THE SCOTTISH
Investment Trust

# The Scottish Investment Trust PLC

## Annual Results for the year ended 31 October 2016.

***The Scottish Investment Trust PLC*** *invests internationally and is independently managed. Its objective is to provide investors, over the longer term, with above-average returns through a diversified portfolio of international equities and to achieve dividend growth ahead of UK inflation. Today it announces its results for the year to 31 October 2016.*

**Highlights**

- First quartile performance over 12 months.
- 29.4% NAV total return.
- 40.6% increase in total dividend per share.
- First full year of high conviction, global contrarian approach.

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## Chairman's Statement

### Performance

In my first year end statement, I am delighted to report that the Company's performance has been strong during the 12 months to 31 October 2016. Over that period, the share price total return was 30.0% and the net asset value per share (NAV) total return was 29.4% (with borrowings at market value). While the Company's objective is to produce above-average returns over the longer term, it is nevertheless pleasing that the Company's new investment approach has demonstrated early benefits.

At the financial year end the Company was ranked in the first quartile of the AIC global peer group over the prior 12 months.

The high conviction, global contrarian investment approach adopted by Alasdair McKinnon and his team has been deployed for the full financial year. This approach differentiates the Company from our global growth investment trust peers. The portfolio currently contains 68 listed equity holdings and is invested without reference to the composition of any index.

The Company does not have a formal benchmark but, by way of comparison, the sterling total return of the international MSCI All Country World Index (ACWI) was 29.1%, while the UK based MSCI UK All Cap Index total return was 12.3%.

### An inflation-beating dividend

Over the financial year, earnings per share rose by 35.9% to 21.6p (2015: 15.9p), with a higher level of income generation from the portfolio and a boost from sterling weakness.

The Board recommends a final dividend of 8.25p per share which, if approved, will mean that the total regular dividend for the year will increase by 8.0% to 13.5p and will represent the 33rd consecutive year of regular dividend increase.

In view of the strong income generation this year, the Board also recommends a special dividend of 9.0p which follows a special dividend of 3.5p in the previous financial year. The total dividend for the year will, if approved, thus increase by 40.6% to 22.5p.

The Board wishes to maintain both the long track record of dividend increases and the aim of the Company to provide dividend growth ahead of UK inflation over the longer term. The Company has healthy revenue reserves which cover in excess of four years of the regular dividend. The Board considers it important for the Manager to examine the merits of investments from a total return perspective and does not wish the composition of the portfolio to be dictated by the income requirements of the Company. Accordingly, the Board believes that these reserves should be utilised, if required, in the future.

As was the case for the past two years, the Board also considers that income generated in excess of the requirement of the regular dividend should be distributed as a special dividend.

## Board composition

I was appointed as Chairman at the AGM in January 2016, following the retiral of Douglas McDougall. The Company benefited greatly from his knowledge, experience and leadership over many years. On behalf of the Board, I should like to thank Douglas for his outstanding contribution.

Jane Lewis and Mick Brewis were appointed as non-executive Directors in December 2015 and elected at the AGM in January 2016. Jane is an investment trust specialist and Mick is an investment management specialist and both bring the experience of long careers in their fields.

## Process of change

The Company has undergone a number of changes over the past two years which I believe have positioned it well for future success.

Alasdair McKinnon was appointed as the Company's Manager in February 2015 and, since then, the investment team has been reorganised and the majority of our company secretarial and back office operations have been outsourced.

An important element of the changes has been the introduction of the high conviction, global contrarian investment approach which, as I mention earlier, differentiates the Company from our global growth investment trust peers. This approach reflects the investment team's natural style as independent thinkers and active, long-term investors who seldom follow the herd. It seeks opportunities created by the tendency of markets to concentrate too much on past performance. The Manager's view is that fashionable companies eventually become overvalued and unfashionable companies eventually become undervalued.

Central to the new investment approach is the Manager’s high conviction in the Company’s underlying investments and, in reflection of this, the Board considers it appropriate for the portfolio to contain fewer holdings than the previous typical range of 70 to 120 listed international equity investments. Accordingly, the portfolio will now typically contain 50 to 100 listed international equity investments. The number of listed holdings as at 31 October 2015 and 31 October 2016 was 74 and 70 respectively.

Following the changes outlined above, we now have a streamlined investment team that is focused for effective decision-making and has a clear investment approach which is explained more fully in the Manager’s Review.

We have also changed our approach with regard to marketing and communications. We will seek to raise the Company’s profile, as we believe that it is an attractive investment vehicle which should appeal to a broad range of potential investors when its attributes are effectively communicated. The first steps in this are visible in our relaunched website at **www.thescottish.co.uk** and a refreshed Annual Report. This has been achieved at a very reasonable cost and within our longstanding annual marketing budget.

## Low costs

The ongoing charges figure for the year under review was 0.49% which compares favourably with other actively-managed investment vehicles. As a self-managed investment trust, this figure represents the ongoing costs of running the Company rather than an ad valorem charge. The process of change over the two years, most notably the restructuring of the investment team and outsourcing of other functions, has helped to reduce the ongoing charges figure from 0.68% in 2014, to 0.52% in 2015 and to 0.49% in the year under review.

### Gearing and partial repayment of long-term borrowings

Gearing was largely unchanged and finished the year at 5%.

As I mentioned in the Interim Report, the majority of the Company's long-term borrowings, which mature in 2030, were arranged almost 17 years ago when a 5.75% coupon was considered attractive. The interest rate environment has changed considerably over this timeframe.

The original purpose of the borrowings was to invest on the basis that the return from a portfolio of equities would exceed the cost of borrowings on a long-term timeframe especially if deployed at an opportune time. The Board believes that this remains a valid assumption given that the borrowings have more than 13 years until expiry and, furthermore, the Board is conscious that a premium would currently be required for early repayment of the borrowings.

However, over recent years the proportionate size of these borrowings has increased due to shares being bought back and cancelled as part of the Company's discount control policy. Accordingly, we took the opportunity to repurchase £21m nominal, being around 20%, of the Company's secured bonds in December 2015. While this decision had a one-off negative impact on the NAV of 0.4% (with borrowings at market value) or 1.0% (with borrowings at par), the £1.2m reduction in the annual interest charge going forward means that the cost will be clawed back well within the lifetime of the bond.

### Discount and share buybacks

The Company follows a policy that aims, in normal market conditions, to maintain the discount to the ex-income NAV (with borrowings at market value) at or below 9%.

The discount at which the share price traded to the NAV over the period varied more than in previous years but finished the period at 8.1%. During the year 9.2m shares were purchased for cancellation at an average discount of 10.6% and a cost of £59.9m.

### Outlook

Although the UK Brexit vote to leave the European Union wrongfooted markets, the swift recovery, particularly in sterling terms, benefited the Company. Since the year-end, there has been a further challenge to the political status quo with the election of Donald Trump as US President. Forthcoming elections have the potential to highlight further rancour towards the European Union.

I do not propose to add to the large volume of material that exists on analysis of these events other than to observe that there is a view, not only confined to the US and the UK, that large sections of the population feel disadvantaged by the consequences of globalisation. In contrast, many large corporations have benefited from these trends but it is still too early to determine what changes, if any, will emerge under new political regimes. Regardless, politicians and bureaucrats are likely to remain sensitive to market movements and will not intend to damage investor confidence.

Finally, the Board believes that the progress made over the year stands the Company in good stead as a low-cost investment vehicle focused on delivering both above-average returns and dividend growth over the longer term.

James Will
Chairman

3 January 2017

# Manager’s Review

## Our contrarian approach

Before examining the year under review, I thought it would be useful to outline our contrarian investment philosophy which we believe will benefit a long-term investor in the Company.

Our contrarian approach is grounded in the simple observation that people like to belong to a group or to feel part of something bigger. Humans, as a species, have evolved to feel uncomfortable outwith the mainstream because, in more arduous times, a coordinated group stood a better chance of survival.

However, we believe this crowding instinct works against the best interests of an investor and that a different stance is required to profit. Accordingly, we do not attempt to follow investment fashions and instead seek investments in which we can foresee long term upside.

We think it is crucial to ignore the emotions associated with past performance and, rather, to view each investment on its future merit. This requires lateral thinking and the willingness to adopt a contrarian point of view as both markets and company management teams have a propensity for hubris in the good times and unjustified pessimism when times are hard.

We divide the stocks in which we invest into three categories.

First, we have those that we describe as **ugly ducklings** – unloved shares that most investors shun. These companies have endured an extended period of poor operating performance and, for the majority, the near-term outlook continues to appear uninspiring. However, we see their out-of-favour status as an opportunity and can foresee the circumstances in which these investments will surprise on the upside. These stocks often have a higher than average dividend yield which can provide an attractive income while we wait for our investment thesis to unfold.

The second category consists of companies where **change is afoot**. These companies have seen a significant improvement in their prospects but this progress has not yet been recognised by the market. Often, they are disliked for historical reasons, with investors unwilling to credit the signs of change that are so far evident.

Thirdly, we have stocks where we see **more to come**. Unlike the first two categories, these companies are generally recognised as good businesses but we see an opportunity as the market does not appreciate the scope for further improvement.

In our experience, the best investments can, over time, move along an axis from ‘ugly duckling’ through ‘change is afoot’ and into the ‘more to come’ category but we are happy to purchase and hold investments in any of the categories.

A key strength of our contrarian approach is that it provides profitable opportunities in all market environments as there are always underappreciated areas of the market.

## The financial year

This was a strong year for investment returns but there were two volatile periods that favoured our contrarian approach.

There was a sharp change in investor sentiment in January 2016 in the aftermath of a small interest rate increase by the US Federal Reserve. Almost overnight, investors shunned highly valued, fashionable stocks in favour of more attractively valued, but unfashionable, investments.

The outcome of the Brexit vote surprised investors who had set excessive store in the soothsaying abilities of opinion pollsters and bookmakers. The kneejerk plunge in markets was chaotic but the portfolio made a swift recovery and quickly advanced to new highs for the year. The downward movement in sterling had an obvious beneficial impact to the value of our overseas investments when considered in sterling terms. The vote also triggered an awakening of interest in our UK domiciled international companies, which stood to benefit from the conversion of their substantial non-sterling revenues.

## NAV Absolute Performance Attribution
## Year to 31 October 2016

| | **Contribution** % |
|---|---|
| Equity portfolio (ungeared) | +28.7 |
| Gearing | +2.3 |
| **Total equities** | **+31.0** |
| Other income, tax and currency | +0.6 |
| Buybacks | +1.0 |
| Expenses | -0.5 |
| Interest charges | -0.7 |
| Premium on repayment of secured bonds | -0.4 |
| Change in market value of borrowings | -1.5 |
| Change in pension liability | -0.1 |
| **NAV with borrowings at market value total return** | **+29.4** |

## Contributors to Absolute Performance
## Year to 31 October 2016

| | **Performance** % | **Positive Contribution** £m | | **Performance** % | **Negative Contribution** £m |
|---|---|---|---|---|---|
| Treasury Wine Estates | 105.2 | 21.0 | British Land | -29.7 | -4.3 |
| Sands China | 62.8 | 13.0 | Marks & Spencer | -24.6 | -2.3 |
| Microsoft | 47.5 | 10.7 | BT | -16.4 | -2.2 |
| Rentokil Initial | 50.5 | 10.1 | Associated British Foods* | -13.4 | -1.4 |
| Nintendo | 92.1 | 7.0 | Standard Life | -16.7 | -1.2 |
| Standard Chartered | 50.3 | 6.2 | Intesa Sanpaolo | -11.5 | -0.9 |
| KDDI | 61.4 | 6.2 | Bank of Ireland | -37.4 | -0.7 |
| Johnson & Johnson | 49.0 | 5.6 | Inditex* | -8.4 | -0.7 |
| Suncor Energy | 31.7 | 5.5 | Panasonic* | -12.5 | -0.7 |
| Royal Dutch Shell | 34.2 | 5.5 | Bank of Kyoto | -7.4 | -0.6 |

* Sold during the year.

Given our focus on individual stock ideas, rather than reporting portfolio activity in terms of geography or industry, I thought it more meaningful to discuss the notable gains and losses, in total return terms, over the year.

**Treasury Wine Estates** (+£21.0m), the largest holding in our portfolio, delivered outstanding performance and more than doubled in sterling terms over the year. This Australian wine company has been rejuvenated under the leadership of Michael Clarke and is being repositioned towards a brand-led strategy. The acquisition of Diageo's wine assets greatly expanded the company's scale and scope at a very reasonable price. On purchase, we viewed the company as an 'ugly duckling' but progress to date and a more general acceptance of the company's strategy means that we now believe that 'change is afoot'.

**Sands China** (+£13.0m), the Macau casino operator, is another investment we view as an 'ugly duckling'. The share price had suffered from the perception that the Chinese economy was heading for a period of very slow growth. However, a recovery in visitor spending supported our view of the broader appeal of Macau as a tourist destination while investor sentiment towards China improved. This, alongside an appealing dividend yield, helped produce a strong total return.

**Microsoft** (+£10.7m) appreciated meaningfully during the year as it continued to demonstrate an ability to shift a large user base to a more valuable subscription model. We originally viewed the company within the 'change is afoot' category but now consider the company has 'more to come'.

**Rentokil Initial** (+£10.1m), the UK support services company, is another example of where we see 'change is afoot'. Following a period of substantial restructuring, the company has refocused on the pest control market and has an opportunity to improve profit margins further. The company performed particularly well in the aftermath of Brexit as a high proportion of overseas revenues proved attractive to investors.

Leading Japanese games company **Nintendo** (+£7.0m) has the opportunity to bring its content to a wider audience and this was highlighted by the enthusiastic reception for the Pokémon Go smartphone game. We consider that 'change is afoot' and the upcoming launches of new smartphone games have the potential to shine further light on Nintendo's underappreciated intellectual property.

We view **Standard Chartered** (+£6.2m) as an 'ugly duckling' as it was shunned for high loan exposure to weak emerging markets and commodities. The prospects for these loans are improving which, alongside the company's ambitious restructuring plan, has the potential to improve the company's lowly valuation.

Improving sentiment towards emerging markets, oil and commodities in general was a common theme for several more of our best investments, particularly in the second half of the financial year. As reported last year, we had increased our exposure to certain stocks where we judged that pessimistic scenarios, related to a slowdown in emerging markets, were overly discounted in share prices. We saw large gains from our investments in **Suncor Energy** (+£5.5m), **Royal Dutch Shell** (+£5.5m), **Rio Tinto** (+£4.0m), **Cemex** (+£3.7m) and **BHP Billiton** (+£2.6m).

In a strong year for markets, it is unsurprising that we made comparatively few notable absolute losses. **British Land** (-£4.3m) suffered from the perceived threat to the UK commercial property market from Brexit but gloomy market assumptions present an interesting 'ugly duckling' recovery opportunity. **BT** (-£2.2m) also performed poorly in the aftermath of the Brexit vote and this was compounded by a potential shift in the regulatory framework. Being contrarian can require patience and this was the case with our new holding in **Marks & Spencer** (-£2.3m). We continue to think this 'ugly duckling' will benefit from the meaningful change which has commenced in earnest under the new leadership of Steve Rowe.

An important part of our contrarian investment approach is to sell investments where we no longer envisage a prospect for significant further upside. Most notably, we sold **Pandora** (+£4.9m), which had performed extremely well and which we considered fully valued, as we saw a less favourable balance of risks for this fashion driven stock. We also sold a number of other long-term holdings, where we judged the current valuation fully reflected their prospects, including Ross Stores, Associated British Foods, Persimmon, Alphabet, Svenska Handelsbanken and Sampo.

The Brexit vote and, subsequent to the year end, the election of Donald Trump as the forthcoming US President indicate that there may be a shift in the political and investment environment. Large segments of the populations in the developed world clearly feel that a decline in their living standards has been ignored by the establishment.

A change in the political zeitgeist, if it actually occurs, will undoubtedly benefit some companies more than others. However, our contrarian investment approach is designed to anticipate and benefit from change and we will continue to seek opportunities which we believe will profit a long-term investor.

Alasdair McKinnon
Manager

3 January 2017

## Financial Summary

| | 2016 | 2015 | Change % | Total Return % |
|---|---|---|---|---|
| NAV with borrowings at market value | 854.9p | 676.1p | +26.4 | +29.4 |
| NAV with borrowings at par | 881.2p | 694.3p | +26.9 | +29.9 |
| Ex-income NAV with borrowings at market value | 837. 5p | 665.0p | +25.9 | |
| Ex-income NAV with borrowings at par | 863.9p | 683.2p | +26.5 | |
| Share price | 769.5p | 608.0p | +26.6 | +30.0 |
| Discount to ex-income NAV with borrowings at market value | 8.1% | 8.6% | | |
| MSCI ACWI | | | +26.4 | +29.1 |
| MSCI UK All Cap Index | | | +7.9 | +12.3 |

| | £'000 | £'000 | |
|---|---|---|---|
| Equity investments | 893,432 | 774,236 | |
| Net current assets | 42,502 | 65,769 | |
| Total assets | 935,934 | 840,005 | |
| Long-term borrowings at par | (83,645) | (104,399) | |
| Pension liability | (3,272) | (2,550) | |
| Shareholders' funds | 849,017 | 733,056 | |
| Total income | 28,440 | 24,057 | +18.2 |
| Earnings per share | 21.62p | 15.91p | +35.9 |
| Regular dividend per share (2016: proposed final 8.25p) | 13.50p | 12.50p | +8.0 |
| Special dividend per share (proposed) | 9.00p | 3.50p | |
| Total dividend per share | 22.50p | 16.00p | +40.6 |
| UK Consumer Prices Index – annual inflation | | | +0.9 |
| UK Retail Prices Index – annual inflation | | | +2.0 |

## Year's High & Low

| | Year to 31 October 2016 | | Year to 31 October 2015 | |
|---|---|---|---|---|
| | High | Low | High | Low |
| NAV with borrowings at market value | 867.8p | 606.3p | 744.9p | 619.8p |
| Closing share price | 774.0p | 544.5p | 668.0p | 560.0p |
| Discount to ex-income NAV with borrowings at market value | 14.4% | 8.1% | 10.4% | 6.4% |

## List of Investments
## As at 31 October 2016

### Listed equities

| Holding | Country | Market value £'000 | Cumulative weight % |
|---|---|---|---|
| Treasury Wine Estates | Australia | 40,410 | |
| Sands China | Hong Kong | 33,103 | |
| Microsoft | US | 32,833 | |
| Rentokil Initial | UK | 30,166 | |
| GlaxoSmithKline | UK | 29,771 | |
| Severn Trent | UK | 28,288 | |
| Tesco | UK | 27,819 | |
| ING | Netherlands | 22,910 | |
| Standard Chartered | UK | 22,564 | |
| Suncor Energy | Canada | 22,559 | 32.5 |
| Royal Dutch Shell | UK | 21,356 | |
| Sumitomo Mitsui Financial | Japan | 20,801 | |
| Rio Tinto | UK | 19,362 | |
| Kingfisher | UK | 19,330 | |
| United Utilities | UK | 17,907 | |
| SAP | Germany | 17,537 | |
| Comcast | US | 17,331 | |
| PepsiCo | US | 17,264 | |
| Johnson & Johnson | US | 16,868 | |
| BHP Billiton | UK | 16,795 | 53.2 |
| Marks & Spencer | UK | 16,411 | |
| Sony | Japan | 16,043 | |
| KDDI | Japan | 15,931 | |
| Roche | Switzerland | 15,916 | |
| BNP Paribas | France | 15,224 | |
| Pfizer | US | 15,185 | |
| Nintendo | Japan | 14,484 | |
| General Electric | US | 13,631 | |
| RSA Insurance | UK | 13,381 | |
| Total | France | 13,249 | 69.9 |
| National Oilwell Varco | US | 11,832 | |
| Baker Hughes | US | 11,503 | |
| Verizon Communications | US | 11,226 | |
| BT | UK | 10,827 | |
| Cemex | Mexico | 10,808 | |
| Ambev | Brazil | 10,713 | |
| BASF | Germany | 10,703 | |
| Toyota Motor | Japan | 9,904 | |
| Vinci | France | 9,875 | |
| Chevron | US | 9,806 | 81.9 |
| British Land | UK | 9,784 | |
| Jardine Matheson | Singapore | 9,665 | |
| East Japan Railway | Japan | 9,384 | |
| Dürr | Germany | 8,957 | |
| Telstra | Australia | 8,774 | |
| Citigroup | US | 8,720 | |
| Avery Dennison | US | 8,602 | |
| Hess | US | 7,838 | |
| Adecco | Switzerland | 7,650 | |
| Aeroportuario del Sureste | Mexico | 6,674 | 91.5 |

| Holding | Country | Market value £'000 | Cumulative weight % |
|---|---|---|---|
| Bank of Kyoto | Japan | 6,576 | |
| Intesa Sanpaolo | Italy | 6,313 | |
| Citizens Financial | US | 6,007 | |
| Exxon Mobil | US | 5,720 | |
| HSBC | UK | 5,566 | |
| Micro Focus International | UK | 5,524 | |
| Bank of Ireland | Ireland | 5,386 | |
| Tourmaline Oil | Canada | 4,784 | |
| International Business Machines | US | 4,773 | |
| TGS-NOPEC Geophysical | Norway | 4,718 | 97.7 |
| ANZ Banking | Australia | 3,789 | |
| BorgWarner | US | 3,428 | |
| Sydney Airport | Australia | 2,619 | |
| Freehold Royalties | Canada | 2,494 | |
| Vodafone | UK | 1,387 | |
| Engie | France | 1,048 | |
| Aberdeen Asset Management | UK | 966 | |
| Standard Life | UK | 949 | |
| Greggs | UK | 917 | |
| WPP | UK | 866 | |
| **Total listed equities** | | **891,504** | **99.8** |

### Unlisted

| Holding | Country | Market value £'000 | Cumulative weight % |
|---|---|---|---|
| Heritable property and subsidiary | UK | 1,400 | |
| Boston Ventures V1 | US | 491 | |
| Apax Europe V-B | UK | 37 | |
| **Total unlisted** | | **1,928** | **0.2** |
| **Total equities** | | **893,432** | **100.0** |

## Distribution of Total Assets

| By Sector | 31 October 2016 % | 31 October 2015 % |
|---|---|---|
| Energy | 12.4 | 10.1 |
| Materials | 7.1 | 5.3 |
| Industrials | 10.5 | 9.6 |
| Consumer Discretionary | 12.4 | 17.7 |
| Consumer Staples | 10.4 | 6.2 |
| Health Care | 8.3 | 6.2 |
| Financials | 15.1 | 15.0 |
| Information Technology | 8.0 | 8.1 |
| Telecommunication Services | 5.1 | 6.2 |
| Utilities | 5.1 | 6.1 |
| Real Estate | 1.1 | 1.7 |
| Net current assets | 4.5 | 7.8 |
| **Total assets** | **100.0** | **100.0** |

| By Region | 31 October 2016 % | 31 October 2015 % |
|---|---|---|
| UK | 32.2 | 27.8 |
| Europe (ex UK) | 14.9 | 21.5 |
| North America | 24.9 | 23.7 |
| Latin America | 3.0 | 1.7 |
| Japan | 10.0 | 8.0 |
| Asia Pacific (ex Japan) | 10.5 | 9.5 |
| Net current assets | 4.5 | 7.8 |
| **Total assets** | **100.0** | **100.0** |

## Allocation of Shareholders' Funds

| | 31 October 2016 % |
|---|---|
| **Total equities** | **105** |
| Net cash and equivalents | 5 |
| Borrowings at par | (10) |
| **Shareholders' funds** | **100** |
| Gearing | 5 |

## Changes in Asset Distribution

| | 31 October 2015 £m | Net purchases (sales) £m | Appreciation (depreciation) £m | **31 October 2016 £m** |
|---|---|---|---|---|
| Energy | 84.7 | 8.1 | 23.1 | 115.9 |
| Materials | 44.5 | 7.1 | 14.7 | 66.3 |
| Industrials | 81.0 | (9.0) | 26.6 | 98.6 |
| Consumer Discretionary | 148.8 | (55.4) | 23.0 | 116.4 |
| Consumer Staples | 51.9 | 18.5 | 26.7 | 97.1 |
| Health Care | 51.7 | 14.1 | 11.9 | 77.7 |
| Financials | 126.1 | (4.3) | 19.3 | 141.1 |
| Information Technology | 67.9 | (21.9) | 29.2 | 75.2 |
| Telecommunication Services | 52.2 | (11.3) | 7.2 | 48.1 |
| Utilities | 50.9 | (4.0) | 0.3 | 47.2 |
| Real Estate | 14.5 | 0.0 | (4.7) | 9.8 |
| **Total equities** | **774.2** | **(58.1)** | **177.3** | **893.4** |

## Changes in Shareholders' Funds

| | 31 October 2015 £m | Net purchases (sales) £m | **31 October 2016 £m** | Appreciation (depreciation) £m | Dividend income £m | Total return £m |
|---|---|---|---|---|---|---|
| **Total equities** | **774.2** | **(58.1)** | **893.4** | **177.3** | **28.3** | **205.6** |
| Net current assets | 65.8 | (29.7) | 42.5 | | | |
| Total assets | 840.0 | (87.8) | 935.9 | | | |
| Long-term borrowings at par | (104.4) | 20.8 | (83.6) | | | |
| Pension liability | (2.5) | 0.0 | (3.3) | | | |
| **Shareholders' funds** | **733.1** | **(67.0)** | **849.0** | | | |

## Income Statement
For the year to 31 October 2016

| | 2016 Revenue £'000 | 2016 Capital £'000 | 2016 Total £'000 | 2015 Revenue £'000 | 2015 Capital £'000 | 2015 Total £'000 |
|---|---|---|---|---|---|---|
| Net gains on investments held at fair value through profit and loss | - | 177,326 | 177,326 | - | 15,778 | 15,778 |
| Net gains on currencies | - | 6,024 | 6,024 | - | 3 | 3 |
| Income | 28,440 | - | 28,440 | 24,057 | - | 24,057 |
| Expenses | (2,407) | (1,673) | (4,080) | (2,892) | (2,008) | (4,900) |
| Net Return before Finance Costs and Taxation | 26,033 | 181,677 | 207,710 | 21,165 | 13,773 | 34,938 |
| Premium on repayment of secured bonds | - | (7,393) | (7,393) | - | - | - |
| Interest payable | (2,529) | (2,529) | (5,058) | (3,096) | (3,095) | (6,191) |
| Return on Ordinary Activities before Tax | 23,504 | 171,755 | 195,259 | 18,069 | 10,678 | 28,747 |
| Tax on ordinary activities | (1,534) | - | (1,534) | (984) | - | (984) |
| **Return attributable to Shareholders** | **21,970** | **171,755** | **193,725** | **17,085** | **10,678** | **27,763** |
| **Return per share** | **21.62p** | **169.04p** | **190.66p** | **15.91p** | **9.95p** | **25.86p** |
| **Weighted average number of shares in issue during the year** | | **101,606,378** | | | **107,353,426** | |

| | 2016 £'000 | 2015 £'000 |
|---|---|---|
| Dividends paid and proposed | | |
| Interim 2016 - 5.25p (2015: 5.00p) | 5,276 | 5,366 |
| Final 2016 - 8.25p (2015: 7.50p) | 7,984 | 7,864 |
| Special 2016 - 9.00p (2015: 3.50p) | 8,671 | 3,670 |
| **Total 2016 - 22.50p (2015: 16.00p)** | **21,931** | **16,900** |

The total column of this statement is the profit and loss account of the Company.

## Balance Sheet
As at 31 October 2016

| | £'000 | 2016 £'000 | £'000 | 2015 £'000 |
|---|---|---|---|---|
| **Fixed Assets** | | | | |
| Equity investments | | 893,432 | | 774,236 |
| **Current Assets** | | | | |
| Debtors | 2,260 | | 24,641 | |
| Cash | 11,694 | | 14,815 | |
| Cash equivalents | 29,210 | | 59,138 | |
| | 43,164 | | 98,594 | |
| **Creditors:** liabilities falling due within one year | (662) | | (32,825) | |
| **Net Current Assets** | | **42,502** | | **65,769** |
| **Total Assets less Current Liabilities** | | **935,934** | | **840,005** |
| **Creditors:** liabilities falling due after more than one year | | | | |
| Long-term borrowings at par | | (83,645) | | (104,399) |
| Pension liability | | (3,272) | | (2,550) |
| **Net Assets** | | **849,017** | | **733,056** |
| **Capital and Reserves** | | | | |
| Called-up share capital | | 24,086 | | 26,397 |
| Share premium account | | 39,922 | | 39,922 |
| Other reserves | | | | |
| Capital redemption reserve | | 46,775 | | 44,464 |
| Capital reserve | | 682,209 | | 570,812 |
| Revenue reserve | | 56,025 | | 51,461 |
| **Shareholders' funds** | | **849,017** | | **733,056** |
| **Net Asset Value per share with borrowings at par** | | **881.2p** | | **694.3p** |
| **Number of shares in issue at year end** | | **96,342,683** | | **105,587,426** |

## Statement of Comprehensive Income
For the year to 31 October 2016

| | 2016 Revenue £'000 | 2016 Capital £'000 | 2016 Total £'000 | 2015 Revenue £'000 | 2015 Capital £'000 | 2015 Total £'000 |
|---|---|---|---|---|---|---|
| Return attributable to shareholders | 21,970 | 171,755 | 193,725 | 17,085 | 10,678 | 27,763 |
| Actuarial losses relating to pension scheme | (596) | (414) | (1,010) | (252) | (175) | (427) |
| Total comprehensive income for the year | 21,374 | 171,341 | 192,715 | 16,833 | 10,503 | 27,336 |
| Total comprehensive income per share | 21.04p | 168.63p | 189.67p | 15.68p | 9.78p | 25.46p |

## Statement of Changes in Equity
For the year to 31 October 2016

| | 2016<br>£'000 | 2015<br>£'000 |
|---|---|---|
| Balance at 1 November | 733,056 | 734,293 |
| Total recognised gains | 192,715 | 27,336 |
| Dividend payments | (16,810) | (13,147) |
| Share buybacks | (59,944) | (15,426) |
| **Balance at 31 October** | **849,017** | **733,056** |

## Cash Flow Statement
As at 31 October 2016

| | 2016<br>£'000 | 2015<br>£'000 |
|---|---|---|
| **Operating activities** | | |
| Net revenue before finance costs and taxation | 26,033 | 21,165 |
| Expenses charged to capital | (1,673) | (2,008) |
| Increase in accrued income | (287) | (92) |
| Decrease in other payables | (403) | (297) |
| Decrease in other receivables | 81 | 861 |
| Adjustment for pension funding | (288) | (490) |
| Tax on investment income | (1,919) | (1,289) |
| **Net cash inflow from operating activities** | **21,544** | **17,850** |
| **Investing activities** | | |
| Purchases of investments | **(162,884)** | **(319,796)** |
| Disposals of investments | **218,530** | **326,984** |
| **Cash flows from investing activities** | **55,646** | **7,188** |
| **Cash flows before financing activities** | **77,190** | **25,038** |
| **Financing activities** | | |
| Equity dividends paid | (16,810) | (13,147) |
| Repayment of secured bond | (28,241) | - |
| Share buybacks | (60,158) | (15,042) |
| Interest paid | (5,030) | (6,075) |
| Overseas tax recovered | - | 205 |
| **Cash flows from financing activities** | **(110,239)** | **(34,059)** |
| **Net movement in cash and cash equivalents** | **(33,049)** | **(9,021)** |
| **Cash and cash equivalents at the beginning of year** | **73,953** | **82,974** |
| **Cash and cash equivalents at the end of year** | **40,904** | **73,953** |

## Responsibility Statement

The Directors are responsible for preparing the Annual 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 Financial Statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland". Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these Financial Statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Financial Statements; and
- prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping 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 enable them to ensure that the Financial Statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of Financial Statements may differ from legislation in other jurisdictions.

The Board of Directors confirms that to the best of its knowledge:

a) the Financial Statements, prepared in accordance with United Kingdom Generally Accepted Accounting Practice, give a true and fair view of the assets, liabilities, financial position and return of the Company;
b) the Strategic Report includes a fair review of the development and performance of the business and the position of the Company together with a description of the principal risks and uncertainties the Company faces; and
c) the Annual Report and Financial Statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

The responsibility statement was approved by the Board of Directors and signed on its behalf by:

James Will
Chairman
3 January 2017

## Notes to the Financial Statements

For the year to 31 October 2016

1. The financial statements have been prepared in accordance with Financial Reporting Standard 102 and with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies and Venture Capital Trusts'. The financial statements are prepared in sterling which is the functional currency of the Company and are rounded to the nearest £'000. They have also been prepared on the assumption that approval as an investment trust will continue to be granted. The financial statements have been prepared on a going concern basis.

2. Return per ordinary share

The revenue return per share is calculated on net revenue on ordinary activities after taxation for the year of £21,970,000 (2015 - £17,085,000) and on 101,606,378 (2015 – 107,353,426) shares, being the weighted average number of shares in issue during the year.

The capital return per share is calculated on net capital return for the year of £171,755,000 (2015 –£10,678,000) and on 101,606,378 (2015 – 107,353,426) shares, being the weighted average number of shares in issue during the year.

The total return per share is calculated on total return for the year of £193,725,000 (2015 –£27,763,000) and on 101,606,378 (2015 – 107,353,426) shares, being the weighted average number of shares in issue during the year.

3. Net asset value per share

The net asset value per share is based on net assets of £849,017,000 (2015: £733,056,000) and on 96,342,683 (2015: 105,587,426) shares, being the number of shares in issue at the year end.

4. Dividends

A final dividend in respect of the year ended 31 October 2016 of 8.25p (2015 – 7.50p) per share will be paid on 17 February 2017 to shareholders on the register on 13 January 2017.

A special dividend in respect of the year ended 31 October 2016 of 9.00p (2015 – 3.50p) per share will be paid on 17 February 2017 to shareholders on the register on 13 January 2017.

5. Related parties

The Directors of the Company receive fees for their services.

6. The financial information set out above does not constitute the Company's statutory Financial Statements for the year ended 31 October 2016 but is derived from those Financial Statements. Statutory Financial Statements for the year ended 31 October 2016 will be delivered to the Registrar of Companies in due course. The Auditors have reported on those Financial Statements; their report was (i) unqualified, (ii) did not include a reference to any matters to which the Auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under Section 498 (2) or (3) of the Companies Act 2006. The text of the Auditors' Report will be found in the Company's full Annual Report and Financial Statements on the Company's website: **www.thescottish.co.uk** Copies may also be obtained from the Company Secretary: R&H Fund Services Limited, 20 Forth Street, Edinburgh EH1 3LH.

## Risk management policies and procedures

As an investment trust, the Company invests in equities and other investments for the long term so as to secure its investment objective stated above. In pursuing its investment objective, the Company is exposed to a variety of risks that could result in a reduction in the Company's net assets and a reduction in the profits available for dividend.

The main risks include investment and market price risk (comprising foreign currency risk and interest rate risk), liquidity risk and credit risk. The Directors' approach to the management of these risks is set out below. The Directors of the Company and of S.I.T. Savings Limited coordinate the Company's risk management.

The Company's policies and processes for managing the risks, and the methods used to measure the risks, which are set out below, have not changed from those applied in the previous year.

a. Investment and market price risk
The holding of securities and investing activities involve certain inherent risks. Events may occur which affect the value of investments. The Company holds a portfolio which is well diversified across industrial and geographical areas to help minimise these risks. It may also use derivatives. From time to time, the Company may wish to use derivatives in order to protect against a specific risk or to facilitate a change in investment strategy such as the movement of funds from one area to another. No such transaction may take place without the prior authorisation of the Board.

b. Foreign currency risk
Approximately 70% of the Company's assets are invested overseas which gives rise to a currency risk. From time to time, specific hedging transactions are undertaken. The Company's overseas income is subject to currency movements.

c. Interest rate risk
The Company finances its operations through a combination of investment realisations, retained revenue reserves, debenture stocks and secured bonds. All debenture stocks and secured bonds are at fixed rates.

d. Liquidity risk
Almost all of the Company's assets comprise listed securities which represent a ready source of funds. In addition, the Company has access to short-term borrowing facilities. Liquidity risk is not as significant as the other risks as most of the Company's assets are investments in quoted equities and are readily realisable. The manager reviews the liquidity of the portfolio when making investment decisions.

e. 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.

f. Capital management policies and procedures
The Company carries on its business as a global growth investment trust. Its objective is to provide investors, over the longer term, with above-average returns through a diversified portfolio of international equities and to achieve dividend growth ahead of UK inflation.

The levels of gearing and gross gearing are monitored closely by the Board and the Manager. The Board currently limits gearing to 20%. While gearing will be employed in a typical range of 0% to 20%, the Company retains the ability to lower equity exposure to a net cash position if deemed appropriate.

The Board, with the assistance of the management, monitors and reviews the structure of the Company's capital on an ongoing basis. This review includes the planned level of gearing which will take into account the management's view on the market, the need to buy back shares for cancellation and the level of dividends.

The Company's policies and processes for managing capital are unchanged from the previous year.