Rathbone Unit Trust Management Limited

Rathbone Smaller Companies Fund

The Continued Rise of UK Smaller Companies

Rathbones

1. Why back UK smaller companies?

• Superior growth prospects •
• Opportunities in inefficient markets •
• Individual value to be found •

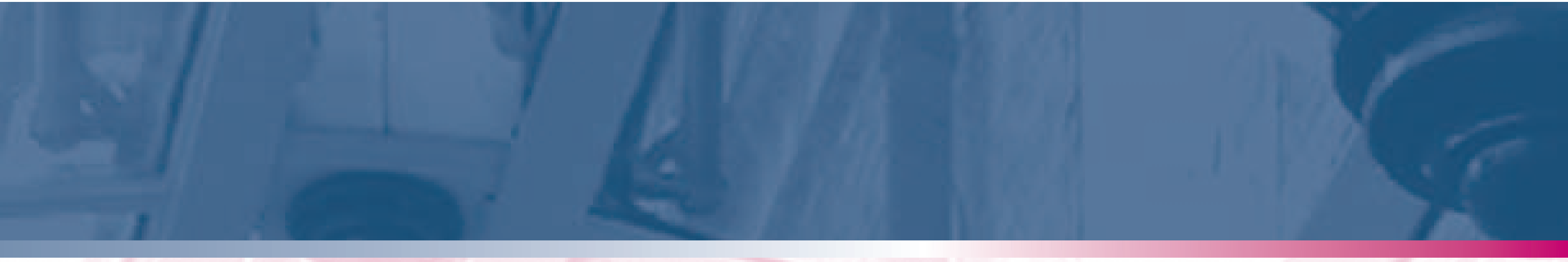
"There are fundamental reasons why UK smaller companies should continue to outperform over the next few years."

2. Strong performance, we think that there may be more to come?

• UK Smaller companies outperforming larger companies •
• The Rathbone Smaller Companies Fund outperforming peers and small company index •

"Disciplined and focused sector and stock selection, as well as flexibility of style is important in maximising total returns. We believe that our robust investment process gives us a very strong foundation for our decision-making."

Rathbones



The continued rise of UK smaller companies

Why UK smaller companies?

An ideal backdrop

Although there has been weakness from the consumer on the High Street, employment remains high, inflation seems to be under control and interest rates may have peaked. Against such a background, smaller companies have continued to hold up well.

Favourable conditions for specialist smaller companies set to continue

For those who believe that they have missed out on the smaller companies boom of the last two years, there are fundamental reasons why smaller companies should continue to out-pace than their larger brethren for some time yet:

- The most important factor is their growth potential. It is becoming clear that to find decent earnings growth, the best place to look is at the smaller end of the market. Smaller companies tend to specialise by exploiting niche markets that are often not suitable for larger companies to enter. This specialisation produces barriers to entry, which in turn gives small companies pricing power. In this low inflationary environment, pricing power is crucial.

- The trend towards globalisation and use of the Internet has lead to increased price transparency and competition. More than ever, companies need to differentiate themselves, and it is the ability to carve out and exploit niche opportunities which places smaller companies in a strong position relative to larger companies.

- In the past, smaller companies have generally suffered more than larger companies from rapid and dramatic interest rate rises. With core inflation currently below target, oil prices still remaining stubbornly high, and the Monetary Policy Committee (MPC) having to take care not to provoke a panic in the housing market, we have seen a peak in interest rates in 2005.

The toughest, battle-hard companies remain

- Following the dot.com crash in 2000, the environment became pretty tough for smaller companies; so tough that analysts deserted the sector in droves. This created a very inefficient market with many oversold stocks, despite the fact that a good proportion, the toughest and most robust, had emerged through the downturn in a leaner and stronger position than when they went into it.

Marina Bond, Investment Manager says: ***"Enter the stock-pickers who are prepared to do the research in order to find real value under these conditions. The inherent value in smaller companies has a long way to go before being unlocked; it is still an under-researched, inefficient market and the universe is large and growing."***

High volatility and superior returns of late... but smaller companies are not necessarily higher risk than larger companies

- It is true that the Alternative Investment Market (AIM) has less stringent disclosure requirements, but the growing list of 'blue-chip' failures, the likes of Railtrack, Enron and Marconi, does suggest that larger companies are not necessarily more transparent. Such companies are often so large that it is just not possible to keep track of what is really going on.

- In the small company arena, you have much greater access to the management of a company and they are usually willing to come and talk to you individually.

Marina says: ***"Many managers of smaller companies funds are outperforming the smaller companies index and the wider market, having found the best of these opportunities. The manager who makes the most of the insight gained from this close contact and greater transparency will be in the best position to find, ratify and exploit the strongest opportunities."***

- Smaller companies are less liquid (harder to buy and sell in quantity) and therefore tend to be more volatile, but a good smaller companies manager will automatically build this into the timing of their investment decisions.

In summary

- In such a low inflationary environment, investors need to look harder for growth opportunities, and it is amongst the small caps that this growth is on offer.

- Through their specialist expertise and niche characteristics they have the pricing power to grow their earnings faster than their larger brethren.

- Despite higher raw material costs, many are operationally robust with strong cashflows and earnings growth. This helps them to withstand any volatility that this uncertain world may present.

"The small end of the market should continue to outperform over the next few years and is prime hunting territory for managers with strong stock-picking skills."

Why Rathbones Smaller Companies Fund?

Strong outperformance of the small cap index and peer group and more patterns

The Rathbone Smaller Companies Fund:

- Is 1st of 33 funds in its sector (S&P UT UK Smaller Companies) since 01.10.93, and is 2nd out of 36 funds over 10 years.
- Has returned +6.48%, +28.19%, +77.81%, +10.38%, +354.95% and +490.10% over 6 months, 1, 3, 5, 10 years and since launch respectively.

This performance has been achieved partly through a relentless focus on stock picking but also due to a strengthening of our investment process. A robust top-down framework which forms the backbone of this process, has given both structure and direction to this stock picking.

Over the last 10 years, the Rathbone Smaller Companies Fund has:

- Outperformed the FTSE All Share index, the FTSE Small Cap xIT index and its own peer group
- Outperformed the FTSE Small Cap xIT index by an average of 2.13% per quarter and in 36 out of 47 quarters (including Q1, 2005).

(Bid to bid, net income reinvested, to 01.08.05).

Focus on fundamentals and valuation

- **Strong management**
- **Ability to grow earnings**
- **Market niche**
- **Barriers to entry**
- **Robust balance sheet & cashflow profile**
- **Conservative accounting**
- **Valuation - stocks at the right price**

Stock selection - what do we look for in our stocks?

We look for companies offering differentiating products or services, with strong management teams which are able to steer their companies ahead of the competition.

We meet the managements of our companies on a regular basis. It is these individuals who are ultimately responsible for the success of the company. We like to see the 'whites of their eyes'.

Cash generation is of particular importance: companies that are able to finance their own growth are likely to be more resilient in tough market conditions. Since the introduction of the new international accounting standards, attention to the cashflow statement has become ever more crucial.

Valuation is also a determining factor in running this fund. We are looking for stocks at the wrong price in relation to their growth prospects and will use a range of valuation metrics.

Such features come together to give the company 'quality' status, and it is quality stocks that tend to support the fund in both good and bad times. The key is to recognise ahead of time when the bias needs to change, and we believe that our investment process gives us a very strong base upon which to make this decision.

Where have we been looking?

A theme with longevity

In the current environment, although stock-picking has taken precedence over the emergence of any new themes, our investment process has continued to support long-standing themes. We have continued to run with the theme of social housing, as the story gains momentum following the publication of the Barker Review. Demand for social housing is increasing all the time and the Decent Homes Standard has focused attention on the estimated £19bn back-log of repair and maintenance work. We have looked at companies exploiting this to the full, and with growing reputations amongst the major local authorities across the UK.

Power and fuel

The fund is underweight in the more speculative oil and mining exploration plays in the view that a bit of a 'bubble' has been created on the back of higher oil prices. There have been a large number of flotations in this area by companies with no proven reserves whatsoever and whose valuations are therefore questionable.

Taking a slightly different approach we have looked at traditional coal-mining, which although is somewhat less fashionable, it still fuels up to 35% of the UK's power stations. The cash flows generated from the assets make it an extremely attractive play on resources.

A few defining words about the investment process behind the success

- **We have a robust investment process**, that has been developed and refined by the current Rathbone Unit Trust team. All members of that team do feel that they have a degree of intellectual ownership of the process.

- The process combines top-down and bottom-up disciplines. **The ideal investment thesis should provide an amalgam of strong company fundamentals backed up by good macro drivers.**

- **We make most efficient use of our resources by in-depth research into specific themes** – becoming "expert" in them. That provides us with a competitive advantage, especially in more niche areas of the market.

- The Rathbone Smaller Companies Fund is the most pure exemplar of this process. **The portfolio is run in a most disciplined and focused manner**, and the manager makes firm investment decisions, rather than tentative gestures in numerous directions. However, we recognise the industry and stock specific risks that we are taking, and seek to balance these risks across the portfolio. The result is a fund that has always shown up well when judged on a risk-adjusted basis.

- **Finally, flexibility is important.** In maximising total returns, we have the ability to switch freely between growth and value styles. The key is to recognise ahead of time when the bias needs to change, and we believe that our investment process gives us a very strong base upon which to make this decision.

About the manager and her track record - Marina Bond

Marina Bond
Investment Manager

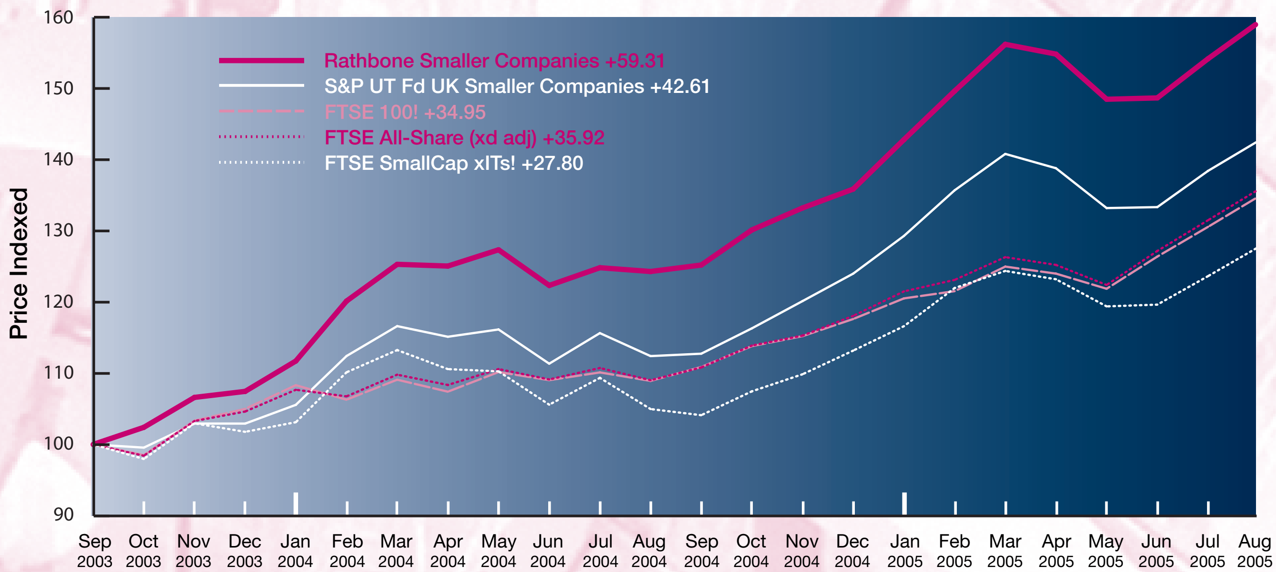
Marina joined Rathbones in February 2000 after graduating from Durham University with a 1st Class BSc in Natural Sciences (Philosophy and Archaeology). Marina manages the Rathbone Smaller Companies Fund.

Marina has worked on our smaller companies portfolio for most of the last 5 years; as co-manager of the Rathbone Smaller Companies Fund with Carl Stick from 1st September 2003 until 1st July 2005, and now as the sole manager of the fund. Since September 2003, the fund is ranked 7th out of 52 funds in its peer group, and has returned +59.31% against a peer group index return of +42.61% and +27.80% for the FTSE All Share index. The chart below illustrates this excellent record.

Marina holds the Investment Management Certificate and the Securities Institute Diploma.

She has recently undertaken challenging trips around South Korea and Kyrgyzstan.

Marina's Record as Co-Manager/Manager



5-year figures on the same basis are also strong in comparison at +10.38% for the fund and +5.01% for the peer group index compared to a marginal rise in the FTSE All Share of +0.63%.

Discrete Year Performance - Percentage Growth

						5 Years
From Quarter/Year:	03.07.00	02.07.01	01.07.02	01.07.03	01.07.04	01.08.00
To Quarter/Year:	02.07.01	01.07.02	01.07.03	01.07.04	01.07.05	01.08.05
Rathbone Smaller Companies Fund	**-9.21%**	**-21.60%**	**-12.98%**	**42.47%**	**23.50%**	**10.38%**
S&P UT UK Smaller Companies sector	-11.58%	-19.19%	-7.19%	31.85%	19.67%	5.01%

Data source Standard & Poors, bid to bid, net income reinvested.The value of investments and the income from them may go down as well as up and you may not get back your original investment. Past performance should not be seen as an indication of future performance.

For further information on the Rathbone Smaller Companies Fund, please call our Information Line on 020 7399 0399, or visit www.rutm.com.

Case Studies

Rathbones

August 2005

Rathbone Smaller Companies Fund – Case Studies

Case Study 1 - Titan Europe

Strengths of this stock

- Market demand
  Titan makes large wheels for the construction and agricultural markets across Europe. Growth is being driven by the expansion of Eastern Europe; and the fact remains that you cannot reinvent the wheel.

- Barriers to entry
  There are large capital costs involved in manufacturing big wheels, and because of their size they are expensive to ship. This makes low cost areas such as China less of a competitive threat.

- Pricing power
  Higher raw material prices have increased costs of manufacture, but Titan has had no difficulty in passing these costs on to customers though higher prices.

- Strong balance sheet and cashflow
  The balance sheet is underpinned by the land and equipment owned, and which is all conservatively valued. The company is extremely cash generative though efficient control of working capital.

- Valuation
  Still attractive from an earnings and cashflow perspective, despite a strong stockmarket performance.

Case Study 2 - Tikit Group

Strengths of this stock

- Market demand
  Niche IT consultant and software supplier which has built strong relationships within the legal industry. The legal industry is moving away from a partnership mentality to a corporate one, and therefore needs to enhance the efficiency of its systems. Consolidation within the industry is accelerating this process.

- Barriers to entry
  Tikit has an established reputation within this sector, where access to confidential legal content places a great emphasis on trust where services are to be outsourced.

- Pricing Power
  Tikit provides services to all of the top 10 and over 75 of the top 100 law firms, and has in the last year expanded into mainland Europe. The company's established reputation for excellence within this specialised industry affords it significant pricing power.

- Strong balance sheet and cashflow
  The company has reported a 24% increase in turnover in 2004, driven by strong increases in Consultancy and Services revenues. The company remains cash generative, which is reflected by the 33% increase in dividend payment in 2004.

- Valuation
  Tikit has been an under-researched stock in which the value is only beginning to be appreciated.

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