Athelney Trust plc

Interim Report

for the six months ended 30 June 2007

Athelney Trust plc

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Athelney Trust plc

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INTERIM RESULTS FOR THE SIX MONTHS ENDED 30 JUNE 2007
CHAIRMAN'S STATEMENT AND BUSINESS REVIEW

I enclose the unaudited results for the six months to 30 June 2007. The salient points are as follows:

- Unaudited Net Asset Value ("NAV") is 201.3p per share (31 December 2006: 189.7p, 30 June 2006: 164.5p), a rise of 6.1 per cent and an increase of 22.4 per cent over the past year.
- Gross Revenue rose by 24 per cent to £56,010 compared to the half year ended 30 June 2006 of £45,165 and the full year to 31 December 2006 of £95,614.
- On a like-for-like basis revenue increased by 11.4 per cent and dividend income rose by 11.7 per cent.
- Revenue return per ordinary share was 1.9p, up 11.8 per cent from the previous half year (31 December 2006: 3.3p, 30 June 2006: 1.7p).
- A dividend of 3.25p was paid in May 2007 (2006: 2.5p) and, as is the Board's practice, no further dividend will be paid until the full year's results are known.

Review of 1 January to 30 June 2007

The last six months, and the short period that preceded it, have certainly produced quite a few shocks: Mexico's disputed presidential election; riots in Hungary; a coup in Thailand; the disturbing, deeply sinister murder of Alexander Litvininenko, allegedly by an ex-KGB operative; the arrest of a group of Royal Navy seamen and Royal Marines by Iran; and Hugo Chavez's nationalization of foreign assets in Venezuela. In Pakistan, along the North West Frontier, the deal between the tribal leaders and the government which confined the army to barracks has resulted in a resurgence of the Taliban and thus provided cover for al-Qu'eda to train and supply future terrorists. The siege of the Red Mosque and outbreak of suicide bombing suggests that worse is to come. Iraq is, of course, a complete disaster and it is immensely depressing that the eventual exit of the U.S.-led coalition will most likely lead to even more inter-sectional violence.

On 27 February, the Shanghai market fell by 9 per cent, followed by sell-offs around the world on the view that just about everyone was vulnerable to a crash in the overheated Chinese stock market. Yet Shanghai rebounded within days and, even when the Chinese authorities tried to take heat out of the market by imposing stamp duty on share purchases, things went remarkably smoothly. More recently we saw a sharp set-back in U.S. Treasuries in June which was quickly followed by a dramatic sell-off in the credit market which may have repercussions elsewhere.

I make no apology for returning to the state of the housing market in the U.S. (particularly the Midwest, Florida and California). Worthy of note is the near collapse of the funds backed by sub-prime (low quality) mortgages from Bear Stearns, a large investment bank. The unfortunately named High-Grade Structured Credit Strategies Enhanced Leverage Fund and its sister the High-Grade Structured Credit Strategies Fund are now all but worthless, having only been launched about a year ago. The Enhanced Leverage fund's problems were compounded by its borrowings which were ten times bigger than its $600 million capital.

The worry must be that the severe housing recession is spreading to the financial area and is threatening the occurrence of systemic fallout. It is estimated that various institutions own about $6 trillion of mortgage-backed securities (MBS) of which $800 billion are sub-prime. About 13 per cent of sub-prime mortgages are currently in default and foreclosure rates are soaring.

How did America get into this mess? In recent years, there has been a concerted effort to increase the share of homeowners in the U.S. from a post-war average of 63 per cent to 70 per cent. Lending standards were relaxed and deposits were no longer required. The extreme was reached with so-called Ninja loans (borrowers needed no income, jobs or assets). The influx of new buyers pushed up house prices which made financial institutions even more eager to lend.

The lenders, however, did not have to worry very much about the risk of default because they rolled these mortgages into MBS packages, which were then sliced and diced in tranches known as Collateralized Debt Obligations (CDOs). Buyers could chose equity (highest risk, highest theoretical dividend yield), mezzanine and investment-grade bonds. The first, equity, is colloquially known as toxic waste and the hunt is on to find out who exactly has purchased and is still holding this nasty stuff. Many of these securities are illiquid so regular prices are not available. Indeed, highly rated CDOs may still be owned by banks or hedge funds that do not have to put a (much lower) value on these securities. They may not recognise the problem until they are forced to by auditors or by ratings downgrades from Moody's and S&P. Moody's has said that it may cut ratings on 91 CDOs worth about $5 billion.

How to value illiquid financial derivatives is an interesting question. As Warren Buffett, the world's most successful investor, pointed out years ago there is no market for complex derivatives so instead of being marked to market (valued at market price), they are marked to (computer) model – or, in some cases, marked to myth. Suppose, he said, you write a contract specifying the number of twins that will be born in Nebraska in 2020. That will be taken up by a counterparty in the usual way. Both of you might then devise different computer models which showed you both making a profit for years. Why would you do that? Because, as derivatives traders, you get a huge bonus on that and similarly illiquid trades. In the case of a hedge fund, there is scope to book a mythical profit, of which the manager can then take his 20 per cent cut in addition to his annual management fee. The more profits of this kind the manager books, the better his fund performs in the short term and the more capital the fund attracts from new investors.

But once these huge losses are recognised, what are the implications for liquidity, which has been the driving force behind markets for a long time now? Say the search for who is still holding the toxic waste ends with the finger pointed at the originating banks and syndicating investment banks?

If a fair proportion of $800 billion is wiped out by enforced mark to market then it is a decent bet that a large dent would be made in the $875 million of capital owned by the commercial banks and how willing would such banks be to continue to fund the present mergers and acquisitions frenzy which has swept the world in recent months?

We are now seeing the liquidity tap being turned off in three ways: central banks are raising interest rates; lending terms are getting tighter and tighter (no more cov-lite and payment-in-kind loans, thank you); and perhaps the strongest evidence of a more prudent rationing of liquidity is the reduced appetite for risk in financial markets (no more MBS, thank you).

None of the above is calculated to cheer so it is heartening to report that equity markets had a decent six months to June 2007. Best of all was China (+42.3 per cent); followed by Pakistan (38.1 per cent); Poland (32.8 per cent); South Korea (28.2 per cent); Turkey (26.5 per cent) and Malaysia (25.6 per cent). Only three markets fell: Saudi Arabia (-9.6 per cent); Colombia (4.6 per cent) and Russia (1.5 per cent). Closer to home, British blue-chips rose by a respectable 7.3 per cent although small caps., as represented by the FTSE Small Cap. Index, increased by a slightly disappointing 3 per cent. Crude oil, having finished 2006 at about $50 per barrel, shot up again to close the period at $71, a rise of about 40 per cent.

As far as the U.K. is concerned, we have had to live with a strong currency and, although the two-dollar pound may not be forever, it certainly has given British business and consumers a gain in spending power. Despite an increasingly unfavourable exchange rate, U.K. manufacturing exports grew by 10 per cent last year. Demand for services that the U.K. is good at – such as investment banking, stockbroking, accountancy and law – has been rising steadily so that the City in all its aspects now accounts for about 15 per cent of U.K. GDP.

Finally, under this sub-heading, profit warnings are edging closer to record highs. In the first half of this year, 191 companies issued alerts, saying that profits would fail to meet targets. This was up from 169 in the first half of last year and is the highest since the 230 in the first half of 2001 at the end of the dotcom boom.

Results

Gross revenue rose by 24 per cent compared with the six months to 30 June 2006: after allowance is made for the special dividend paid by *Mallett* in 2007, like-for-like growth was a rather more pedestrian 11.4 per cent.

	Number
Companies paying dividends	63
Companies sold (therefore no true comparison)	17
Companies purchased (therefore no true comparison)	19
Increased total dividends in the half year	20
Reduced total dividends in the half year	2
No change in dividend	5

Corporate Activity

Three of our companies were taken over for cash: *Enterprise; European Motor Holdings* and *City Lofts*, producing a profit of 698 per cent, 242 per cent and 30.3 per cent respectively. Since 30 June, *Ben Bailey* has agreed to a cash offer which, if it goes through, would result in Athelney booking a profit of 83.8 per cent. Similarly, *Hitachi Capital* would give a profit of 9.5 per cent. Furthermore, *Domestic & General* and *Nichols* are separately engaged in bid talks although, of course, there is no certainty that deals will be agreed.

Portfolio Review

Holdings of *Aero Inventory, Umeco, Character Group, Debtmatters, Prime People, Renew Holdings, Smallbone, H&T Group, Ambrian Capital, FDM Group, Finsbury Food, M&C Saatchi, Quarto Group, Trifast* and *Creston* were all purchased for the first time. *Blacks Leisure*, *Johnson Service, AT Communications* and *Erinaceous Group* were all sold. In addition, a total of twenty-one holdings were top-sliced to provide capital for the new purchases.

Dividend

As is the Board's practice, consideration of a dividend will be left until the final results are known. However, having increased the annual dividend from 1p per share in 1996 to 3.25p in 2007, the Board is keen to maintain Athelney's progressive record, remaining within the context of what can be afforded without undue financial strain.

Update

The unaudited NAV at 31 July 2007 was 199.8p whereas the share price on the same day stood at 203p. Further updates can be found on www.athelneytrust.co.uk

Outlook

I think that it might well be a mistake to increase interest rates further in the U.K. and the Eurozone but I suspect that the authorities will do so anyway. Then there is the stubbornly high price of crude oil despite the supply situation being relatively easy at the moment. And we had better not forget about developments in America, discussed at length earlier in my Statement and Business Review. All in all, the short term seems full of difficulties but, looking to the slightly longer term, I remain absolutely convinced that a portfolio of carefully chosen equities (including a sensible proportion of high quality small caps.) will once again offer an attractive home for long-haul investment capital. Fingers firmly crossed, prospects for 2008 look positive.

H.B. Deschampsneufs

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INVESTMENT AND PORTFOLIO ANALYSIS AT 30 JUNE 2007

SECTOR	STOCK	HOLDING	VALUE (£)	SECTOR £	SECTOR %
Aerospace and defence	Aero Inventory	9,000	42,300		
	Umeco	7,250	42,376	**84,676**	**2.12%**
Basic resource (ex mining)	Acertec	20,000	31,000	**31,000**	**0.78%**
Chemicals	Treatt	10,500	33,285	**33,285**	**0.83%**
Construction and materials	Clarke (T)	18,000	38,340		
	Galliford Try	30,000	47,625		
	Renew Holdings	35,000	38,850	**124,815**	**3.13%**
Electronic and electrical equipment	XP Power Ltd	8,000	37,940	**37,940**	**0.95%**
Food and beverages	Finsbury Food Group	29,500	33,925		
	Nichols	13,050	35,496		
	Shepherd Neame "A"	5,400	99,377		
	Wynnstay Group	30,000	78,600	**247,398**	**6.20%**
General financial	Albemarle & Bond	18,000	40,140		
	Ambrian Capital Plc	42,000	27,720		
	Arbuthnot Banking Group	10,000	54,000		
	Arden Partners	18,000	34,020		
	Blue Oar	130,000	32,500		
	Camellia	1,200	105,600		
	Charles Taylor Consulting	8,000	30,280		
	City of London Investment Group	17,000	46,750		
	Davenham Group	10,000	33,500		
	Debtmatters Group	17,000	19,550		
	Dowgate Capital	166,666	23,333		
	Hitachi Capital (UK) Plc	16,000	42,240		
	Jarvis Securities	17,500	32,375		
	Park Group	130,000	24,700		
	S & U	8,000	44,400		
	Tenon Group	50,000	30,750		
	Vantis	36,667	75,167	**697,025**	**17.46%**
Healthcare equipment and services	Tristel	60,000	36,000	**36,000**	**0.90%**
House, leisure and personal goods	Ben Bailey	6,800	43,996		
	Havelock Europe	24,000	37,200		
	Smallbone	36,500	38,508	**119,704**	**3.00%**
Industrial engineering	Gooch & Housego	15,000	63,000		
	Goodwin	12,000	88,200		
	Severfield-Rowen	3,600	80,568		
	Slingsby (H.C)	4,000	42,400		
	Somero Enterprises	27,550	41,876		
	Trifast	40,000	33,800	**349,844**	**8.77%**
Industrial transportation	Braemar Shipping Services	20,000	83,500		
	Clarkson	6,300	57,456		
	Fisher (James)	11,000	66,220	**207,176**	**5.19%**
Insurance	Domestic & General Group	3,300	44,880		
	Personal Group Holdings	19,500	54,600	**99,480**	**2.49%**
Media	Character Group	22,000	34,980		
	Chime Communications	85,000	45,050		
	Creston	19,000	30,400		
	Huntsworth	35,000	36,838		
	International Greetings	18,000	74,025		

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INVESTMENT AND PORTFOLIO ANALYSIS AT 30 JUNE 2007 (CONTINUED)

SECTOR	STOCK	HOLDING	VALUE (£)	SECTOR £	SECTOR %
Media (continued)	M&C Saatchi Plc	20,500	31,980		
	Media Square	213,179	25,049		
	Quarto Group Inc Com	18,000	32,580	**310,902**	**7.79%**
Pharmaceuticals and biotechnology	Genus	12,000	82,620	**82,620**	**2.07%**
Real estate	Colliers CRE	17,400	29,232		
	Mountview Estates	1,750	124,250		
	Smart (J) & Co.	4,000	32,000	**185,482**	**4.65%**
Retailers	Flying Brands	15,000	40,350		
	H & T Group	17,000	37,910		
	Lookers	30,000	52,725		
	Mallett	12,000	24,960		
	SCS Upholstery	10,000	25,125		
	Stanley Gibbons	55,000	127,600	**308,670**	**7.73%**
Support services	Broker Network Holdings	14,000	52,920		
	Dawson Holdings	34,000	35,870		
	Gibbs & Dandy	10,000	39,000		
	Latham (James)	16,000	40,800		
	Litho Supplies	50,500	31,815		
	Macfarlane Group	100,000	30,250		
	N.W.F Group	10,000	107,500		
	Prime People	26,000	28,080		
	RWS Holdings	12,000	43,560		
	Speymill Group	40,000	40,200		
	VP	17,000	65,450		
	Waterman Group	36,000	68,400		
	WSP Group	15,000	111,750	**695,595**	**17.43%**
Technology hardware	Belgravium Technologies	350,000	49,000	**49,000**	**1.23%**
Technology software and services	FDM Group	27,500	36,575		
	Group NBT	15,000	43,800		
	Pennant International	116,000	31,320		
	Phoenix IT	8,500	35,636	**147,331**	**3.69%**
Travel and leisure	Air Partner	6,000	74,400		
	Enterprise Inns	10,000	68,900	**143,300**	**3.59%**

Portfolio Value		**£ 3,991,243**	**100.00%**
Net Current Liabilities		**£ (801)**	
Deferred tax		**£ (361,757)**	
TOTAL VALUE		**£ 3,628,685**	
Shares in issue		**1,802,802**	
Unaudited NAV	**201.3p**		

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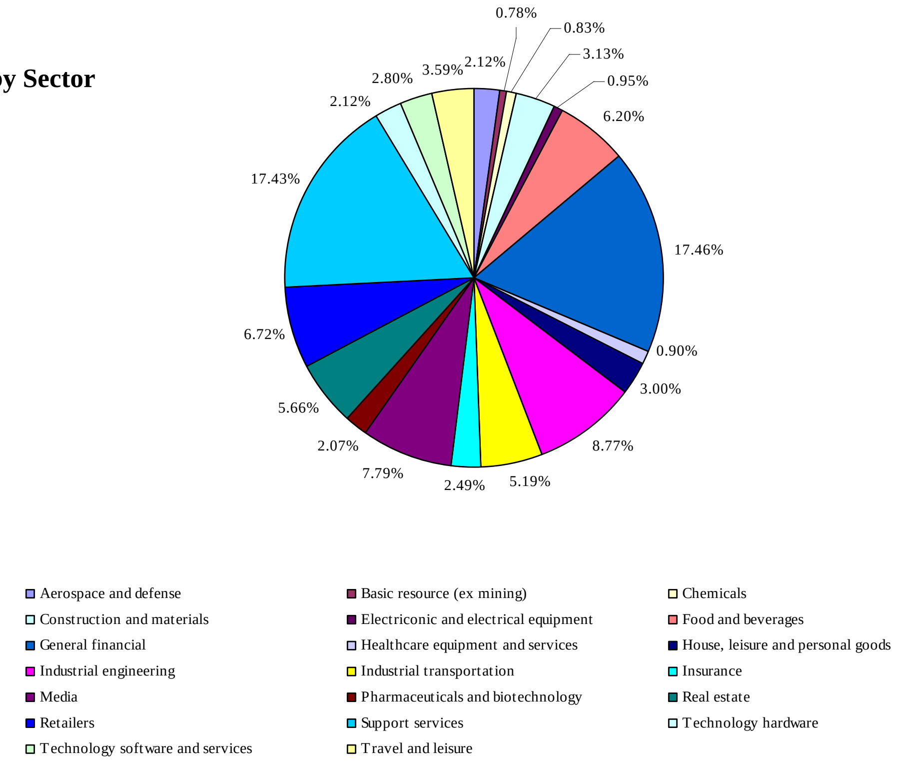
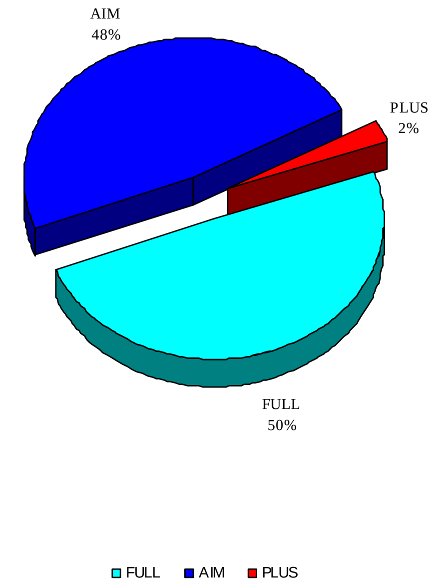
INVESTMENT AND PORTFOLIO ANALYSIS AT 30 JUNE 2007 (CONTINUED)

Portfolio by Sector



Portfolio by Listing



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INTERIM INCOME STATEMENT
(INCORPORATING THE REVENUE ACCOUNT)

	Unaudited			**Unaudited**			***Year ended 31 December 2006***
	6 months ended 30 June 2007			**6 months ended 30 June 2006**			
	Revenue	**Capital**	**Total**	**Revenue**	**Capital**	**Total**	***Total***
	£	**£**	**£**	**£**	**£**	**£**	**£**
Profits on investments	-	295,354	295,354	-	178,417	178,417	*708,480*
Income	56,010	-	56,010	45,165	-	45,165	*95,615*
Investment Management expenses	(4,776)	(14,150)	(18,926)	(4,015)	(11,787)	(15,802)	*(32,380)*
Other expenses	(24,314)	-	(24,314)	(17,352)	-	(17,352)	*(35,355)*
Return on ordinary activities before taxation	26,920	281,204	308,124	23,798	166,630	190,428	*736,360*
Taxation	7,723	(48,722)	(40,999)	6,537	(29,002)	(22,465)	*(114,164)*
Return on ordinary activities after taxation	34,643	232,482	267,125	30,335	137,628	167,963	*622,196*
Dividends Paid:							
Dividend	(58,591)	-	(58,591)	(45,070)	-	(45,070)	*(45,070)*
	(23,948)	232,482	208,534	(14,735)	137,628	122,893	*577,126*
Return per ordinary share	1.9p	12.9p	14.8p	1.7p	7.6p	9.3p	*34.5p*

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INTERIM BALANCE SHEET AS AT 30 JUNE 2007

	Unaudited 30 June 2007	Unaudited 30 June 2006	*31 December 2006*
	£	**£**	**£**
Fixed assets			
Investments	3,991,243	3,180,278	*3,706,392*
Current assets			
Debtors	80,367	103,536	*105,603*
Cash at bank and in hand	22,153	30,007	*32,486*
	102,520	133,543	*138,089*
Creditors: amounts falling due within one year	(103,321)	(40,826)	*(50,797)*
Net current assets	(801)	92,717	*87,292*
Total assets less current liabilities	3,990,442	3,272,995	*3,793,684*
Provisions for liabilities and charges	(361,757)	(307,934)	*(374,390)*
Net assets	3,628,685	2,965,061	*3,419,294*
Capital and reserves			
Called up share capital	450,700	450,700	*450,700*
Share premium account	405,605	405,605	*405,605*
Other reserves (non distributable)			
Capital reserve - realised	985,293	590,450	*719,086*
Capital reserve - unrealised	1,690,531	1,427,789	*1,723,399*
Revenue reserve	96,556	90,517	*120,504*
Shareholders' funds - all equity	3,628,685	2,965,061	*3,419,294*
Net Asset Value per share	201.3p	164.5p	*189.7p*

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CASHFLOW STATEMENT FOR THE SIX MONTHS ENDING 30 JUNE 2007

	Unaudited 6 months ended 30 June 2007		**Unaudited 6 months ended 30 June 2006**		***Year ended 31 December 2006***
	£	**£**	**£**	**£**	**£**
Net cash (outflow) / inflow from operating activities		37,755		60,642	*68,111*
Servicing of finance					
Dividends paid	(58,591)		(45,070)		*(45,070)*
Net cash (outflow) from servicing of finance		(58,591)		(45,070)	*(45,070)*
Taxation					
Corporation tax paid		-		-	*(18,613)*
Investing activities					
Purchases of investments	(577,437)		(433,030)		*(1,103,978)*
Sales of investments	587,940		407,417		*1,091,988*
Net cash inflow / (outflow) from Investing activities		10,503		(25,613)	*(11,990)*
(Decrease) in cash in the year		(10,333)		(10,041)	*(7,562)*

Reconciliation of operating net revenue to net cash (outflow) / inflow from operating activities	**£**	**£**	**£**
Revenue return on ordinary activities before taxation	26,920	23,798	*52,044*
(Increase) in debtors	25,235	41,574	*39,506*
(Decrease)/ increase in creditors	(250)	7,057	*725*
Management expenses charged to capital	(14,150)	(11,787)	*(24,164)*
	37,755	60,642	*68,111*

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NOTES TO THE INTERIM ACCOUNTS
FOR THE SIX MONTHS ENDED 30 JUNE 2007

1. The financial information contained in this report is unaudited and does not constitute statutory accounts within the meaning of Section 240 of the Companies Act 1985 (as amended). The results for the year ended 31 December 2006 were reported on by the auditors and received an unqualified report and contained no statement under Section 237(2) or (3) of the Companies Act 1985 (as amended) and a copy of the audited accounts has been filed with the Registrar of Companies.

2. The unaudited results for the period ended 30 June 2007 have been prepared on the basis of the accounting policies adopted in the audited accounts for the year ended 31 December 2006.

3. The calculation of earnings per share for the six months ended 30 June 2007 is based on the attributable return on ordinary activities after taxation and on the average weighted number of shares in issue during the period.

	6 months ended 30 June 2007			6 months ended 30 June 2006		
	Revenue £	**Capital £**	**Total £**	**Revenue £**	**Capital £**	**Total £**
Attributable return on ordinary activities after taxation	34,643	232,482	267,125	30,335	137,628	167,963
Number of shares		1,802,802			1,802,802	
Return per ordinary share	1.9p	12.9p	14.8p	1.7p	7.6p	9.3p

	12 months ended 31 December 2006		
	Revenue £	**Capital £**	**Total £**
Attributable return on ordinary activities after taxation	60,322	561,874	622,196
Number of shares		1,802,802	
Return per ordinary share	3.3p	31.2p	34.5p

4. Copies of the interim results for the six months ended 30 June 2007 will be sent to all shareholders as soon as practicable. Copies of the interim results will be available free of charge for one month from the Company's Nominated Advisers:

Noble & Company Limited
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Athelney Trust plc

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