at 31 May 2010.

Classification under fair value hierarchy:

All the investments are equity investments. Within the fair value hierarchy, all the investments fall within Level 1. There have been no transfers between any of the three levels during the year.

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

Level 1: valued using quoted prices in active markets for identical assets.

Level 2: valued by reference to valuation techniques using observable inputs other than quoted prices.

Level 3: valued by reference to valuation techniques using inputs that are not based on observable market data.

The valuation techniques used by the Company are explained in note 1 (d) on page 37.

Level 3: Reconciliation of Level 3 fair value measurement of financial assets.

	£'000
At 31 May 2009	
Opening fair value	119
Sale proceeds	(119)
Closing fair value at 31 May 2010	–

Notes to the Financial Statements
continued

10 Investments held at fair value (continued)

(b) Company	Portfolio investments £'000	Subsidiary undertaking £'000	Total £'000
Cost at 1 June 2009	195,646	–	**195,646**
Investment holding (losses)/gains at 1 June 2009	(21,414)	2,264	**(19,150)**
Valuation at 1 June 2009	174,232	2,264	**176,496**
Movements in the year:			
Acquisitions at cost	41,534	–	**41,534**
Disposals at cost	(42,478)	–	**(42,478)**
Movement in investment holding gains/(losses)	54,035	(1)	**54,034**
Valuation at 31 May 2010	227,323	2,263	**229,586**
Cost at 31 May 2010	194,702	–	**194,702**
Investment holding gains	32,621	2,263	**34,884**
Valuation at 31 May 2010	227,323	2,263	**229,586**

Included in the total investments are (i) unlisted investments that are quoted on the Alternative Investment Market with an aggregate valuation of £20,769,000 (2009: £15,262,000) and (ii) unlisted investments that are unquoted and shown at the directors' fair valuation of £2,263,000 (2009: £2,383,000).

(c) Total capital gains/(losses) from investments (Group)	2010 £'000	2009 £'000
Gains/(losses) on the sale of investments based on historical cost	**2,056**	(4,286)
Revaluation loss/(gains) recognised in previous years	**4,588**	(11,841)
Gains/(losses) on investments sold in the year based on the carrying value at the previous balance sheet date	**6,644**	(16,127)
Investment holding gains/(losses) at 31 May	**49,447**	(79,174)
	56,091	(95,301)

All capital gains/(losses) are from UK investments.

Notes to the Financial Statements

continued

11 Subsidiary undertaking

The Company has an investment in the entire issued ordinary share capital, fully paid, of £2 in its wholly owned subsidiary undertaking, Henderson Smaller Companies Finance Limited, which is registered in England and Wales and operates in the United Kingdom as an investment dealing company. The investment is stated in the Company's accounts at net asset value, which is considered by the directors to equate to fair value.

The amount due to the subsidiary company at 31 May 2010 amounted to £2,263,000 (2009: £2,264,000). This payable has been eliminated on consolidation.

12 Substantial interests

The Group held interests in 3% or more of any class of share capital in two investee companies (2009: one investee company). These investments are not considered by the directors to be significant in the context of these financial statements.

13 Other receivables

	Group 2010 £'000	Group 2009 £'000	**Company 2010 £'000**	Company 2009 £'000
Securities sold for future settlement	**563**	512	**563**	512
Tax recoverable	**31**	37	**31**	37
Prepayments and accrued income	**828**	1,450	**828**	1,450
Other receivables	**9**	855	**9**	855
	1,431	2,854	**1,431**	2,854

All receivables are due for less than six months, except for withholding tax recoverable of £15,000 (2009: £16,000) which is past due but not impaired.

14 Other payables

	Group 2010 £'000	Group 2009 £'000	**Company 2010 £'000**	Company 2009 £'000
Securities purchased for future settlement	**107**	880	**107**	880
Amounts owed to the subsidiary undertaking	**–**	–	**2,263**	2,265
Accruals and deferred income	**204**	87	**204**	86
	311	967	**2,574**	3,231

15 Non current liabilities

	Group and Company 2010 £'000	Group and Company 2009 £'000
Debenture stock: redemption after more than five years:		
10½ per cent Debenture Stock 2016 (redeemable at par on 31 May 2016)	**20,000**	20,000
Preference stock:		
4,257 preference stock units of £1 each (2009: 4,257)	**4**	4
	20,004	20,004

Notes to the Financial Statements
continued

15 Non current liabilities (continued)

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

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

16 Risk management policies and procedures

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

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

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

(i) Market risk
The fair value of a financial instrument held by the Company may fluctuate due to changes in market prices. This market risk comprises market price risk (see note 16 (ii)), currency risk (see note 16 (iii)) and interest rate risk (see note 16 (iv)). The Board reviews and agrees policies for managing these risks. The Manager assesses the exposure to market risk when making each investment decision and monitors the overall level of market risk on the whole of the investment portfolio on an ongoing basis.

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

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

Notes to the Financial Statements

continued

16 Risk management policies and procedures (continued)

The Company's exposure to changes in market prices at 31 May 2010 on its equity investments was £227,323,000 (2009: £174,232,000).

Concentration of exposure to market price risk

An analysis of the Company's investments is shown on pages 9 to 11 and a sector analysis is set out on page 4. At 31 May 2010 all the investments were in companies listed or quoted in London, most of them being companies established in and operating from the United Kingdom. Accordingly, there is a concentration of exposure to the UK, although it is recognised that an investment's country of domicile or of listing does not necessarily equate to its exposure to the economic conditions in that country.

Market price risk sensitivity

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

The impact of a 25% increase in the value of the investments on the revenue return as at 31 May 2010 is a decrease of £199,000 (2009: £152,000) and on the capital return is an increase of £56,831,000 (2009: £43,558,000). Accordingly, the total impact is an increase of £56,632,000 (2009: £43,406,000).

The impact of a 25% decrease in the value of the investments on the revenue return as at 31 May 2010 is an increase of £199,000 (2009: £152,000) and on the capital return is a decrease of £56,831,000 (2009: £43,558,000). Accordingly, the total impact is a decrease of £56,632,000 (2009: £43,406,000).

(iii) Currency risk

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

As at 31 May 2010, the Company did not hold any non-sterling denominated investments (2009: nil).

(iv) Interest rate risk

Interest rate movements may affect:

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

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

Management of the risk

The possible effects on the fair value of the investments that could arise as a result of changes in interest rates are taken into account when making investment decisions and borrowing decisions. The Company rarely holds significant cash balances but finances part of its investment activity through borrowings at levels approved and monitored by the Board. The debenture stock provides long term finance at a fixed rate of interest; it was issued in 1987 to enable the Company to benefit from long term planned gearing. In addition, the Company makes use of short term borrowings. The Company has a committed bank borrowing facility for a total of £5 million; borrowings are drawn down for short periods at rates of interest that are determined by reference to the market rates applicable at the time of borrowing.

Notes to the Financial Statements

continued

16 Risk management policies and procedures (continued)

Interest rate exposure

The Company's financial liabilities at 31 May 2010 that give exposure to fixed interest rate risk are set out in note 15.

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

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

Interest rate sensitivity

The Company is not materially exposed to changes in interest rates. The Company's bank facility allows borrowings to a maximum of £5 million; the interest payable on the Company's £20 million issue of debenture stock is fixed at 10.5%.

(v) Liquidity risk

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

Management of the risk

Liquidity risk is not significant as the majority of the Company's assets are investments in quoted equity securities that are readily realisable. The Company has borrowed £20 million by its issue in 1987 of £20 million 10½ per cent Debenture Stock 2016. The Company is able to draw short term borrowings of up to £5 million from its committed borrowing facility of £5 million (formerly £15 million) with ING Bank N.V., London Branch (expiring on 21 May 2011). There were borrowings of £2,003,000 drawn down under the facility at 31 May 2010 (2009: £nil). In addition, the Company has an uncommitted overdraft facility with its custodian, the extent of which is determined by the custodian on a regular basis by reference to the value of the securities held by it on behalf of the Company; there were no borrowings under the overdraft facility at 31 May 2010 (2009: nil).

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

Liquidity risk exposure

The remaining contractual maturities of the financial liabilities at 31 May 2010, based on the earliest date on which payment can be required, was as follows:

	2010 Due within 1 year £'000	**2010 Due between 1 and 5 years £'000**	**2010 Due after more than 5 years £'000**	2009 Due within 1 year £'000	2009 Due between 1 and 5 years £'000	2009 Due after more than 5 years £'000
Debenture stock*	**2,100**	**8,400**	**22,100**	2,100	8,400	24,200
Preference stock*	**–**	**–**	**–**	–	–	–
Bank loans and interest	**2,005**	**–**	**–**	–	–	–
Other payables and accruals	**311**	**–**	**–**	967	–	–
	4,416	**8,400**	**22,100**	3,067	8,400	24,200

*See also note 15 on pages 48 and 49. The Company has in issue preference stock without a set redemption date with a total par value of £4,000 (2009: £4,000) which has a negligible ongoing finance cost. The bank loans in place at 31 May 2010 were due to be repaid on or before 23 July 2010, together with interest.

Notes to the Financial Statements

continued

16 Risk management policies and procedures (continued)

(vi) Credit risk

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

Management of the risk

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

– investment transactions are carried out with a large number of brokers, whose credit standard is reviewed regularly by the Manager, and limits are set on the amount that may be due from any one broker;

– cash at bank is held only with reputable banks with high quality external credit ratings.

In summary, the exposure to credit risk at 31 May 2010 was to cash and cash equivalents of £1,097,000 (2009: £234,000) and to other receivables of £1,431,000 (2009: £2,854,000) (see note 13).

(vii) Fair values of financial assets and financial liabilities

The investments are held at fair value through profit or loss. All the net current liabilities are held in the balance sheet at a reasonable approximation of fair value. At 31 May 2010 the fair value of the debenture stock was £25,494,000 (2009: £24,000,000). The debenture stock is carried in the balance sheet at par.

(viii) Capital management policies and procedures

The Company's capital management objectives are:

– to ensure that it will be able to continue as a going concern; and

– to secure long term capital growth for the shareholders by investment in quoted securities in the UK.

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

The Company's total capital at 31 May 2010 was £229,540,000 (2009: £176,353,000) comprising £2,003,000 (2009: £nil) of unsecured bank loans, £20,000,000 (2009: £20,000,000) of debenture stock, £4,000 (2009: £4,000) of preference stock and £207,533,000 (2009: £156,349,000) of equity share capital and reserves.

The Company has a three year revolving credit facility of £5 million ("the Facility") with ING Bank N.V., London Branch. The Facility expires in May 2011 and the Company had drawn down £2,003,000 under this facility as at 31 May 2010. The Company was fully compliant with the terms of the Facility for the period from 1 June 2009 to the date of this Annual Report.

17 Called up share capital

	2010 £'000	2009 £'000
Authorised:		
188,000,000 ordinary shares of 25p each (2009: 188,000,000)	**47,000**	47,000
Allotted, issued and fully paid:		
74,906,796 ordinary shares of 25p each (2009: 77,370,296)	**18,727**	19,343

During the year the Company made market purchases for cancellation of 2,463,500 of its own issued ordinary shares (2009: 3,078,734) at a total cost of £4,151,000 (2009: £5,750,000). No shares have been bought back since 31 May 2010. Details of these purchases are given on page 21 in the Directors' Report.

Notes to the Financial Statements

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18 Capital redemption reserve and capital reserves

(a) Group	Capital redemption reserve £'000	Capital reserve arising on revaluation of investments held £'000	Capital reserve arising on investments sold £'000	Capital reserves £'000
At 1 June 2009	26,078	(21,414)	121,344	99,930
Transfer on disposal of investments (see note 10 (c))	–	4,588	(4,588)	–
Net capital gains for the year	–	49,447	6,644	56,091
Buy-backs of ordinary shares	616	–	(4,151)	(4,151)
At 31 May 2010	**26,694**	**32,621**	**119,249**	**151,870**

Investment holding gains at 31 May 2010 include £1,928,000 in respect of unlisted investments (2009: losses of £5,525,000).

(b) Company	Capital redemption reserve £'000	Capital reserve arising on revaluation of investments held £'000	Capital reserve arising on investments sold £'000	Capital reserves £'000
At 1 June 2009	26,078	(19,150)	121,344	102,194
Transfer on disposal of investments (see note 10 (c))	–	4,588	(4,588)	–
Net capital gains for the year	–	49,446	6,644	56,090
Buy-backs of ordinary shares	616	–	(4,151)	(4,151)
At 31 May 2010	**26,694**	**34,884**	**119,249**	**154,133**

19 Retained earnings – revenue reserve

	Group £'000	Company £'000
At 1 June 2009	10,998	8,734
Ordinary dividends paid	(4,205)	(4,205)
Revenue profit for the year	3,449	3,450
At 31 May 2010	**10,242**	**7,979**

As permitted by the Companies Act 2006, the Company has not presented its own Statement of Comprehensive Income. The net profit after taxation of the Company amounted to £59,540,000 (2009: loss of £90,365,000).

Notes to the Financial Statements

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20 Net asset value per ordinary share (Group and Company)

The net asset value per ordinary share is based on the net assets attributable to the ordinary shares of £207,533,000 (2009: £156,349,000) and on the 74,906,796 ordinary shares in issue at 31 May 2010 (2009: 77,370,296).

An alternative net asset value per ordinary share can be calculated by deducting from the total assets less current liabilities of the Group the preference stock and the debenture stock at their market (or fair) values rather than at their par (or book) values (see note 16 (vii) on page 52). The net asset value per ordinary share at 31 May 2010 calculated on this basis was 269.7p (2009: 196.9p).

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

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

	£'000
Net assets attributable to the ordinary shares at 1 June 2009	156,349
Net profit for the year	59,540
Ordinary dividends paid in the year	(4,205)
Repurchase of 2,463,500 ordinary shares	(4,151)
Net assets attributable to the ordinary shares at 31 May 2010	**207,533**

21 Capital commitments and contingent liabilities

Capital commitments

There were no capital commitments as at 31 May 2010 (2009: £nil).

Contingent liabilities

There were no contingent liabilities in respect of sub-underwriting commitments as at 31 May 2010 (2009: £2,819,000).

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continued

22 Related party transactions

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

Details of the fee arrangements for these services are given on page 24 in the Directors' Report. The management fees payable to Henderson under this agreement in respect of the year ended 31 May 2010 were £679,000 (2009: £687,000) of which £123,000 was accrued at 31 May 2010 (2009: prepaid £49,000). VAT is no longer payable on management (including performance) fees.

No performance fee was payable to Henderson in respect of the year ended 31 May 2010 (2009: £nil).

In addition to the above services, Henderson has provided the Company with marketing services. The total fees paid or payable for these services for the year ended 31 May 2010 amounted to £15,000 (excluding VAT) (2009: a writeback of £10,000), of which £3,000 was outstanding at 31 May 2010 (2009: £3,000).

The compensation payable to key management personnel in respect of short term employment benefits was £96,874 (2009: £95,614). In practice this disclosure relates wholly to the fees of £96,874 payable to the directors in respect of the year (2009: £95,614); the directors are all non-executive and receive no other compensation. The Directors' Remuneration Report on pages 26 and 27 provides details. The Company has no employees.

General Shareholder Information

Release of results
Half year results are announced in January. Full year results are announced in late July or early August.

AGM
The annual general meeting is held in London in late September or early October.

Dates of dividend and interest payments
Ordinary shares: final dividend announced in late July or early August and paid in October.

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

Final dividend warrants and tax vouchers
Dividend warrants and tax vouchers for the 2010 final dividend will be posted on 6 October 2010 to shareholders on the register on 17 September 2010. The dividend will be paid on 8 October 2010, subject to approval at the AGM.

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

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

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

SEDOL number
The SEDOL (London Stock Exchange Daily Official List) number of the Company's shares is 0906506. The mnemonic is HSL.

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

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

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

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

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

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

Directors and other Information

Directors

J D Fishburn *(Chairman)*
S M Davis *(Chairman of the Audit Committee)**
J J Nelson *(Senior Independent Director)*
K E Percy
M A Sieghart
B Hollond

*Mrs Davis will retire from the Board on 24 September 2010, from which date Mrs Hollond will chair the Audit Committee.

Manager

Henderson Global Investors Limited,
represented by N M Hermon

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

Company Secretary

Henderson Secretarial Services Limited,
represented by G S Rice ACIS

Registered Office

201 Bishopsgate
London EC2M 3AE
Telephone: 020 7818 1818

Registered Number

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

Registrar

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
Telephone: 0870 703 0194

Custodian

JPMorgan Chase Bank, N.A.
125 London Wall
London EC2Y 5AJ

Independent Auditors

PricewaterhouseCoopers LLP
Hay's Galleria
1 Hay's Lane
London SE1 2RD

Solicitors

Slaughter and May
One Bunhill Row
London EC1Y 8YY

Broker

Collins Stewart Europe Limited
9th Floor
88 Wood Street
London EC2V 7QR

Share Identification Codes

SEDOL: 0906506
ISIN: GB0009065060
EPIC: HSL

aic
The Association of Investment Companies

London Stock Exchange
LISTED
PREMIUM

The Henderson Smaller Companies Investment Trust plc is managed by

Henderson
GLOBAL INVESTORS

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