

# Aberdeen UK Tracker Trust

Low-cost exposure to the UK market

Aberdeen UK Tracker Trust (AUKT) is unique among investment trusts in tracking the FTSE All-Share index. It seeks to match index performance closely in both capital and income terms, through maintaining low costs and efficient trading. It provides more efficient exposure to the UK market than a FTSE 100 or FTSE 250 tracker as it is not required to buy and sell entire holdings as stocks move between indices, and also does not have to manage fund inflows and outflows that can affect the performance of open-ended funds. Gearing is not employed and the manager aims to maintain tracking error at around 3bps. AUKT's ongoing charge of 0.3% is competitive and the 6% discount to NAV provides a slight yield uplift.

12 months ending	Total share price return (%)	Total NAV return (%)	FTSE All Share index (%)	FTSE 350 (incl. ITs) (%)	FTSE World Index (%)
30/06/12	(2.7)	(4.0)	(3.1)	(3.0)	(3.5)
30/06/13	19.4	17.2	17.9	17.6	22.1
30/06/14	14.0	12.5	13.1	13.0	10.0
30/06/15	2.8	2.3	2.6	2.4	9.9

Note: 12-month rolling discrete total return performance.

## Investment strategy: Tracking the FTSE All-Share

AUKT aims to closely match the FTSE All-Share index return in both capital and income terms. It employs full physical replication for FTSE 350 shares which represent c 96% of the All-Share index market capitalisation. The majority of FTSE SmallCap stocks are also held excluding c 50 of the smallest illiquid stocks. Trading takes place when index changes occur, generally at the quarterly rebalancing when brokers can offer favourable commission rates due to the large volume of shares traded. Previously holding dividend income as cash, with effect from 1 July 2015, the manager will make use of FTSE 100 and FTSE 250 futures to equitize the dividend stream and more closely match the index total return.

## Market outlook: Scope for UK outperformance

Despite recent downward revisions to GDP forecasts, the UK economy is expected to be one of the strongest among advanced economies. While UK growth is expected to slow in 2016, the growth of UK-listed companies' overseas earnings should be helped by the acceleration of global GDP growth in 2016, forecast by the IMF. The slower progression of the UK market compared with global markets over the last 12 months has seen its forward P/E multiple premium substantially disappear, while its 3.5% dividend yield is considerably higher than average across other global markets. Together with a favourable corporate earnings outlook, this suggests scope for the UK stock market to recoup some of its recent underperformance in the near to medium term.

## Valuation: Narrowing discount

AUKT's share price discount to NAV including income has followed a modestly narrowing trend over the last three years, averaging 5.6%. Although the discount has narrowed to 5.9% from a 12-month high of 7.6%, it is still wider than its 12-month low of 2.9%, suggesting scope for further narrowing.

## Investment trusts

31 July 2015

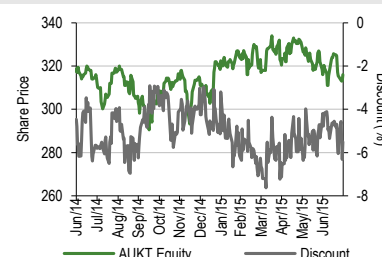
**Price** 316p  
**Market cap** £319.2m  
**AUM** £332.8m

NAV\* 329.3p  
Discount to NAV 4.0%  
NAV\*\* 336.0p  
Discount to NAV 5.9%

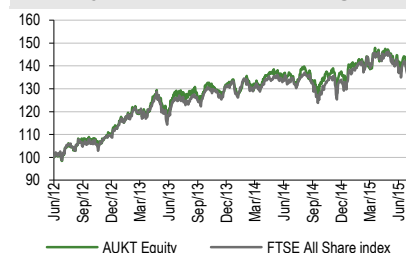
\*Excluding income. \*\*Including income.

Yield 3.5%  
Ordinary shares in issue 101.0m  
Code AUKT  
Primary exchange LSE  
AIC sector UK All Companies

## Share price/discount performance



## Three-year cumulative perf. graph



52-week high/low 334.0p 290.5p  
NAV\*\* high/low 352.2p 303.0p

\*\*Including income.

## Gearing

Gross\* 0.0%  
Net cash\* 2.0%

\*As at 30 June 2015.

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**Exhibit 1: Trust at a glance**
**Investment objective and fund background**

AUKT invests in a portfolio designed to closely track the FTSE All-Share index, in terms of both capital and income, fully replicating the FTSE 350 index and holding the majority of the constituents of the FTSE SmallCap index.

**Recent developments**

- 29 July 2015: interim results to 30 June 2015. NAV total return +2.9% vs FTSE All-Share index +3.0%. 6.40p interim dividend vs 5.70p for H114.
- 17 June 2015: management fees reduced to 0.20% up to £100m of total assets and 0.09% above £100m.
- 12 March 2015: FY14 results. NAV total return +0.9% vs FTSE All-Share index +1.2%. 4.50p final dividend; FY14 dividend 10.20p vs 10.30p for FY13.

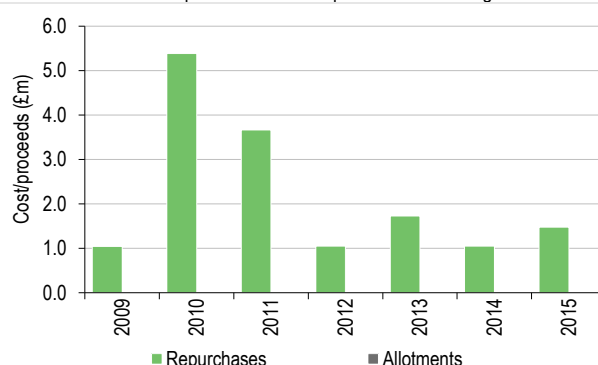
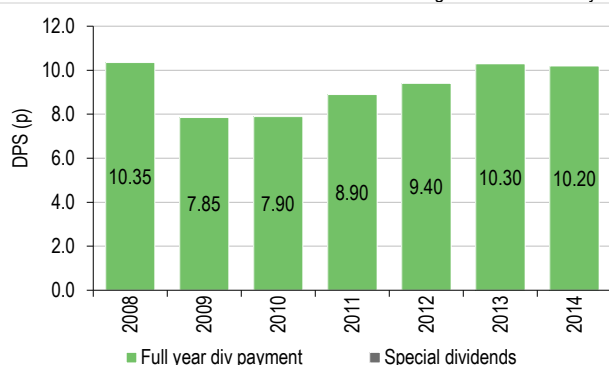
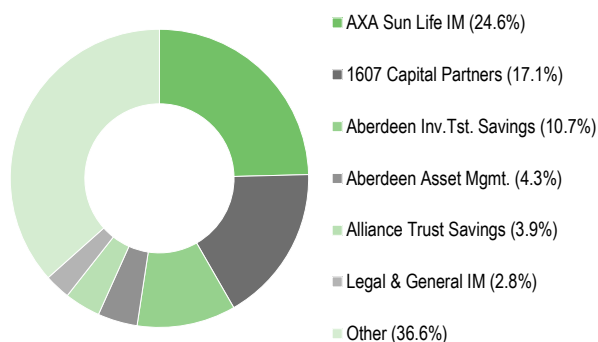
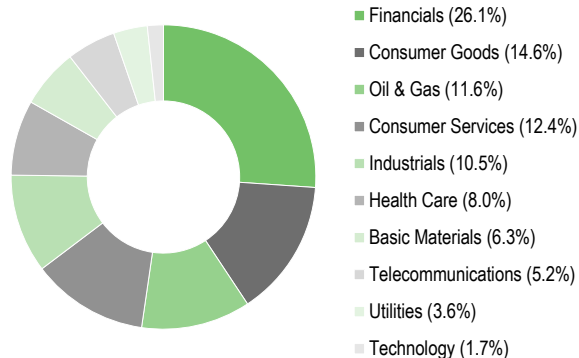
Forthcoming		Capital structure		Fund details	
AGM	April 2016	Ongoing charges	0.32%	Group	Aberdeen Asset Management
Preliminary results	March 2016	Net cash	2.0%	Manager	David Jones
Year end	31 December	Annual mgmt fee	Tiered, 0.09-0.20% of NAV	Address	Bow Bells House, 1 Bread Street, London, EC4M 9HH
Dividend paid	May, August	Performance fee	None	Phone	0500 00 00 40
Launch date	July 1990	Trust life	Indefinite	Website	<a href="http://www.aberdeenuktracker.co.uk">www.aberdeenuktracker.co.uk</a>
Continuation vote	Annual, next in April 2016	Loan facilities	None		

**Dividend policy and history**

Dividends are paid twice per year with all revenue earnings paid out. Interim and final dividends were rebalanced in 2014 to reflect earnings flow in each half year.

**Share buyback policy and history**

AUKT has annually renewed authority to buy back up to 14.99% and allot up to 10% of issued share capital. Shares are repurchased to manage the discount.


**Shareholder base (as at 6 July 2015)**

**Portfolio distribution (as at 30 June 2015)**

**Top 10 holdings (as at 30 June 2015)**

Company	Sector	Industry	Portfolio weight %	
			30 June 2015	30 June 2014
HSBC	Financials	Banks	5.3	5.4
BP	Oil & Gas	Oil & Gas Producers	3.7	4.6
Royal Dutch Shell 'A'	Oil & Gas	Oil & Gas Producers	3.3	4.6
GlaxoSmithKline	Health Care	Pharmaceuticals & Biotech.	3.1	3.7
British American Tobacco	Consumer Goods	Tobacco	3.0	3.2
Vodafone	Telecom Services	Mobile Telecoms	2.9	2.5
AstraZeneca	Health Care	Pharmaceuticals & Biotech.	2.4	2.6
Lloyds Banking Group	Financials	Banks	2.3	1.9
Diageo	Consumer Goods	Beverages	2.2	2.3
Royal Dutch Shell 'B'	Oil & Gas	Oil & Gas Producers	2.1	3.0
<b>Top 10</b>			<b>30.3</b>	<b>33.8</b>

Source: Aberdeen UK Tracker Trust, Edison Investment Research.

## Why consider an index tracking fund?

We discuss in more detail in our initiation note of 12 September 2014 ([Low-cost UK exposure with a slight discount](#)) the reasons investors may want to consider an index tracking fund. The key features of a tracker fund are performance that closely matches its benchmark index and a low cost structure. The theory behind index fund investing as a strategy is that investing in a particular market is a zero-sum game as for every investment that outperforms the index, there has to be another that underperforms. The effect of costs means that over half of investments underperform and gives low-cost funds such as index trackers a greater probability of outperforming. Supporting the zero-sum argument, a recent study published by Vanguard shows that for global equities over a 15-year timeframe, 64% of funds underperformed the benchmark and including funds that closed or merged, would take that figure to 82%.

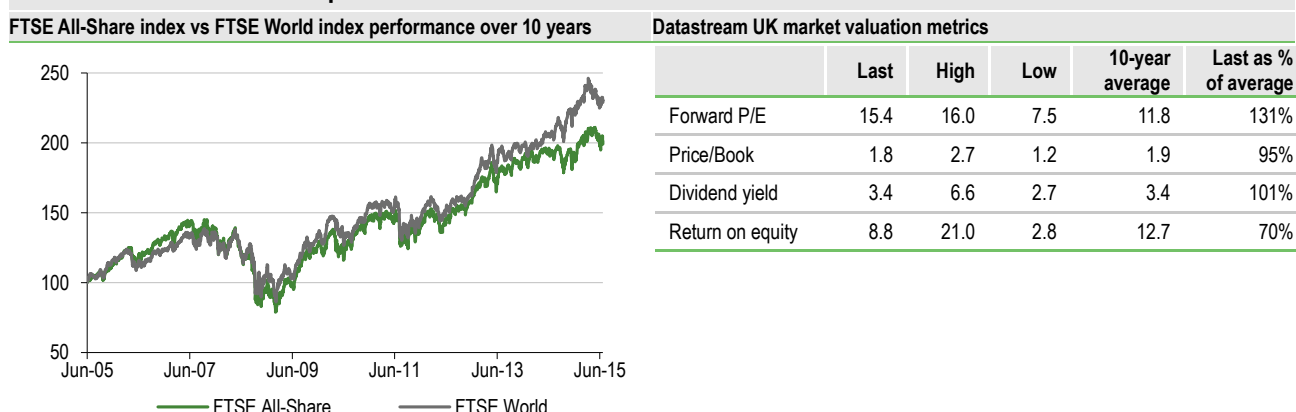
## Market outlook: Scope for UK outperformance

As illustrated in Exhibit 2, the UK stock market has delivered a strong performance since the 2008 global financial crisis. Performance has been similar to the world market for nine of the last 10 years while lagging over one year largely due to above-average exposure to oil & gas and mining stocks. While the market has run ahead of earnings growth, pushing the forward P/E multiple close to a 10-year high, other valuation metrics appear less demanding. The price to book multiple is modestly below its 10-year average and the dividend yield is slightly ahead of its 10-year average.

Although there have been recent downward revisions to UK GDP growth forecasts,<sup>1</sup> UK economic growth is expected to be among the strongest of the advanced economies. While UK growth is expected to slow in 2016, with UK-listed companies generating a significant proportion of revenues overseas, corporate earnings growth should be helped by the acceleration of global GDP growth from 3.3% in 2015 to 3.8% in 2016 (predicted by the IMF).

The slower progression of the UK market compared with world markets over the last 12 months has brought its forward P/E multiple to a similar level to the world market's 15.2x while its 3.4% dividend yield is substantially higher than the world market's 2.4% yield. Together with a relatively favourable corporate earnings outlook, this suggests scope for the UK stock market to regain some of the ground lost to other world markets.

**Exhibit 2: UK stock market performance and valuation metrics**



Source: Thomson Datastream, Edison Investment Research

<sup>1</sup> For example, the IMF's July 2015 projections for 2015 and 2016 were reduced by 0.3% and 0.1% to 2.4% and 2.2% respectively.

## Fund profile: FTSE All-Share index tracker

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Launched in 1990 as the Malvern UK Index Trust and renamed Edinburgh UK Tracker Trust in 1997, the trust became Aberdeen UK Tracker Trust in April 2013, having been part of the Aberdeen Asset Management stable since AAM's acquisition of Edinburgh Fund Managers in 2003. The trust became the only investment trust tracking the FTSE All-Share Index through its merger with Tribune UK Tracker Trust in 2007. (Since the Edinburgh US Tracker Trust became the North American Income Trust in 2012, AUKT is the only investment trust tracking any index.)

The trust is managed with the objective of closely tracking the capital and income performance of the FTSE All-Share index. It is run by David Jones of Aberdeen's Quantitative Investments department, formed through the acquisition of Scottish Widows Investment Partnership, which saw AAM's £7.5bn of tracker fund assets rise to £30bn (plus £33bn in other quantitative strategies). Around two-thirds of AAM's index-tracking assets are invested in the UK, mostly in segregated mandates tracking various FTSE UK indices.

## The fund manager: David Jones

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### The manager's view: Targeting low costs and efficient trading

While increased market volatility is an issue for many active managers, David Jones is more concerned with the increased level of corporate activity introducing greater trading costs over the last 12 months with eight companies (including seven IPOs) entering the FTSE 350 index at the June 2015 rebalancing and the FTSE All-Share index experiencing 1.6% turnover. Most of AUKT's trading is undertaken at the quarterly index rebalancing dates when large volumes of shares are traded and brokers can offer favourable commission rates. However, Jones has to manage events such as BHP Billiton's spin-out of South32 which required selling the Australian-listed shares at the same level as they exited the UK index so that AUKT did not suffer any effect on performance.

Although Jones sets a minimum trade size of £20,000 when rebalancing the portfolio, which leads to holdings in smaller stocks diverging from the index, he is focused on maintaining tracking error at around three basis points and would review AUKT's small cap holdings if tracking error approached five basis points. Although June represents the major annual rebalancing of the FTSE All-Share index, Jones highlights that AUKT only made 27 buy trades matched with 45 sell trades and two-way portfolio turnover was 1.6%.

Jones sees low costs and efficient trading as key to holding performance close to the index with the equitization of dividend flows enabling closer matching of total returns. While acknowledging that a modest level of gearing could act to offset the effect of costs on returns, he believes the benefit is outweighed by the risk of compounding short-term underperformance in periods of index decline.

## Asset allocation

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### Investment process: Physical replication of the index

AUKT employs a process of physical replication, buying shares directly in the FTSE All-Share index constituents rather than gaining exposure synthetically through the use of derivatives. This avoids exposure to counterparty risk. FTSE 350 stocks (representing 96.3% of the FTSE All-Share index at end June 2015) are fully replicated, with portfolio exposures maintained in line with index weightings. The trust's FTSE SmallCap holdings account for the majority of the index's market capitalisation, although c 50 of the smallest stocks are not held due to liquidity constraints, leaving AUKT holding 591 of the 647 constituents of the FTSE All-Share index at end June 2015.

Additions or deletions from the portfolio largely depend on new issue inclusions at the quarterly index rebalancing, and any corporate actions (such as takeovers) leading to stocks leaving the index. Trading takes place when index changes occur which is generally at the quarterly rebalancing. Trades are timed to minimise transaction costs, which in practice tends to mean trading as close as possible to the effective date for index changes, when brokers offer lower commissions because they are transacting larger volumes of business.

AUKT's objective is to match the FTSE All-Share Index return as closely as possible in both capital and income terms. Previously investing dividend income in liquidity funds in the period between receipt and AUKT's own half-yearly dividend payments, with effect from 1 July 2015, the manager will make use of FTSE 100 and FTSE 250 futures to equitize the dividend stream which should result in AUKT's total return performance more closely matching the index.

## Current portfolio positioning

As at 30 June 2015, AUKT held 591 stocks in the portfolio compared with 647 stocks in the FTSE All-Share index. The top 10 holdings (Exhibit 1) were similar to a year earlier, with Lloyds Banking Group replacing BG, although they represented a smaller 30.3% of the portfolio compared with 33.8%, largely a reflection of the weak performance of BP and Royal Dutch Shell 'A' and 'B' shares.

As shown in Exhibit 3, the portfolio distribution by sector, closely matches the index reflecting the strategy of fully replicating the constituents of the FTSE 350 and holding the majority of the FTSE SmallCap stocks. The greatest divergence is the slight underweight in the financials sector, a result of AUKT not holding many of the small, illiquid investment trusts as well as its own shares. The most significant decreases from a year earlier were in oil & gas and basic materials reflecting the weaker performance of these sectors related to the sharp fall in the oil price and weakening prices for many other commodities. The greatest increases were in financials and consumer services.

<b>Exhibit 3: Portfolio and index distribution by sector</b>						
% unless stated	End June 2015	End June 2014	Change	FTSE All-share index weight	FTSE 100 index weight	All-share weight vs FTSE 100
Financials	26.1	23.9	2.2	26.4	23.4	3.0
Consumer Goods	14.6	14.1	0.5	14.7	16.9	(2.3)
Consumer Services	12.4	10.5	1.9	12.2	10.8	1.5
Oil & Gas	11.6	15.6	(4.0)	11.6	13.6	(2.0)
Industrials	10.5	10.0	0.5	10.3	7.3	3.1
Health Care	8.0	8.5	(0.5)	8.1	9.4	(1.3)
Basic Materials	6.3	7.9	(1.6)	6.3	7.0	(0.7)
Telecommunications	5.2	4.3	0.9	5.2	6.2	(1.0)
Utilities	3.6	3.8	(0.2)	3.6	4.2	(0.6)
Technology	1.7	1.4	0.3	1.6	1.2	0.4
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>	<b>100.0</b>	

Source: Aberdeen UK Tracker Trust, Edison Investment Research.

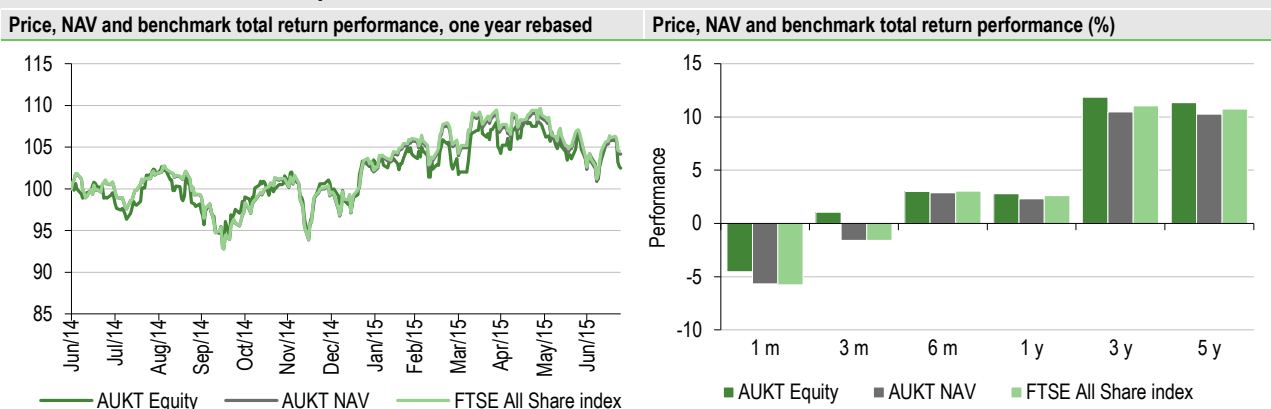
As well as broader market-cap exposure, the FTSE All-Share index provides a differentiated sector exposure to the FTSE 100 index, with notably greater weightings in financials (lower exposure to banks is offset by the large number of smaller financial services companies) and industrials and lower weightings in consumer goods and oil & gas.

## Performance: Succeeding in closely tracking the index

As shown in Exhibit 5, AUKT's NAV total return performance has closely matched the FTSE All-Share index over one, three and five years. The slight underperformance reflects the costs incurred in running the fund, as well as the modest performance dilution which is a consequence of AUKT holding income received as cash until its half-yearly dividend payments. Although cash has been invested in money market funds, low current rates mean that returns on cash typically have fallen short of index returns, which acted as a drag on performance. The equitisation of the dividend

stream through investing in index futures from July 2015 should lead to the index total return being more closely matched. The rebalancing of AUKT's interim and final dividends in 2014 to match the flow of income has led to cash being held for shorter periods, thus reducing performance dilution.

**Exhibit 4: Investment trust performance to 30 June 2015**



Source: Thomson Datastream, Edison Investment Research. Note: Three and five-year performance figures annualised.

**Exhibit 5: Share price and NAV total return performance, versus indices (percentage points)**

	One month	Three months	Six months	One year	Three years	Five years
Price relative to FTSE All Share index	1.3	2.7	(0.0)	0.2	2.2	2.8
NAV relative to FTSE All Share index	0.1	(0.0)	(0.1)	(0.3)	(1.5)	(2.2)
Price relative to FTSE 350 (inc ITs)	1.4	2.8	0.2	0.4	2.8	3.3
NAV relative to FTSE 350 (inc ITs)	0.2	0.1	0.0	(0.1)	(0.9)	(1.7)
Price relative to FTSE World index	0.6	6.5	1.1	(6.4)	(5.2)	(1.8)
NAV relative to FTSE World index	(0.5)	3.8	0.9	(6.9)	(8.6)	(6.6)

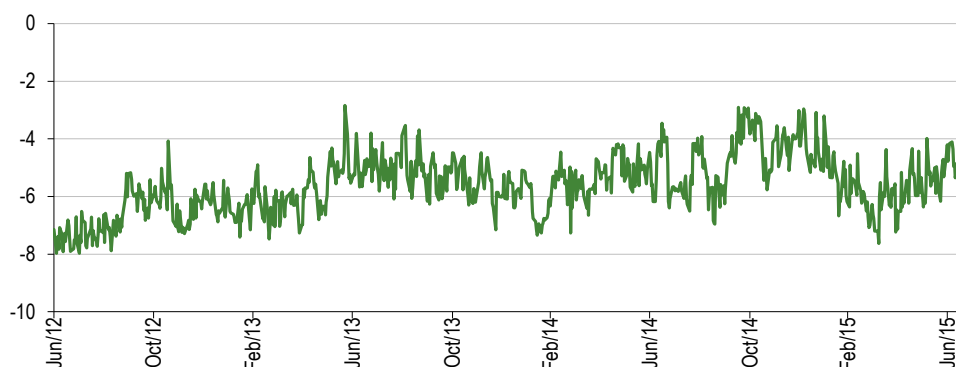
Source: Thomson Datastream, Edison Investment Research. Note: Data to end-June 2015. Geometric calculation.

## Discount: Recent narrowing

AUKT has an annual continuation vote which acts as the primary discount control mechanism. In addition, the board closely monitors the level of the share price relative to NAV. In the final quarter of 2014, an online promotional campaign was undertaken to encourage retail investor interest. Share buy backs are also used in an attempt to narrow the discount and limit share price volatility.

As illustrated in Exhibit 6, AUKT's share price discount to NAV including income has followed a modestly narrowing trend over the last three years with one and three-year average discounts of 5.1% and 5.6% respectively. Although the discount has narrowed from its 12-month high of 7.6% in April 2015 to 5.9% currently, its 12-month low of 2.9% suggests scope for further narrowing.

**Exhibit 6: Share price discount to NAV (including income) over three years (%)**



Source: Thomson Datastream, Edison Investment Research.



## Capital structure and fees

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AUKT has 101.0m shares in issue and holds 2.0m shares in treasury, having repurchased 0.5m shares in H115. The trust has annually renewed authority to repurchase up to 14.99% and allot up to 10% of its issued share capital. Repurchased shares may be either cancelled or held in treasury. AUKT's policy is not to employ gearing and at end June 2015 it held net cash of 2.0%.

In June 2015, AUKT announced it has reduced its management fees to 0.20% pa of total assets less current liabilities up to £100m and 0.09% in excess of £100m. Management fees were previously 0.25% pa up to £100m, 0.10% pa from £100m up to £250m and 0.09% in excess of £250m. Ongoing charges increased from 0.30% in 2013 to 0.32% in 2014, primarily due to additional compliance costs associated with the requirement to appoint a depositary, and the management fee reduction is expected to offset this increase.

## Dividend policy

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AUKT pays interim and final dividends for each financial year in August and May respectively. Dividends are declared which reflect the full income received from the constituents of the index, less the expenses of running the trust. From 2014, the interim and final dividends were rebalanced to reflect the flow of earnings in each half year, resulting in the interim dividend being higher than the final dividend. For 2014, interim and final dividends of 5.70p and 4.50p were paid with the total 10.20p dividend for the year being marginally lower than the 10.30p paid for 2013. For 2015, an interim dividend of 6.40p has been declared.

Dividend growth for the FTSE All-Share index in 2014 was held back by the weakening of the US dollar in late 2013 and early 2014 and index constituents having a significant proportion of US dollar-based revenues. With the US dollar strengthening against sterling in the second half of 2014, the index has seen a return of dividend growth in the first half of 2015. AUKT's current yield of 3.2% reflects the index yield of 3.4% and the trust's 0.32% ongoing charge, while the discount of the shares to NAV provides a slight yield uplift.

## Peer group comparison

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Exhibit 7 shows a comparison of AUKT with a peer group comprising the constituents of the AIC UK All Companies sector investing principally in equities and using the FTSE All-Share as a benchmark or reference index (eight out of 16 trusts), and a second peer group of open-ended FTSE All-Share index tracker funds larger than £300m. AUKT is the only index tracker as well as being the only fund not employing gearing in the closed-ended peer group, making comparison less relevant. AUKT's NAV total return has underperformed the closed-ended peer group average over one, three, five and 10 years. In terms of risk-adjusted performance, AUKT's Sharpe ratios over one and three years are lower than the peer group average reflecting the trust's weaker performance over these timeframes. AUKT has the lowest ongoing charge in the closed-ended peer group and one of the highest dividend yields.

In comparison with the open-ended index tracker peer group, AUKT's performance is at the lower end of the range over one year while it has outperformed the average over three, five and 10 years. The range of returns for the open-ended peers over each time period is likely to be a reflection of the effect on performance of fund inflows and outflows, which is not an issue for AUKT due to its closed-ended structure. It is also noticeable that funds with higher fees have tended to underperform and AUKT's ongoing charge sits towards the lower end of the range for the open-ended peer group.

**Exhibit 7: UK All Companies investment trusts and FTSE All-Share index trackers as at 24 July 2015**

% unless stated	Market cap/fund size £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	NAV TR 10 Year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex-par)	Ongoing charge	Perf fee	Net gearing	Dividend yield (%)
<b>UK All Companies closed-ended funds</b>												
Aberdeen UK Tracker	318.2	1.9	37.7	52.4	90.6	0.2	1.0	(3.8)	0.32	No	98	3.2
Artemis Alpha Trust	118.9	2.5	16.2	39.6	115.9	(0.1)	0.7	(16.9)	0.99	Yes	104	1.3
Fidelity Special Values	546.0	12.9	92.3	92.6	181.0	1.1	2.0	(0.2)	1.12	No	120	1.6
Henderson Opportunities	82.6	15.5	101.7	139.7		1.3	2.1	(1.9)	1.24	Yes	120	1.3
Invesco Perp Select UK Equity	67.6	13.5	80.6	128.4		1.0	1.8	2.6	1.08	Yes	115	3.6
Keystone	246.1	9.7	63.7	99.3	176.8	0.7	1.6	(5.0)	0.87	Yes	107	3.2
Schroder UK Growth	261.9	1.7	52.4	64.8	101.0	0.1	1.1	(8.7)	0.47	No	96	3.1
Threadneedle UK Select Trust	38.9	7.1	50.2	53.7	124.4	0.5	1.2	(7.3)	1.73	Yes	105	2.5
<b>Sector average</b>	<b>295.4</b>	<b>7.4</b>	<b>55.5</b>	<b>73.5</b>	<b>130.2</b>	<b>0.7</b>	<b>1.3</b>	<b>(5.2)</b>	<b>1.17</b>		<b>103</b>	<b>2.4</b>
<b>Open-ended FTSE All-Share index trackers</b>												
Aberdeen Foundation Growth	1,284.0	2.4	33.3	45.8					1.12			
Aviva Inv UK Index Tracking	759.2	2.6	35.0	51.8	88.5				0.93			
BlackRock UK Equity Tracker	8,257.6	3.4	38.1	53.6					0.21			
CAF UK Equitrack	576.0	3.3	37.7	52.9					0.32			
F&C FTSE All Share Tracker	359.8	3.3	37.3	51.9	88.1				0.46			
Fidelity Index UK	1,694.0	3.4							0.07			
Halifax FTSE All Share Tracker	2,191.0	2.1	34.6	46.8	70.1				1.03			
HSBC FTSE All Share Index	996.7	3.4	37.6	52.4	85.6				0.17			
L&G (N) Tracker Trust	1,385.5	2.4	33.8	46.3	75.2				1.15			
L&G UK Index	4,802.5	4.2	38.2	53.3					0.56			
M&G Index Tracker	501.1	2.5	37.4	52.3	87.8				0.46			
Royal London All Share Tracker	502.9	2.8	38.5	54.4					0.15			
Scot Wid UK All Share Tracker	8,420.5	3.0	37.2	53.0	89.4				0.36			
SSgA UK Equity Tracker	3,436.7	3.7	36.8	52.9	88.1				0.15			
Virgin UK Index Tracking	2,585.2	1.9	31.0	45.5	74.5				1.00			
<b>Average</b>	<b>2,516.8</b>	<b>3.0</b>	<b>36.2</b>	<b>50.9</b>	<b>83.0</b>				<b>0.54</b>			

Source: Morningstar, FE Trustnet, Thomson Datastream, Edison Investment Research. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets.

## The board

Following the retirement of Christopher Purvis in December 2014 after seven years' service, the board comprises four non-executive directors, all of whom are independent of the manager. Kevin Ingram was appointed as a director in March 2010 and as chairman in April 2013. Paul Yates joined the board in March 2012 along with Wendy Mayall who became senior independent director in March 2015. Tom Challenor was appointed as a director in October 2014 on the retirement of David Hager who had served on the board since February 2007.

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