

Shires Smaller Companies plc



INTERIM REPORT
30 JUNE 2006

MANAGED BY

GLASGOW
INVESTMENT MANAGERS

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Objective

The objective of the Company is to provide a high and growing dividend and capital growth from a portfolio invested principally in the ordinary shares of smaller UK companies and UK fixed income securities.

Financial Highlights

	As at 30 June 2006	As at 31 December 2005	%
			change
Total investments	£88.7m	£89.9m	-1.3
Shareholders' funds	£56.0m	£56.3m	-0.5
Net asset value per share	253.4p	254.8p	-0.5
Share price	240.0p	252.5p	-4.9
(Discount)/Premium (share price to adjusted net asset value)*	(3.6%)	1.0%	
Dividends per share	8.0p	7.75p+	
Fourth Interim Dividend (2005)	4.75p	4.75p	
First Interim Dividend (2006)	3.25p	3.00p	
Second Interim Dividend (2006)^	3.25p	3.00p	

+ Half year to 30 June 2005.

^ The Second Interim Dividend is not reflected in these accounts.

Performance

(periods to 30 June 2006)

	6 months %	1 year %	3 years %	5 years %
Shires Smaller Companies plc				
– Net asset value total return*	3.4▲	15.3▲	83.6†	60.0†
– Share price total return	-1.9▲	9.2▲	86.1†	67.6†
FTSE SmallCap Index (excluding Investment Companies)‡	4.3	17.0	66.6	29.3
FTSE All-Share Index‡	6.1	19.7	66.1	27.8

Performance

(Continued)

Discrete Year Performance

Year to:	30 June 2002	30 June 2003	30 June 2004	30 June 2005	30 June 2006
	4.8%†	(14.5)%†	28.9%†	32.8%†	9.5%†

Bid to bid closing share price, net income re-invested.

Past performance should not be seen as an indication of future performance.

	As at 30 June 2006	As at 31 December 2005
Net Dividend Yield		
Shires Smaller Companies plc▲	5.9%•	5.4%
FTSE SmallCap Index (excluding Investment Companies)‡	2.2%	2.1%
FTSE All-Share Index‡	3.1%	3.0%

* Based on IFRS NAV reduced by the dividend adjustment of 4.75p

▲ Source: Glasgow Investment Managers Limited (based upon IFRS accounting policies)

† Source: Prepared for the Association of Investment Trust Companies by Fundamental Data (based upon prior UK GAAP and AITC SORP accounting policies).

‡ Source: Datastream.

• Based on share price and last four paid quarterly dividends.

Chairman's Statement

Financial Highlights

I am pleased to report that the dividends paid by the Company have increased over the last six months. The first and second interim dividends for 2006 have totalled 6.5p compared to 6.0p last year, giving a yield of 5.9% based upon a share price of 240.0p as at 30 June 2006. This dividend increase of 8.3% was facilitated by the reduction in interest payments on long term borrowings and the growth in underlying company dividend receipts. Subject to any unforeseen circumstances current estimates suggest that the dividend can be increased further in the current year. However this should not be taken as a forecast of profits.

Investment Returns

The total return on net assets over the six months was 3.4%, slightly lower than the 4.3% return on the FTSE SmallCap Index (excluding Investment Companies), the Company's benchmark. This underperformance was principally due to a fall in the value of the corporate bond portfolio as expectations of a downward movement in UK interest rates diminished.

The total return to shareholders, or share price total return, was -1.9%. This reflects the fact that the discount at which the share price stood to the net asset value per share (NAV) was 3.6% compared to a premium of 1.0% at 31 December 2005.

It should be noted that all net asset value returns, calculations of discounts and regular NAV reporting are calculated excluding the IFRS dividend adjustment detailed in the 2005 Annual Report. This treatment is in line with a recommendation from the Association of Investment Trust Companies.

Earnings and Dividends

As shown in the financial highlights section the first and second interim dividends paid to date for the 2006 financial year amounted to 6.5p compared to 6.0p for the same period last year. This comprised two payments of 3.25p per share, made on 28 April 2006 and 31 July 2006 respectively. You will recall that a new £10 million loan was taken out following the repayment of the previous £10 million borrowings in December 2005. The interest rate on the new loan is fixed at 5.49% compared to 9% on the old loan, thereby reducing costs. Lower costs along with increased dividends received from investee companies have boosted the revenue account allowing increased dividend payments by the Company.

Chairman's Statement

(Continued)

Portfolio Profile

The distribution of assets table on page 12 shows 105.6% of net assets was invested in ordinary shares at 30 June 2006. This compares to 101.3% at 31 December 2005. This rise was due to continued growth in the value of equities in the six month period, a net investment into equities of £584,000 and a fall in the value of the corporate bond portfolio. Total gearing at 30 June 2006 was 58.4% of net assets, down from 59.6% at 31 December 2005. The majority of the Company's gearing continues to be invested in high-yielding fixed interest securities which make a significant contribution to the high level of income distributed to shareholders.

Outlook

Recent economic trends suggest that the current global economic growth cycle has peaked. In the USA, the housing market and retail sales are starting to decelerate, indicating that increased interest rates may be inducing a consumer led slow down. It is therefore likely that US interest rates and inflation will peak in the foreseeable future. In the UK, second quarter GDP, retail sales and inflation were ahead of expectation. The increase in UK interest rates to 4.75% was a direct consequence of this, with further increases probable if inflation remains above target. Equity markets will remain highly sensitive to the peaking of the economic growth, inflation, and interest rate cycles.

Despite this uncertain backdrop, the UK corporate profits environment remains positive. UK company balance sheets remain strong which will support further dividend growth and share buy backs. Dividend payments are well covered by earnings and are growing above the rate of inflation. Investors need to be prepared for continued volatility of share prices but dividend payments by portfolio companies should remain healthy and progress gradually. Given this, together with reasonable valuation levels, it suggests that the stockmarket should make further gains.



H S Cathcart
Chairman

Consolidated Income Statement

for the half year ended 30 June 2006

	Half year to 30 June 2006		
	Revenue £000	(unaudited) Capital £000	Total £000
Gains			
Gains on investments at fair value	–	612	612
Zero coupon finance costs	–	(112)	(112)
Revenue			
Dividend income	1,286	–	1,286
Interest income from investments	740	(32)	708
Deposit Interest	4	–	4
Net (loss)/gain on financial assets held for trading	(59)	–	(59)
	<u>1,971</u>	<u>468</u>	<u>2,439</u>
Expenses			
Investment management fee	(204)	(204)	(408)
Other administrative expenses	(147)	–	(147)
Finance costs of borrowings	(219)	(219)	(438)
	<u>(570)</u>	<u>(423)</u>	<u>(993)</u>
Profit before tax	1,401	45	1,446
Tax expense	–	–	–
Profit for the year	<u>1,401</u>	<u>45</u>	<u>1,446</u>
Profit attributable to equity holders of the Company	<u>1,401</u>	<u>45</u>	<u>1,446</u>
Earnings per ordinary share (pence)			6.5p

The Total column is the Income Statement of the Group

There are no discontinued operations

Consolidated Income Statement

(continued)

Half year to 30 June 2005 (unaudited)			Year to 31 December 2005 (audited)		
Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
–	4,143	4,143	–	9,903	9,903
–	(639)	(639)	–	(1,128)	(1,128)
1,048	–	1,048	2,794	–	2,794
988	(65)	923	1,674	(69)	1,605
5	–	5	18	–	18
(15)	–	(15)	58	–	58
<u>2,026</u>	<u>3,439</u>	<u>5,465</u>	<u>4,544</u>	<u>8,706</u>	<u>13,250</u>
(178)	(178)	(356)	(368)	(368)	(736)
(128)	–	(128)	(298)	–	(298)
(302)	(302)	(604)	(606)	(606)	(1,212)
(608)	(480)	(1,088)	(1,272)	(974)	(2,246)
1,418	2,959	4,377	3,272	7,732	11,004
–	–	–	–	–	–
<u>1,418</u>	<u>2,959</u>	<u>4,377</u>	<u>3,272</u>	<u>7,732</u>	<u>11,004</u>
<u>1,418</u>	<u>2,959</u>	<u>4,377</u>	<u>3,272</u>	<u>7,732</u>	<u>11,004</u>
		19.8p			49.8p

Group Balance Sheet

as at 30 June 2006

	30 June 2006 (unaudited) £000	31 December 2005 (audited) £000	30 June 2005 (unaudited) £000
Non current assets			
Ordinary shares	59,149	57,086	51,853
Convertibles	2,186	2,029	2,354
Corporate bonds	21,264	22,738	22,784
Other fixed interest	6,117	8,065	6,285
Zero coupon finance call options	3,919	3,281	1,121
Zero coupon finance put options	819	1,385	313
	<u>93,454</u>	<u>94,584</u>	<u>84,710</u>
Current assets			
Trade and other receivables	–	580	1,911
Accrued income and prepayments	947	1,148	1,066
Financial assets of dealing subsidiary	306	365	319
Cash and cash equivalents	719	1,140	1
Zero coupon finance put options	–	–	1,759
	<u>1,972</u>	<u>3,233</u>	<u>5,056</u>
Current liabilities			
Current portion of long-term loan	–	–	(9,997)
Trade and other payables	(417)	(1,505)	(813)
Short-term borrowings	(5,720)	(6,885)	(6,803)
Zero coupon finance put options	–	–	(5,744)
	<u>(6,137)</u>	<u>(8,390)</u>	<u>(23,357)</u>
Non current liabilities			
Long-term loan	(10,000)	(10,000)	–
Zero coupon finance call options	(17,712)	(16,547)	(10,862)
Zero coupon finance put options	(5,558)	(6,539)	(4,452)
	<u>(33,270)</u>	<u>(33,086)</u>	<u>(15,314)</u>
Net assets	<u>56,019</u>	<u>56,341</u>	<u>51,095</u>
Issued capital and reserves attributable to equity holders of the parent			
Called up share capital	11,055	11,055	11,055
Share premium account	11,892	11,892	11,892
Capital redemption reserve	2,032	2,032	2,032
Realised capital reserve	16,907	16,115	12,179
Unrealised capital reserve	12,227	12,974	12,298
Revenue reserve	1,906	2,273	1,639
	<u>56,019</u>	<u>56,341</u>	<u>51,095</u>
Net asset value per ordinary share (pence)	<u>253.4p</u>	<u>254.8p</u>	<u>231.1p</u>

Note: These are not statutory accounts under section 240 of the Companies Act 1985 and are unaudited. The figures and financial information for the year ended 31 December 2005 have been extracted from the 2005 report and accounts which have been delivered to the Registrar of Companies; the report of the auditors on these accounts was unqualified and did not contain a statement under Section 237(2) or (3) of the Companies Act 1985.

Consolidated Cash Flow Statement

for the half year ended 30 June 2006

	Half year to 30 June 2006 (unaudited) £000	Half year to 30 June 2005 (unaudited) £000	Year to 31 December 2005 (audited) £000
Cash flows from operating activities			
Investment income received	2,233	2,005	4,204
Deposit interest received	6	5	17
Investment management fee paid	(421)	(350)	(743)
Sales less purchases of current financial assets held for trading	–	(334)	(307)
Other cash receipts	–	350	350
Other cash expenses	(186)	(117)	(229)
Cash generated from operations	1,632	1,559	3,292
Interest paid	(449)	(594)	(1,186)
Taxation	–	–	–
Net cash inflows from operating activities	<u>1,183</u>	<u>965</u>	<u>2,106</u>
Cash flows from investing activities			
Purchases of investments	(11,915)	(14,551)	(41,714)
Sales of investments	13,245	13,456	41,796
Net cash inflow/(outflow) from investing activities	<u>1,330</u>	<u>(1,095)</u>	<u>82</u>
Cash flows from financing activities			
Proceeds of issue of shares	–	514	514
Equity dividends paid	(1,769)	(1,703)	(3,030)
Redemption of zero coupon finance – Cost payable on Maturity	–	–	(4,000)
Zero coupon finance – Proceeds from new investment	–	–	4,066
Net increase/(decrease) in cash and cash equivalents	<u>744</u>	<u>(1,319)</u>	<u>(262)</u>
Cash and cash equivalents at start of period	(5,745)	(5,483)	(5,483)
Cash and cash equivalents at end of period	<u>(5,001)</u>	<u>(6,802)</u>	<u>(5,745)</u>
Cash and cash equivalents comprise:			
Cash and cash equivalents	719	1	1,140
Short-term borrowings	(5,720)	(6,803)	(6,885)
	<u>(5,001)</u>	<u>(6,802)</u>	<u>(5,745)</u>

Consolidated Statement of Changes in Equity

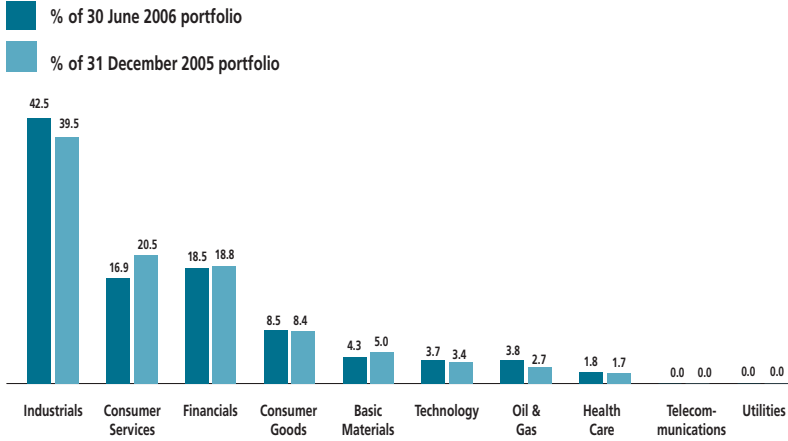
for the half year ended 30 June 2006

	Share Capital £000	Share Premium £000	Capital Redemption Reserve £000	Realised Capital Reserve £000	Unrealised Capital Reserve £000	Retained Revenue Reserve £000	Total £000
As at 31 December 2005	11,055	11,892	2,032	16,115	12,974	2,273	56,341
Revenue for the period	–	–	–	–	–	1,401	1,401
Capital profits for the period	–	–	–	792	(747)	–	45
Equity dividends	–	–	–	–	–	(1,768)	(1,768)
As at 30 June 2006	11,055	11,892	2,032	16,907	12,227	1,906	56,019

Analysis of Equity Portfolio

(based on value of Ordinary Shares)

The equity portfolio is wholly invested in the UK.



Distribution of Assets

	Valuation at 31 December 2005 (audited) £000	%	Purchases £000	Sales £000	Appreciation/ (Depreciation) £000	Valuation at 30 June 2006 (unaudited) £000	%
Listed investments							
Ordinary shares	57,086	101.3	9,087	(8,503)	1,479	59,149	105.6
Convertibles	2,029	3.6	–	–	157	2,186	3.9
Corporate bonds	22,738	40.4	1,552	(2,107)	(919)	21,264	38.0
Other fixed interest	8,065	14.3	244	(2,055)	(137)	6,117	10.9
	<u>89,918</u>	<u>159.6</u>	<u>10,883</u>	<u>(12,665)</u>	<u>580</u>	<u>88,716</u>	<u>158.4</u>
Other non current assets	4,666	8.3				4,738	8.4
Current assets	3,233	5.7				1,972	3.5
Current liabilities	(8,390)	(14.9)				(6,137)	(10.9)
Non current liabilities	(33,086)	(58.7)				(33,270)	(59.4)
Net assets	<u>56,341</u>	<u>100.0</u>				<u>56,019</u>	<u>100.0</u>
Net asset value per share	254.8p					253.4p	

Glasgow Investment Managers Limited
(Authorised and regulated by the Financial Services Authority)

Glasgow Investment Managers ("*Glasgow*"), the company which manages Shires Smaller Companies plc, is principally owned by its staff and retired founder with an investment trust (Shires Income plc) holding the remaining interest.

Glasgow also manages two other investment trust companies:

- Shires Income plc
- Glasgow Income Trust plc

Shares in Shires Smaller Companies plc, Shires Income plc and Glasgow Income Trust plc are also available within the Glasgow Investment Collection, as detailed below.

The Glasgow Investment Collection

The Glasgow Investment Collection was launched in January 2004. It offers the opportunity for investors to choose to invest in one or a combination of all of the following three investment trusts: Shires Smaller Companies plc, Shires Income plc and Glasgow Income Trust plc, the investment trusts managed by *Glasgow*. These investments can be made through an ISA, TrustPlan, PEP Transfer or a new Children's Savings Plan.

The Glasgow Investment Collection offers:

- Regular monthly savings, from as little as £20 per month;
- Lump sum investment from £200;
- PEP or ISA transfer;
- A share exchange scheme;
- Dividend reinvestment.

Further information may be obtained from *Glasgow* on FREEFONE 0800 435 797

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degree of risk than most funds. In certain circumstances, the Manager may enter into derivatives transactions in order to manage risk in the portfolio and generate income. The market in these instruments can be highly volatile and there is a high risk of loss. Derivatives may only be used subject to the restrictions set out for the Trust.

Investment Trusts have the facility to borrow, which is known as “gearing.” Shires Smaller Companies plc participates in gearing. Normally gearing is measured as a percentage. A gearing percentage of 10% means that an Investment Trust with net assets of £100 million has £10 million of borrowing(s). The level of gearing can change quite significantly depending on fluctuations in market levels. When there is a change in value of the Investment Trust’s underlying portfolio, the use of gearing may result in exaggerated movements in the Trust’s net asset value. Gearing may also result in Investment Trust price movements being more volatile than the price movements in the Trust’s underlying investment portfolio.

The favourable tax treatment of PEPs and ISAs is subject to government legislation, and as such, may be changed. The value of tax relief will depend upon your individual circumstances.

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