

Standard Life UK Smaller Companies

Disciplined approach driving outperformance

Standard Life UK Smaller Companies (SLS) is managed by Harry Nimmo at Aberdeen Standard Investments. He has followed the same investment process since he took over management of the trust in 2003, through a number of economic cycles, and considers it to be stable, predictable and well defined, while providing an element of resilience during periods of stock market weakness. He also believes that the investment process is optimal for running large amounts of UK small-cap money. Nimmo has a long-term record of outperformance – SLS’s NAV total return is ahead of its blended benchmark over the last one, three, five and 10 years, and above the averages of its larger peers in the AIC UK Smaller Companies sector over one and five years, and broadly in line over three years.

12 months ending	Share price (%)	NAV (%)	Blended benchmark* (%)	Numis Smaller Cos plus AIM ex-ICs (%)	FTSE AIM (%)	FTSE All-Share (%)
30/11/14	(11.3)	(4.0)	(0.6)	(2.5)	(11.3)	4.7
30/11/15	29.1	27.7	11.9	8.2	3.0	0.6
30/11/16	2.2	3.8	6.3	7.9	12.8	9.8
30/11/17	43.8	31.8	21.3	23.6	27.1	13.4
30/11/18	(13.1)	(5.3)	(8.1)	(8.6)	(8.2)	(1.5)

Source: Thomson Datastream. Note: All % on a total return basis in GBP. *Numis Smaller Cos ex-ICs to 31 December 2017 and Numis Smaller Cos plus AIM ex-ICs thereafter.

Investment strategy: Focused around the Matrix

Nimmo diligently follows what he considers to be six principles for successful investment in small-cap companies: sustainable growth, concentrate your efforts, focus on quality, run winning positions, management longevity, and valuation is secondary. He employs Aberdeen Standard Investments’ proprietary Matrix to screen the investible universe via 13 proven indicators of financial performance. Companies need a sufficiently high Matrix score to warrant in-depth fundamental research. The manager invests for the long term in his pursuit of generating capital growth, aiming to ‘buy tomorrow’s larger companies today’. Gearing is permitted in a range of 5% cash to 25% debt as a percentage of net assets.

Market outlook: Time to be more selective

The performance of equities, including those in the UK, has been much choppier in 2018, compared with a particularly benign environment in 2017. Along with other macro considerations, UK investors are concerned by the uncertainty surrounding Brexit, which is putting the shares of companies with domestic operations under particular pressure. Given this backdrop, investors may find appeal in a more selective approach to UK equity exposure.

Valuation: Discount wider than average

SLS’s current 8.4% share price discount to cum-income NAV is wider than the 4.8% to 5.4% range of average discounts over the last one, three, five and 10 years. The board actively manages the discount, aiming to keep it below 8% (in normal market conditions – see page 7). This is achieved primarily via share repurchases. While the trust’s objective is to generate long-term growth rather than income, SLS also offers a dividend yield of 1.7%.

Investment trusts

11 December 2018

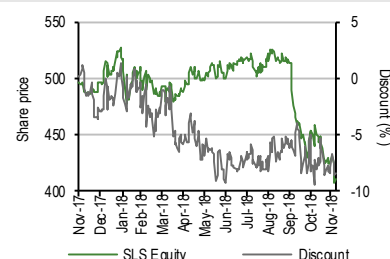
Price 410.0p
Market cap £413m
AUM £479m

NAV* 445.8p
Discount to NAV 8.0%
NAV** 447.6p
Discount to NAV 8.4%

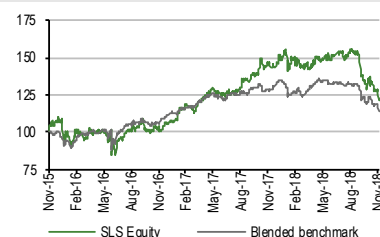
*Excluding income. **Including income. As at 7 December 2018.

Yield 1.7%
Ordinary shares in issue 100.7m
Code SLS
Primary exchange LSE
AIC sector UK Smaller Companies
Benchmark Numis Smaller Cos plus AIM ex-ICs

Share price/discount performance



Three-year performance vs index



52-week high/low 528.0p 407.0p
NAV** high/low 562.7p 445.5p

**Including income.

Gearing

Gross* 5.1%
Net* 0.1%

*As at 31 October 2018.

Analysts

Mel Jenner +44 (0)20 3077 5720
Gavin Wood +44 (0)20 3681 2503

investmenttrusts@edisongroup.com

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Exhibit 1: Trust at a glance

Investment objective and fund background

Standard Life UK Smaller Companies Trust (SLS) aims to achieve long-term capital growth through investment in a diversified portfolio mainly consisting of UK-quoted smaller companies. SLS started life as Edinburgh Smaller Companies in 1993 and Standard Life Investments (now Aberdeen Standard Investments) assumed management from 2003. The trust merged with Dunedin Smaller Companies Investment Trust in October 2018.

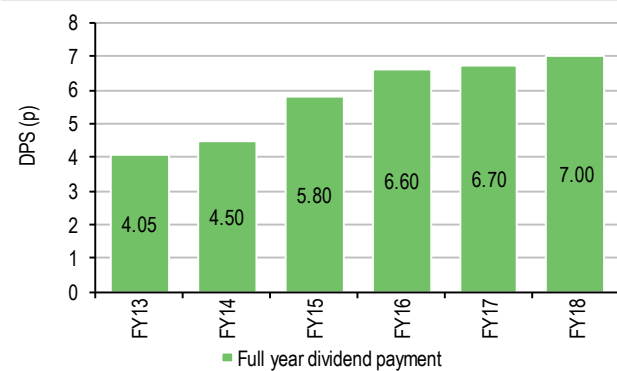
Recent developments

- 25 October 2018: Retirement of non-executive director Carol Ferguson at AGM.
- 8 October 2018: Completion of merger with Dunedin Smaller Companies Investment Trust.
- 8 October 2018: Appointment of Alexa Henderson as non-executive director.
- 24 August 2018: 12-month results to 30 June 2018. NAV TR +24.8% versus benchmark +8.5% TR. Share price TR +17.7%.

Forthcoming		Capital structure		Fund details	
AGM	October 2019	Ongoing charges	1.04% (FY18)	Group	Aberdeen Standard Investments
Interim results	February/March 2019	Net gearing	0.1%	Manager	Harry Nimmo
Year end	30 June	Annual mgmt fee	Tiered (see page 7)	Address	1 George Street, Edinburgh, EH2 2LL
Dividend paid	Apr and Oct/Nov	Performance fee	None	Phone	+44 (0)345 6002268
Launch date	1993	Trust life	Indefinite	Website	www.standardlifeuksmallercompaniestrust.co.uk
Continuation vote	N/A	Loan facilities	£45m		

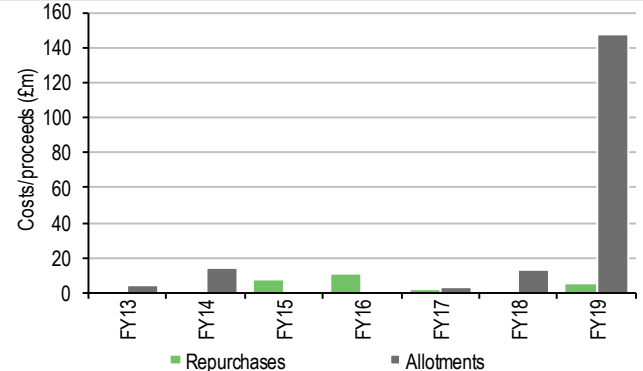
Dividend policy and history (financial years)

While focused on SLS's long-term capital growth objective, the manager pays close attention to the potential for dividend growth, and SLS's ordinary dividends have compounded at an average rate of 21.5% pa over 10 years.

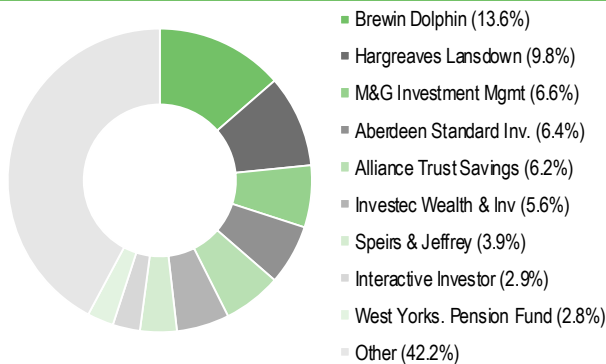


Share buyback policy and history (financial years)

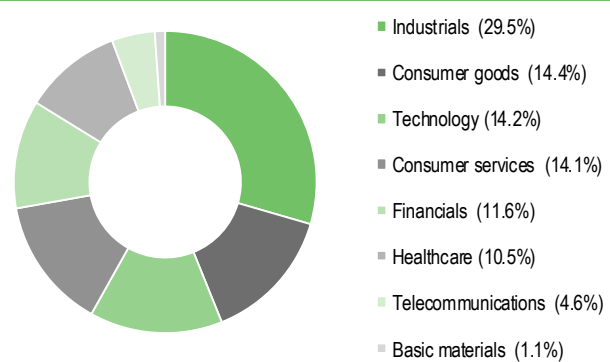
The board is focused on managing the discount such that the share price discount to cum-income NAV is less than 8%. FY19 allotments include 27.9m shares issued as a result of the merger with Dunedin Smaller Companies Investment Trust.



Shareholder base (as at 31 October 2018)



Portfolio exposure by sector (as at 31 October 2018)



Top 10 holdings (as at 31 October 2018)

Company	Sector	Portfolio weight %	
		31 October 2018	31 October 2017*
Dechra Pharmaceuticals	Healthcare	3.5	3.4
Fevertree Drinks	Consumer goods	3.4	4.1
Hilton Food	Consumer goods	3.3	N/A
Cranswick	Consumer goods	3.3	3.0
Abcam	Healthcare	3.3	N/A
First Derivatives	Information technology	3.2	4.1
RWS	Industrials	3.2	N/A
Gamma Communications	Telecommunications	3.0	N/A
Workspace	Financials	3.0	N/A
XP Power	Industrials	2.9	3.1
Top 10 (% of holdings)		32.1	35.0

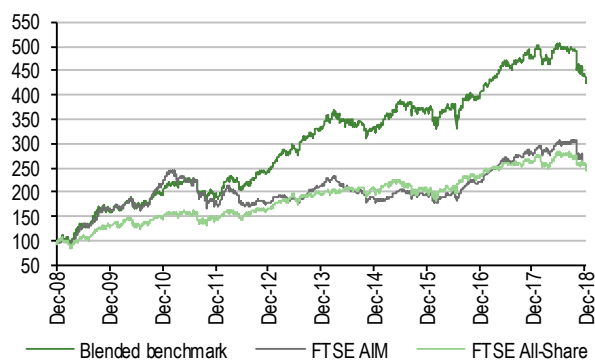
Source: Standard Life UK Smaller Companies Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-October 2017 top 10.

Market outlook: Volatility may continue

Exhibit 2 (LHS) shows that over the last decade, SLS's blended benchmark has significantly outperformed both the FTSE AIM and FTSE All-Share indices. However, this was primarily due to a period of outperformance during 2012 and 2013; over the last five years, the total returns of all three indices are broadly in line. Global stock markets have been more volatile in 2018 compared with 2017 as concerns have risen over slower global growth and rising US interest rates, with UK investors also facing uncertainty surrounding Brexit. These macro concerns are leading to heightened risk aversion, which is likely to continue until there is more clarity about the effects on economic growth prospects. As shown in the table below, smaller-cap stocks generally trade at modestly higher multiples than the largest UK companies, which can arguably be attributed to their relative immaturity and higher growth rates. In the current uncertain market environment, investors seeking exposure to UK small-cap stocks may wish to consider a fund that has a disciplined investment approach, along with a very strong, long-term performance track record.

Exhibit 2: Market performance and valuation metrics

Performance of UK indices



Index valuation metrics (as at 7 December 2018)

	NSCI + AIM ex-IC	FTSE AIM	FTSE All-Share
P/E (x)	13.0	15.5	11.2
Price to book (x)	1.4	1.7	1.6
EV/sales (x)	1.2	1.6	1.3
Dividend yield (%)	3.0	1.5	4.6

Source: Thomson Datastream, Edison Investment Research, Bloomberg. Note: SLS's blended benchmark is the Numis Smaller Companies ex-Investment Companies Index to 31 December 2017 and the Numis Smaller Companies plus AIM ex-Investment Companies Index thereafter.

Fund profile: UK small-cap equity specialist

SLS has been managed by Aberdeen Standard Investments (formed by the merger in August 2017 of Standard Life and Aberdeen Asset Management) since 1 September 2003. Lead manager Harry Nimmo (investment director: head of smaller companies at Aberdeen Standard Investments) aims to generate long-term capital growth from a diversified portfolio (c 50 holdings) of UK-quoted smaller companies, following an unconstrained investment approach. Since 1 January 2018, performance has been measured against the Numis Smaller Companies plus AIM ex-Investment Companies Index (the previous benchmark was the Numis Smaller Companies ex-Investment Companies Index). Nimmo is responsible for the employment of gearing between 5% net cash and 25% net gearing (at the time of drawdown); at end-October, net gearing was 0.1%. A maximum 5% of total assets is permitted in a single position, and companies with a market cap below £50m are restricted to 5% of total assets, as are companies involved with 'Blue Sky' (more speculative) products or services. A maximum 50% of the portfolio may be invested in companies in the FTSE AIM Index. On 8 October 2018, SLS completed a merger with Dunedin Smaller Companies Investment Trust. The board believes that the trust's resulting increased scale will lead to a reduction in the ongoing charges ratio and increased liquidity in the company's shares. This is the second such deal in the last decade, having merged with Gartmore Smaller Companies Trust in February 2009.

The fund manager: Harry Nimmo

The manager's view: Importance of having a long-term outlook

Nimmo is keen to stress the importance of having a long-term view when investing in UK small-cap stocks. He says that historical performance data from the open-ended Standard Life UK Smaller Companies Fund shows that investors who have held a position for six years, have on average, earned an average total return of at least 10% pa. The manager says these findings have held true even if investments are made at stock market peaks. While retaining a positive longer-term outlook for UK small-cap equities, the manager is more cautious on their near-term prospects, noting Brexit remains a significant overhang to investor sentiment and economic activity. However, he believes that if the UK stock market continues to weaken, there is potential for SLS to outperform the benchmark, similar to during the global financial crisis in 2007-08. Nimmo says that during volatile periods, investors tend to panic and small-cap stocks, in particular, come under pressure, as witnessed in October this year when concerns arose over rising US interest rates in response to a tight labour market. The manager says that higher interest rates are more detrimental to higher-rated stocks; however, he believes that his focus on quality and growing businesses will outweigh this effect in the long term. He notes that SLS's portfolio companies very rarely cut their dividends and he invests in businesses that he believes can grow through an economic downturn.

Asset allocation

Investment process: Use of proprietary Matrix

Nimmo adheres to six principles for successful investment in small-cap companies: look for sustainable earnings and dividend growth; concentrate your efforts; focus on quality companies; let winning positions run, look for management longevity; and valuation is secondary.

The manager seeks to generate long-term capital growth by 'buying tomorrow's larger companies today', focusing on companies with proven business models and a high percentage of recurring revenue. He employs Aberdeen Standard Investments' proprietary stock selection Matrix to screen the investible universe of c 650 stocks, using 13 proven indicators of financial performance, including earnings revision momentum, price momentum, valuation, credit strength and the level of director dealing. He adheres to Aberdeen Standard Investments' 'Focus on Change' philosophy that different factors drive individual stocks and markets at varying times in the investment cycle. The belief is that asset valuations are driven by company fundamentals, but stock markets can be inefficient in pricing in underlying changes. The Matrix provides a shortlist of potential investments for further in-depth analysis, while helping the manager to monitor the performance of the portfolio and the prospects of existing holdings. Stocks are assigned a Matrix score between +35 and -35 – with scores of +10 to +35 deemed potential buy candidates and scores between -10 and -35 potential sells. The manager does not necessarily purchase a stock following a period of weakness; his decision is driven by the company's overall Matrix score, which is partly affected by share price weakness. He notes that SLS's aggregate Matrix score is c +6.5, which is near the low end of the typical historical range of +6 to +10, which reflects the manager's less optimistic near-term outlook for UK small-cap equities. Stocks may be sold or trimmed if there is deterioration in the Matrix score, the original investment thesis is no longer valid, or if the position size has grown larger than 5% of the portfolio.

Current portfolio positioning

While performance is measured against the Numis Smaller Companies plus AIM ex-Investment Companies Index, the manager's unconstrained investment approach means that the trust's sector

exposures can vary markedly compared to the benchmark. As shown in Exhibit 3, SLS continues to have no exposure to oil & gas or utilities, and has recently initiated a position in the basic materials sector, with the trust's four largest industry exposures making up more than 70% of the portfolio. Changes in sector weightings over the 12 months to end-October 2018 were relatively modest, with the largest increase in financials (+5.0pp) and the largest decrease in consumer services (-3.8pp). At end-October 2018, SLS had an 86.1% active share (a measure of how a portfolio differs from its benchmark, with 100% representing no commonality and 0% representing full index replication), which is moderately lower than 91.9% six months previously.

Exhibit 3: Portfolio sector exposure (ex-cash and gearing, % unless stated)

	Portfolio end-October 2018	Portfolio end-October 2017	Change (pp)
Industrials	29.5	27.3	2.2
Consumer goods	14.4	16.9	(2.5)
Technology	14.2	14.4	(0.2)
Consumer services	14.1	18.0	(3.8)
Financials	11.6	6.6	5.0
Healthcare	10.5	12.8	(2.3)
Telecommunications	4.6	4.1	0.6
Basic materials	1.1	0.0	1.1
	100.0	100.0	

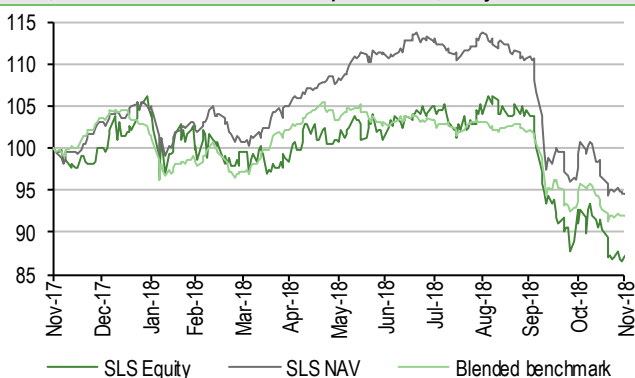
Source: Standard Life UK Smaller Companies Trust, Edison Investment Research

Recent purchases include Games Workshop and Kainos. The manager held a position in Games Workshop several years ago, but sold when he believed that the company "lost its way". However, there is a new CEO in place, who Nimmo believes is embracing the opportunities available from using the internet, and broadening the appeal of the company's products. The new CEO has successfully rolled out its business overseas and Nimmo expects growth to accelerate as the company brings on new capacity to alleviate its current constraints. Kainos is a Belfast-based data service consultant, which is benefiting from the digitisation of local government processes. Nimmo says that this is one of the few companies that should benefit from a hard Brexit, due to higher demand for its services.

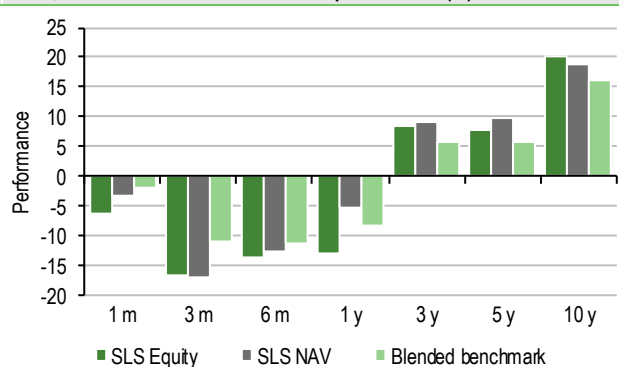
Performance: Short-term wobble, longer-term positive

Exhibit 4: Investment trust performance to 30 November 2018

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

Over the last 12 months, SLS's NAV and share price total returns of -5.3% and -13.1% respectively compare with the benchmark's -8.1% total return. This includes a particularly tough period for performance in October 2018, which was partly due to inheriting a position in Patisserie Valerie from Dunedin Smaller Companies Investment Trust's portfolio (the company had a good Matrix score, but has been delisted following the announcement of accounting irregularities). Performance was also particularly affected by two top 10 holdings – Fevertree Drinks (concerns about weaker

than expected industry volumes) and First Derivatives (affected by a short-selling report) – which are highly rated stocks and suffered disproportionately during the October stock market sell-off.

Exhibit 5: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to blended benchmark*	(4.4)	(6.4)	(2.8)	(5.4)	7.8	11.0	42.5
NAV relative to blended benchmark*	(1.3)	(6.7)	(1.6)	3.1	9.4	20.6	28.0
Price relative to Numis Smaller Cos plus AIM ex-ICs	(4.4)	(6.4)	(2.8)	(4.9)	4.6	13.6	67.3
NAV relative to Numis Smaller Cos plus AIM ex-ICs	(1.3)	(6.7)	(1.6)	3.6	6.2	23.5	50.2
Price relative to FTSE AIM	(1.7)	(1.3)	(0.2)	(5.3)	(3.0)	21.7	143.1
NAV relative to FTSE AIM	1.5	(1.6)	1.1	3.2	(1.5)	32.2	118.3
Price relative to FTSE All-Share	(4.6)	(11.1)	(6.5)	(11.8)	4.1	13.1	145.0
NAV relative to FTSE All-Share	(1.4)	(11.4)	(5.3)	(3.9)	5.7	22.9	119.9

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-November 2018. Geometric calculation. *Benchmark is Numis Smaller Cos ex-ICs to 31 December 2017 and Numis Smaller Cos plus AIM ex-ICs thereafter.

SLS's relative returns are shown in Exhibit 5. Despite a short period of underperformance, the manager's longer-term record of outperformance remains intact. SLS has outperformed the blended benchmark in both NAV and share price terms over the last three, five and 10 years (and over one year in NAV terms). It is also worth noting that SLS has outperformed the FTSE All-Share index over three, five and 10 years, with the trust's relative performance particularly strong over the longer term.

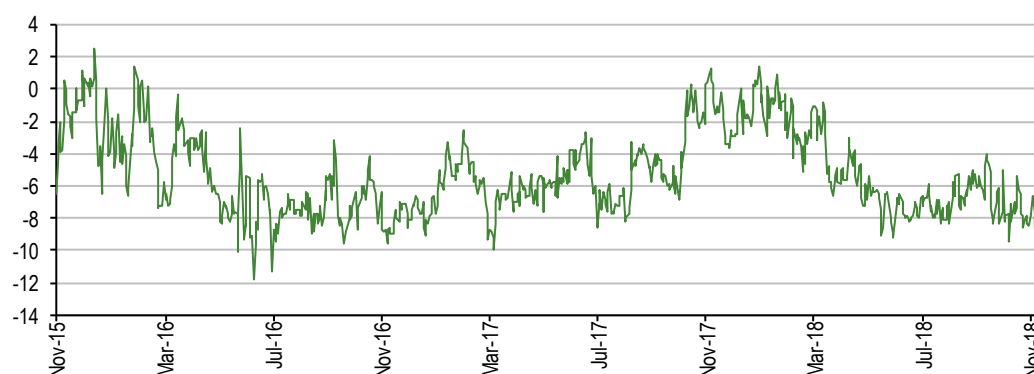
Exhibit 6: NAV total return performance relative to benchmark over 10 years



Source: Thomson Datastream, Edison Investment Research

Discount: Wider than historical averages

Exhibit 7: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

SLS is currently trading at an 8.4% share price discount to cum-income NAV, which compares to the range of a 1.4% premium to a 9.4% discount over the last 12 months. The current discount is wider than the 4.8% to 5.4% range of average discounts over the last one, three, five and 10 years.

The board employs an active discount control mechanism, aiming to maintain the share price discount to cum-income NAV below 8% (in normal market conditions). The trust has authority, renewed annually, to repurchase up to 14.99% of its share capital. It also utilises discretionary tender offers (for up to 10% of shares in issue, at 98% of prevailing NAV); although share repurchases are the primary method for managing the discount. SLS's discount widened in the first half of 2018 when new shares were issued following the expiry of the trust's convertible unsecured loan stock in March 2018 and there was also downward pressure on the share price following the announcement of the merger with Dunedin Smaller Companies Investment Trust.

Capital structure and fees

Following the issuance of 4.7m shares as a result of the final conversion of SLS's convertible unsecured loan stock in March 2018, the trust has one class of share. SLS currently has 100.7m ordinary shares in issue, with a further 3.5m shares held in treasury. The manager has discretion to utilise gearing between a net cash position of 5% and net gearing up to a maximum of 25% of net assets. At end-October, net gearing was a minimal 0.1%, reflecting Nimmo's caution on the near-term outlook for small-cap UK equities. Since 1 November 2018, SLS has had a £45m unsecured loan agreement with the Royal Bank of Scotland – a five-year, fixed-rate loan of £25m at 2.349% and a five-year revolving credit facility of £20m.

Following the announcement of the merger with Dunedin Smaller Companies Investment Trust, SLS has a revised fee structure. Since 1 July 2018, Aberdeen Standard Investments is paid a fee based on net rather than total assets; 0.85% pa up to £250m, 0.65% pa between £250m and £550m, and a new lower level of 0.55% pa on net assets above £550m. The ongoing charges ratio in FY18 was 1.04%, 4bp lower than 1.08% in FY17, which represented the third sequential annual decline. SLS's board is confident of another reduction in the ongoing charges ratio in the current financial year, due to the trust's larger size following the merger with Dunedin Smaller Companies Investment Trust and the reduction in the management fee.

Dividend policy and record

SLS pays dividends twice a year in April and October/November. The FY18 annual distribution of 7.0p per share was a 4.5% increase versus 6.7p in FY17, while the revenue return of 7.24p was 12.8% higher year-on-year. At end-FY18, SLS had revenue reserves of £8.3m, which is equivalent to c 1.6x the FY18 total dividend.

Over the last 10 years, regular dividends have compounded at an average annual rate of 21.5%, but growth has been more modest in recent years. The manager highlights that SLS continued to grow its dividends through the global financial crisis and he expects continued growth regardless of any economic downturn. He explains that as companies reach a level of maturity, they pay higher distributions, but dividend growth is lower and he also notes an above-average level of special dividends received between FY12 and FY15. Nimmo is hopeful that dividend growth will accelerate in coming years, and says that all of SLS's top 10 holdings are growing their dividends at a double-digit rate. The trust currently offers a dividend yield of 1.7%.

Peer group comparison

SLS is a member of the AIC UK Smaller Companies sector. In Exhibit 8, we compare it to the other nine funds with market caps greater than £100m and that have been trading for more than three years. The trust's NAV total returns are above the simple averages over one and five years, while lagging modestly over three and 10 years. SLS's discount is narrower than average, in a peer group where none of the trusts are trading at a premium. The trust's ongoing charge is above average, although this is likely to reduce, and befitting its focus on capital growth, its dividend yield is one of the lowest in the peer group.

Exhibit 8: Selected peer group as at 7 December 2018*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
Standard Life UK Smaller Cos	413.0	(7.7)	22.5	53.0	468.2	(7.8)	1.0	No	100	1.7
Aberforth Smaller Companies	1,045.3	(10.6)	11.0	28.9	342.5	(12.4)	0.8	No	100	2.5
BlackRock Smaller Companies	567.4	(6.6)	32.4	61.7	613.1	(10.7)	0.7	No	104	2.4
BlackRock Throgmorton Trust	328.0	(5.6)	33.6	64.8	609.4	(10.6)	0.9	Yes	113	2.0
Henderson Smaller Companies	545.3	(10.6)	20.5	50.6	586.7	(12.8)	0.4	Yes	106	2.9
Invesco Perpetual UK Smaller	147.5	(6.3)	27.8	63.7	379.0	(5.1)	0.8	Yes	100	2.5
JPMorgan Smaller Companies	156.8	(9.8)	11.9	30.3	378.1	(12.6)	1.0	No	109	2.7
Montanaro UK Smaller Companies	183.3	(11.7)	5.7	18.8	281.7	(8.0)	0.8	No	104	5.2
Rights & Issues Investment Trust	166.1	(8.1)	54.1	85.8	570.6	(4.2)	0.5	No	100	1.5
Strategic Equity Capital	130.7	(12.1)	13.3	54.4	503.1	(15.5)	1.3	Yes	100	0.5
Simple average	368.3	(8.9)	23.3	51.2	473.2	(10.0)	0.8		104	2.4
Rank (out of 10 funds)	4	4	5	6	6	3	2		6	8

Source: Morningstar, Edison Investment Research. Note: Performance as at 6 December 2018. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

There have recently been two changes to SLS's board. On 8 October 2018, following the merger with Dunedin Smaller Companies Investment Trust, Alexa Henderson was appointed as an independent, non-executive director. She is also a director of F&C UK Real Estate Investments, JP Morgan Japan Smaller Companies Trust, James Walker (Leith) and Bravura Solutions. Henderson was previously a director of Dunedin Smaller Companies Investment Trust. Following the resignation of Carol Ferguson at the AGM on 25 October 2018, there are now four other independent, non-executive directors on the board: Allister Langlands (appointed in July 2014 and chairman since August 2017); Timothy Scholefield (appointed in February 2017, now senior independent director following Ferguson's resignation); Caroline Ramsay (appointed in August 2016); and Ashton Bradbury (appointed in July 2018). Bradbury was previously a fund manager with Old Mutual Global Investors, where he established its small- and mid-cap equities team.

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