EDISON

Miton Income Opportunities Trust

Moving to merge with DIVI

Investment trusts

On 2 July the boards of Miton Income Opportunities Trust (MIOT), formerly Henderson Fledgling Trust, and The Diverse Income Trust (DIVI) updated the market on progress towards the proposed merger. The investment manager of both companies, Miton Group, has advised the boards that MIOT's portfolio is now over 90% aligned, by value, with the core strategy of DIVI. Reaching this threshold was a condition for the proposed merger to proceed earlier than the 15 February 2014 deadline. Under the terms of the merger, MIOT shareholders will receive new shares in DIVI, valued at a 2.5% premium to DIVI's NAV, adjusted for costs incurred by DIVI in relation to the scheme. Progress in aligning MIOT's portfolio will allow the process to accelerate and a formal proposal is expected to be sent to shareholders in early September.

12 months ending	Total share price return* (%)	Total NAV return* (%)	Total return FTSE All-Share Index* (%)	Total return FTSE 350 Index* (%)	Total return FTSE Fledgling Index* (%)
30/06/10	16.0	18.9	21.1	13.6	14.4
30/06/11	40.6	36.2	25.6	25.4	36.9
30/06/12	(32.5)	(28.2)	(3.1)	3.4	(21.0)
30/06/13	46.7	24.1	17.9	16.0	32.0

Note: *Twelve-month rolling discrete performance.

Investment strategy: Diversified UK portfolio

Miton Capital Partners, DIVI's manager, was appointed as manager of MIOT from 1 March 2013 and on 4 April 2013 shareholders approved a new investment policy, mirroring that of DIVI. MIOT's portfolio has since been realigned, a process the manager says is now 90% complete, by value. By alignment, the manager means that 90% of the portfolio is now invested in stocks that are consistent with DIVI's existing investment objective. This includes common stock holdings as well as different stocks of a similar nature. Some MIOT holdings are in stocks that DIVI's manager would have previously liked to acquire but could not due to liquidity constraints. The new MIOT strategy, as with DIVI, is to invest in UK-quoted companies with attractive and growing dividends. It invests without reference to any index benchmark, across a range of market capitalisations, diversifying its portfolio by stock and industry to control risk. The majority of investment managers in the sector weight their portfolios toward the largest higher-yielding stocks in the UK market, improving liquidity but increasing stock-specific risk.

Valuation: Convergence with DIVI's

MIOT's discount has closed substantially since the merger proposals were announced in February and as progress has been made in aligning its portfolio with that of DIVI. MIOT now trades close to par compared with a three-year average discount of 15.8%. Under the merger terms, and with DIVI currently trading at a c 3.0% premium, MIOT represents an opportunity to acquire DIVI at a very mild discount.

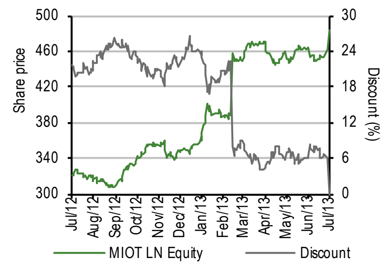
10 July 2013

Price	**483p**
Market cap	**£78m**
AUM	**£78m**
NAV*	486.7p
Discount to NAV	0.2%
NAV**	484.8p
Premium to NAV	0.1%
Yield	2.5%

*Adjusted for debt at market value and excluding income, as at 8 July 2013. **Adjusted for debt at market value, including income, as at 8 July 2013.

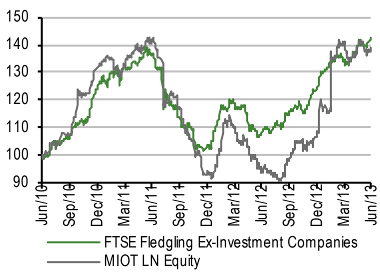
Ordinary shares in issue	16.1m
Code	MIOT
Primary exchange	LSE
AIC sector	UK Smaller Companies

Share price/discount performance



Positive values indicate a discount; negative values indicate a premium.

Three-year cumulative perf. graph



52-week high/low	484.75p	307.50p
NAV* high/low	500.4p	402.5p

*Adjusted for debt at market value, excluding income.

Gearing

Gross	0.0%
Net	0.0%

Analysts

Matthew Read +44 (0)20 3077 5758

Andrew Mitchell +44 (0)20 3681 2500

investmenttrusts@edisongroup.com

Edison profile page

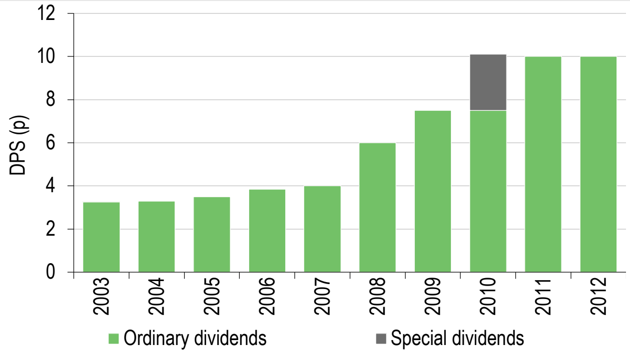
Miton Income Opportunities Trust is a research client of Edison Investment Research Limited

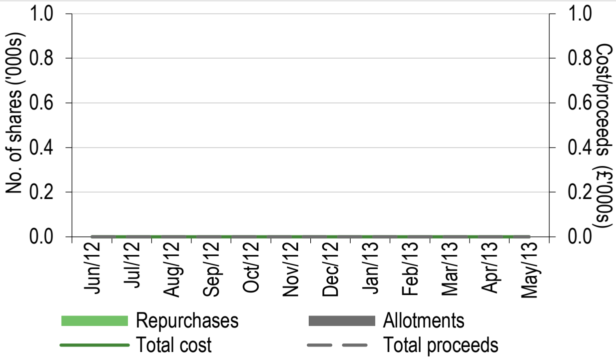
Exhibit 1: Trust at a glance

Investment objective and fund background	Recent developments
On 5 April 2013 shareholders approved a new investment objective and policy that brings MIOT into line with DIVI. MIOT's new investment objective is to provide shareholders with an attractive level of dividends, coupled with capital growth over the longer term. It will invest in a diversified portfolio primarily of quoted or traded small-cap companies that have the prospect of paying good and growing dividends. MIOT may also invest in larger-cap companies, including FTSE 100 constituents, where it is believed this may increase shareholder value. As a stock-specific portfolio, there is no benchmark, but the trust targets income growth higher than other income funds.	2 July 2013: Announcement that the 90% realignment trigger has been reached. The boards have agreed to proceed with a full merger. Details of the proposals are expected to be released in September for approval at a general meeting to be held shortly thereafter.

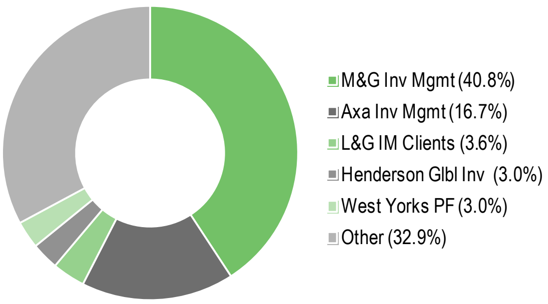
Forthcoming		Capital structure		Fund details	
AGM	December 2013*	Ongoing charges	1.29%	Group	Miton Group
Preliminary results	November 2013*	Net gearing	0.0%	Manager	Gervais Williams, Martin Turner
Year end	31 August	Annual mgmt fee	1.0% of market cap	Address	10-14 Duke Street, Reading Berkshire, RG1 4RU, UK
Dividend paid	May, October	Performance fee	None		
Launch date	December 1994	Trust life	Merger by end-Feb 2014**	Phone	+44 (0) 118 952 8900
Continuation vote	Annual	Loan facilities	None	Website	www.mitongroup.com

Dividend policy and history	Share buyback policy and history
Two dividends annually, paid in May and October. The dividend is expected to rise over the longer term. **An enhanced interim of 6.0p has been paid for 2013 (see pg 8). A further interim may be paid from reserves prior to completion of the proposed merger with DIVI. DIVI pays quarterly dividends.**	Renewed annually, the trust has authority to purchase up to 14.99% of issued share capital.

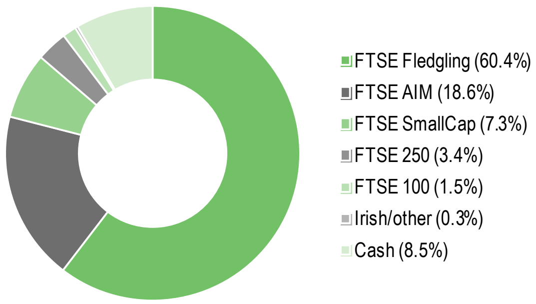




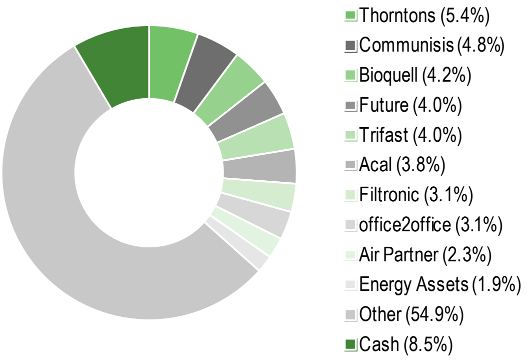
Shareholder base (as at 30 April 2013)



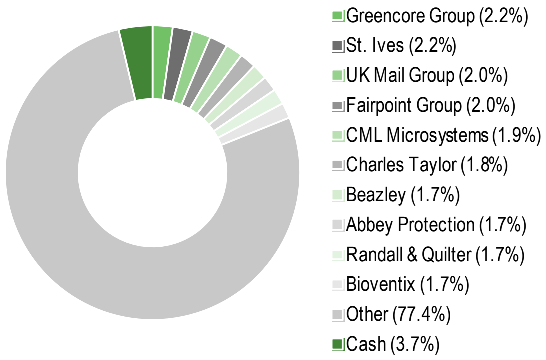
Distribution of portfolio (as at 31 May 2013)



MIOT Portfolio composition (as at 31 May 2013)



DIVI Portfolio composition (as at 31 May 2013)



Source: Miton Income Opportunities Trust, Edison Investment Research. Note: *Unless the merger with DIVI occurs sooner. **In the absence of a merger with the DIVI, MIOT has an indefinite life with annual continuation votes.

Fund profile: Moving to a diversified UK equity portfolio

MIOT's portfolio has been refocused to align with DIVI's. This aims to deliver both diversified equity income and long-term capital growth by investing across the whole range of market capitalisations on the UK-stock market, but with a long-term bias to non FTSE 100 constituents. Subject to conditions, the merger can proceed once 90% of MIOT's portfolio is aligned with DIVI's strategy, on or before 15 February 2014. In terms of progress, the boards of both MIOT and DIVI announced on 2 July that the investment manager, Miton Group, has advised that MIOT's portfolio has passed the 90% trigger point and so the boards of both DIVI and MIOT have agreed to proceed with the merger. MIOT's board has now commenced the preparation of merger documentation so that it can be put in the hands of MIOT shareholders in September for approval shortly thereafter. The merger is to be effected by way of a scheme of reconstruction of MIOT under which DIVI will issue new ordinary shares in consideration for the transfer of the entire investment portfolio of MIOT. No Alternative cash exit is proposed. Miton Capital Partners has agreed to waive its management fee until the earlier of the merger's completion or 12 months from their appointment.

Why merge?

From its launch in December 1994 to April 2013, Miton Income Opportunities Trust (formerly Henderson Fledgling Trust between 1 June 2011 and 5 April 2013, and Gartmore Fledgling Trust [GFT] prior to 1 June 2011) followed a hybrid strategy. The majority of the portfolio (initially 85%, subsequently reduced to 65%) was indexed against the Fledgling Index, with an active overlay applied to the balance of the portfolio. Initially the strategy performed well. Over time, the number of stocks and market cap of the Fledgling Index has reduced significantly. As a consequence, the proportion of a company that needed to be held for MIOT to achieve an index neutral weighting in its portfolio increased. As a further consequence, the cost of conducting the periodic rebalancing exercises increased, as did the time required to complete the rebalancing. This undermined the indexing strategy and led to underperformance. As a consequence the board announced a strategic review in November 2012. The conclusion was the recommendation of the merger with DIVI on 15 February 2014.

The merger is potentially beneficial to both parties:

1. Gervais Williams (lead manager of DIVI) was lead manager of GFT between February 2001 and September 2010 when he left Gartmore. MIOT's shareholders will have access to a manager they are familiar with, who previously provided them with very strong performance – under Gervais, GFT's share price returned 126.5%, while its NAV returned 139.4%. This compares to returns on the FTSE SmallCap and FTSE All-Share of 15.0% and 32.1% respectively during the same period. Furthermore, Gervais is familiar with many of the stocks in MIOT's portfolio.
2. MIOT will have a credible investment strategy that has been proven over the last two years (see Exhibit 5).
3. Both trusts' shareholders will see the size of the fund in which they are invested increase, which should allow fixed costs to be spread over a larger asset base and lead to an improvement in liquidity. Irrespective of the merger, DIVI has been included in the FTSE SmallCap Index from 24 June.

Diversification within UK equity income portfolios

Interest rates on cash, government bond yields and income returns on related asset classes are depressed and seem likely to remain so for some time. Conversely, holders of equities benefit from an attractive immediate yield and superior protection from inflation. The stocks listed on the UK equity market encompass a broad range of industrial and geographical exposure. However, most managers of UK equity income funds, with one eye on market cap weightings in their benchmarks, constrict their portfolios to a similar small group of the largest dividend-paying companies. Just nine companies represent 50% of FTSE 100 dividend payments, just 12 companies represent 50% of FTSE All-Share dividend payments and the FTSE 100 accounts for 87% of FTSE All-Share dividend income. The effect is that their portfolios can exhibit high stock and sector-specific risk. As shown by dividend cuts by the banks after the credit crisis, and BP after the Gulf of Mexico spill, the largest dividend payers can disappoint. This can affect individual portfolios heavily, due to concentration, but such an event will usually be felt across the sector.

At present, only 38 of the largest 100 companies yield more than 3.5% and these form the core of most UK equity income portfolios, but there are c 180 other 3.5%+ yielders further down the market-cap scale. Multi-cap portfolios offer greater scope for stock and sector diversification. Moreover, smaller companies often have more potential to show meaningful growth, are more likely to be under-researched and more limited access to debt finance can lead to stronger balance sheets that are better able to support faster dividend growth.

The fund managers: Gervais Williams and Martin Turner

The managers' view: Portfolio 90% aligned with DIVI strategy

Despite very recent market volatility, the calendar year to date has seen a positive equity market performance, with the FTSE All-Share, FTSE SmallCap and FTSE Fledgling up 7.5%, 11.9% and 11.9% respectively, reflecting a continued switch by investors from risk aversion to return-seeking against the backdrop of quantitative easing and very low 'risk-free' returns. The managers report that, while this has been helpful in a number of instances for making portfolio divestments, liquidity improvements have mostly been seen at the large-cap end of the market and that concerns over whether some trades are now becoming crowded is not an issue at the small-cap end. As such, they initially held back on making allocations to large FTSE stocks, focusing instead on the smaller-cap investments where, despite the issue of liquidity, they are still able to find opportunities. Recent equity market weakness has provided the opportunity to adjust the large caps and the managers report that MIOT's portfolio is now over 90% aligned, by value, with DIVI's strategy.

The managers believe that in the longer term, in a low-growth environment, dividends are likely to represent a larger element of shareholder return and companies that can grow their dividends will be rewarded. The credit boom saw asset prices across the board rise significantly and, in this environment, high-beta strategies frequently outperformed. However, the volatility associated with such strategies demands high liquidity, which, in the managers' view, led investors to favour large-cap stocks over small caps. Smaller companies have been out of favour for a long time and most investment managers are underweight; even a small shift towards a more positive attitude to smaller companies could have a significant effect on share prices. Although yet to firmly materialise, the managers believe that, as investors turn to equities in their search for income, they will over time be increasingly drawn down the market-cap scale in search of superior growth prospects. At the same time, both MIOT's and DIVI's portfolios include a number of low-yielding companies. These are included because the managers see the potential for these companies to make substantial dividend increases in the future. Their long-term aim is to grow, either separately or combined, MIOT's and DIVI's dividends at a faster rate than the peer group.

Asset allocation

Investment process: Bottom-up stock selection

The investment process now used to manage MIOT has largely been a continuation of that used when Gervais Williams previously managed the fund. It is employed in the management of DIVI, albeit with a focus on different stocks. DIVI's strategy does not have a formal benchmark index, allowing the managers to target a significant proportion of small company equities in a highly diversified portfolio of 80-120 investments. Typically, no holding exceeds 1.5% of the portfolio at the time of acquisition. The managers rebalance the portfolio on a continuous basis, monitoring the performance of stocks relative to price targets. DIVI's turnover is 60-80% per year. Further details of the investment process can be seen Edison's note of February 2013.

Overview: Diversified UK equity portfolio

As at 31 May 2013, MIOT had 96 quoted equity investments. The top-10 holdings account for 36.6% of the portfolio, cash 8.5%, and the remaining 86 equity investments 54.9%. At 31 May 2013 Fledgling stocks continued to make up the majority of MIOT's portfolio.

Exhibit 2: Asset allocations as at 31 May 2013

	MIOT portfolio weight (%)	DIVI portfolio weight (%)	MIOT weight – DIVI weight (%)	MIOT weight/ DIVI weight
FTSE 100	1.5	6.4	(4.9)	0.23
FTSE 250	3.4	23.6	(20.2)	0.14
FTSE SmallCap	7.3	26.4	(19.1)	0.28
FTSE Fledgling	60.4	3.8	56.6	15.89
FTSE AIM	18.6	33.5	(14.9)	0.56
Plus Markets	0.0	1.7	(1.7)	0.00
Irish/Other	0.3	0.9	(0.6)	0.33
Cash	8.5	3.7	4.8	2.28
	100.0	**100.0**	**0.0**	

Source: Miton Income Opportunities Trust, Bloomberg, Edison Investment Research

Recent activity and current portfolio positioning

Exhibit 2 provides a comparison of MIOT and DIVI's portfolio allocations as at 31 May 2013, the last date for which portfolio details have been published. At that stage the manager reported that around 75% MIOT's portfolio had been realigned with DIVI's strategy, although, as Exhibit 2 also shows, MIOT retained a substantial allocation to Fledgling stocks. At the time the manager commented that the 75% alignment was greater than this portfolio breakdown might seem to suggest, because it contained a number of stocks that fit the core strategy, even though these might not have been actually held by DIVI. Subsequently, the manager has continued to drip-feed stock into the market when liquidity windows have been open, and further progress has been made. According to the manager, 90% of the portfolio is now aligned. On the assumption that the merger of MIOT and DIVI completes, over time the manager expects the combined portfolio to show only a modest lengthening of the current DIVI's stock list; to c 120 (currently 108). In the shorter term we suspect the number may well be higher as the manager avoids selling down stocks that fit well with the core strategy and are attractively priced. Recent additions to MIOT's portfolio include Randall & Quilter, Charles Taylor and Fairpoint. Randall & Quilter was an existing MIOT holding. MIOT participated in the recent placing as the manager considers the planned expansion will provide a strong platform for dividend growth. Charles Taylor is a new addition to MIOT's portfolio that was not already present in DIVI's. The manager considers that its insurance support services business offers strong growth potential. Fairpoint is a core DIVI holding. The manager considers it has strong dividend growth potential and has used recent weakness to build MIOT's position.

Performance: Positive outlook for new strategy

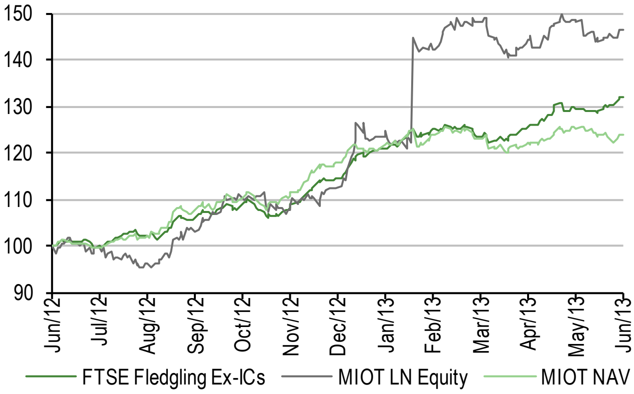
As Exhibit 3 illustrates, MIOT's share price saw a strong uplift in February when the merger proposals were announced, improving share price performance across all of the times provided. NAV performance, by comparison, benefits from no such uplift and better illustrates the challenges MIOT faced with its old strategy. Historically, the rebalancing of MIOT's portfolio to maintain its fledgling focus carried a cost that is seen in MIOT's performance vs the index, which was exacerbated by the portfolio stocks' low liquidity. As Exhibit 4 illustrates, this was a price worth paying because while MIOT's performance trailed that of the Fledgling Index, the latter strongly outperformed the small caps and the broader market. However, since mid-2011, this has not been the case and fledgling stocks have trailed small-cap stocks, with MIOT's performance trailing further, eating into its longer-term performance record.

While past performance is no guarantee of future returns, shareholders may take some comfort from DIVI's recent performance record as illustrated in Exhibits 5 and 6. Comparing Exhibits 4 and 5 shows that DIVI's NAV performance, relative to both the FTSE All-Share and FTSE 350 High yield, is appreciably ahead of MIOT's. This is underlined by the direct performance comparisons provided in Exhibit 6.

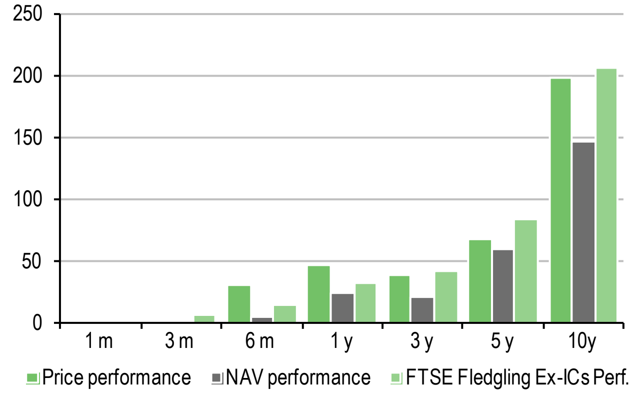
Exhibit 4 illustrates that, whilst MIOT has recently underperformed its old benchmark the fledgling index, it has outperformed both the FTSE All-Share and FTSE 350 High Yield indices although, during this period of transition, its performance is yet to match that of DIVI.

Exhibit 3: Investment trust performance to 31 May 2013

Price, NAV and benchmark total return perf, one year rebased



Price, NAV and benchmark total return performance (%)



Source: Miton Income Opportunities Trust, Thomson Datastream, Edison Investment Research

Exhibit 4: MIOT share price and NAV total return performance, relative to benchmarks (%) to 30 June 2013

	One month	Three months	Six months	One year	Three years	Five years	10 years
Share Price relative to FTSE All-Share	4.8	0.5	22.1	28.7	(4.4)	29.2	61.5
NAV relative to FTSE All-Share	4.9	2.5	(3.0)	6.1	(22.2)	21.4	9.7
Share Price relative to FTSE 350 High Yield	4.5	(0.8)	20.2	30.7	(11.2)	29.5	79.9
NAV relative to FTSE 350 High Yield	4.6	1.2	(4.9)	8.1	(29.0)	21.7	28.1
Share Price relative to FTSE Fledgling	(3.0)*	(7.8)*	15.1	14.7	(3.7)	(16.1)	(8.8)
NAV relative to FTSE Fledgling	(2.9)*	(5.8)*	(10.0)	(7.9)	(21.5)	(23.9)	(60.7)

Source: Miton Income Opportunities Trust, Thomson Datastream, Edison Investment Research. Note: *The Fledgling index ceased to be MIOT's benchmark from 5 April 2013 when the new investment objective was adopted.

Exhibit 5: DIVI share price and NAV total return performance, relative to benchmarks (%) to 30 June 2013

	One month	Three months	Six months	One year	Two years	Since launch*
Share Price relative to FTSE All-Share	5.1	2.9	6.3	20.5	24.3	25.6
NAV relative to FTSE All-Share	5.5	4.9	6.7	18.8	28.2	28.5
Share Price relative to FTSE 350 High Yield	4.9	1.6	4.3	22.5	18.7	19.6
NAV relative to FTSE 350 High Yield	5.3	3.5	4.7	20.8	22.5	22.4

Source: Diverse Income Trust, Thomson Datastream, Edison Investment Research. Note: *From 28 April 2011.

Exhibit 6: DIVI and MIOT share price and NAV total return performance comparison (%), to 30 June 2013

	One month	Three months	Six months	One year	Two years	Since launch*
MIOT Share Price Total Return	(1.2)	(1.1)	30.2	46.7	(15.3)	(14.0)
DIVI Share Price Total Return	0.1	1.3	14.8	38.5	38.6	38.6
MIOT NAV Total Return	(1.1)	0.9	5.1	24.1	1.0	1.4
DIVI NAV Total Return	0.5	3.2	15.1	36.8	42.4	41.4

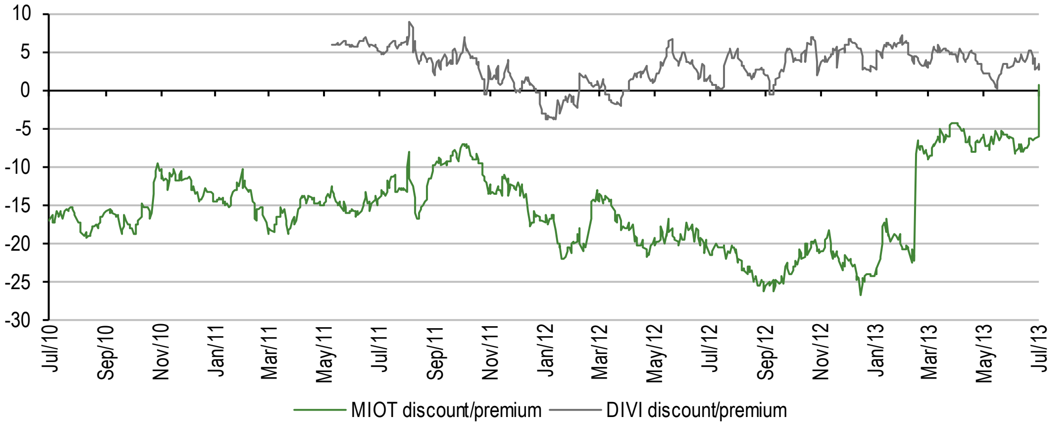
Source: Diverse Income Trust, Thomson Datastream, Edison Investment Research. Note: *From 28 April 2011.

Discount: DIVI at a discount

Exhibit 7 shows the discount of MIOT over the last three years and DIVI's discount since its launch. This illustrates that MIOT's discount saw a sharp narrowing in February on the announcement of the proposed merger with DIVI. This narrower discount was maintained and, following the announcement on 2 July that the 90% realignment trigger has been reached, the discount has closed further such that MIOT now trades close to par. MIOT's average discount since the February announcement has been 6.3%, which compares with its average during the previous three years of 15.8%. Exhibit 7 also shows that DIVI has predominantly traded at a premium since its launch, the average premium being 3.2%. This is despite two successful c-share issues and the announcement of the proposed merger with MIOT.

Trading at a small discount to DIVI

Exhibit 7: Share price discounts/premiums to NAV of MIOT and DIVI



Source: Thomson Datastream, Edison Investment Research. *Note: Positive values indicate a premium; negative values indicate a discount.

MIOT will exchange its shares for DIVI's at a 2.5% premium to DIVI's NAV. DIVI is currently trading at a fair ex-premium of 2.7% (MIOT's fair ex-discount is 0.2%), suggesting that if the merger proceeds as planned, MIOT currently offers a mildly discounted way to access DIVI. Assuming the transfer was to take place at current prices and NAVs, a MIOT share purchased at the current price of 485.5 gives exposure to 486.7p of NAV. In turn, this would convert to 474.8p of DIVI NAV (after deducting the 2.5% conversion premium). DIVI's shares currently trade at a 2.7% premium to NAV, which, if sustained, would imply a 487.6p (474.8p x 1.027) valuation/price for those net assets. At current prices, DIVI would have to fall to a c 2.7% premium to its own NAV post the conversion for the benefit to MIOT shareholders to be eradicated. Of course, prices and NAVs are unlikely to be the same at the time of conversion, but where there is an implied discount of MIOT compared with DIVI this provides some protection against additional frictional costs of realigning the MIOT portfolio, which is already 90% complete. It may also provide a small buffer against further underperformance of the legacy assets still invested under the old strategy.

Capital structure: Conventional, currently ungeared

MIOT is a conventional investment trust, having only one class of share in issue – 25p ords. Historically, MIOT has effectively pursued an ungeared strategy. The periodic rebalancing of the portfolio, a requirement of the indexing strategy, needed finance, but any borrowings tended to be short term in nature. At present MIOT is ungeared. It is permitted to gear up to 15% of net assets, but it is not expected that this authority will be used during the realignment process. MIOT's authority mirrors that of DIVI, which is also permitted to gear up to 15% of net assets. While currently ungeared, DIVI has a bank borrowing facility and has used modest gearing (typically net gearing has remained below 5%) since its launch. MIOT's investment management fee arrangements also mirror those of DIVI, whereby the manager is entitled to receive a management fee of 1% of the market capitalisation of the company, valued and paid monthly in arrears. However, MIOT's differ as the manager has agreed to waive its fee until the earlier of the merger's completion or 12 months from its appointment. Neither DIVI nor MIOT pays a performance fee. For MIOT's historical fee arrangements, please see Edison's note on Henderson Fledgling of September 2011.

MIOT's ongoing charges for the year ended 31 August 2012 were 1.29% (2011: 1.15%). DIVI's ongoing charges were 1.9% for its first accounting period and, for the year ended 31 May 2013, are expected to be c 1.45%. Although MIOT does not have a fixed life, a resolution to allow the company to continue in existence as an investment trust is put to shareholders at each AGM. Assuming the merger proceeds MIOT shares will be converted into DIVI ordinary shares, which are redeemable. DIVI shareholders are entitled to request the redemption of part or all of their shareholding, at NAV, on 31 May of each year. While redemptions are made at the board's discretion, it has indicated it is minded to approve all redemption requests.

Dividend policy: Now with a focus on income

MIOT's new investment objective mirrors that of DIVI and so MIOT is now focused on providing investors with both attractive and growing income as well as capital growth. Assuming the merger completes, MIOT shareholders will see a move to quarterly dividends. At present MIOT pays two dividends annually. Under the old investment objective MIOT had a progressive dividend policy, but the primary focus was on capital growth with income a secondary consideration. MIOT paid an enhanced interim dividend at the end of May of 6.0p, which included 4p of accumulated revenue reserves. The board has advised that a further interim dividend may be paid, prior to the completion of the merger and arguably for the purpose of providing parity in revenue reserves, although the final dividend may not be maintained if the merger proceeds. As at 28 February 2012, MIOT had 10.22p of accumulated revenue reserves per share, equivalent to 4.22p after payment of the enhanced interim. As at 30 November 2012, and prior to the second c-share conversion, DIVI had revenue reserves of 0.78p per share.

The board

All directors are non-executive and independent of the investment manager. They are Tom Bartlam (chairman), Peter Dicks and Rod Birkett (directors). The average length of service is 6.8 years.

Berlin +49 (0)30 2088 9525
Friedrichstrasse 95
10117 Berlin
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 9258 1162
Level 33, Australia Square
264 George St, Sydney
NSW 2000, Australia

Wellington +64 (0)4 8948 555
Level 15, 171 Featherston St
Wellington 6011
New Zealand