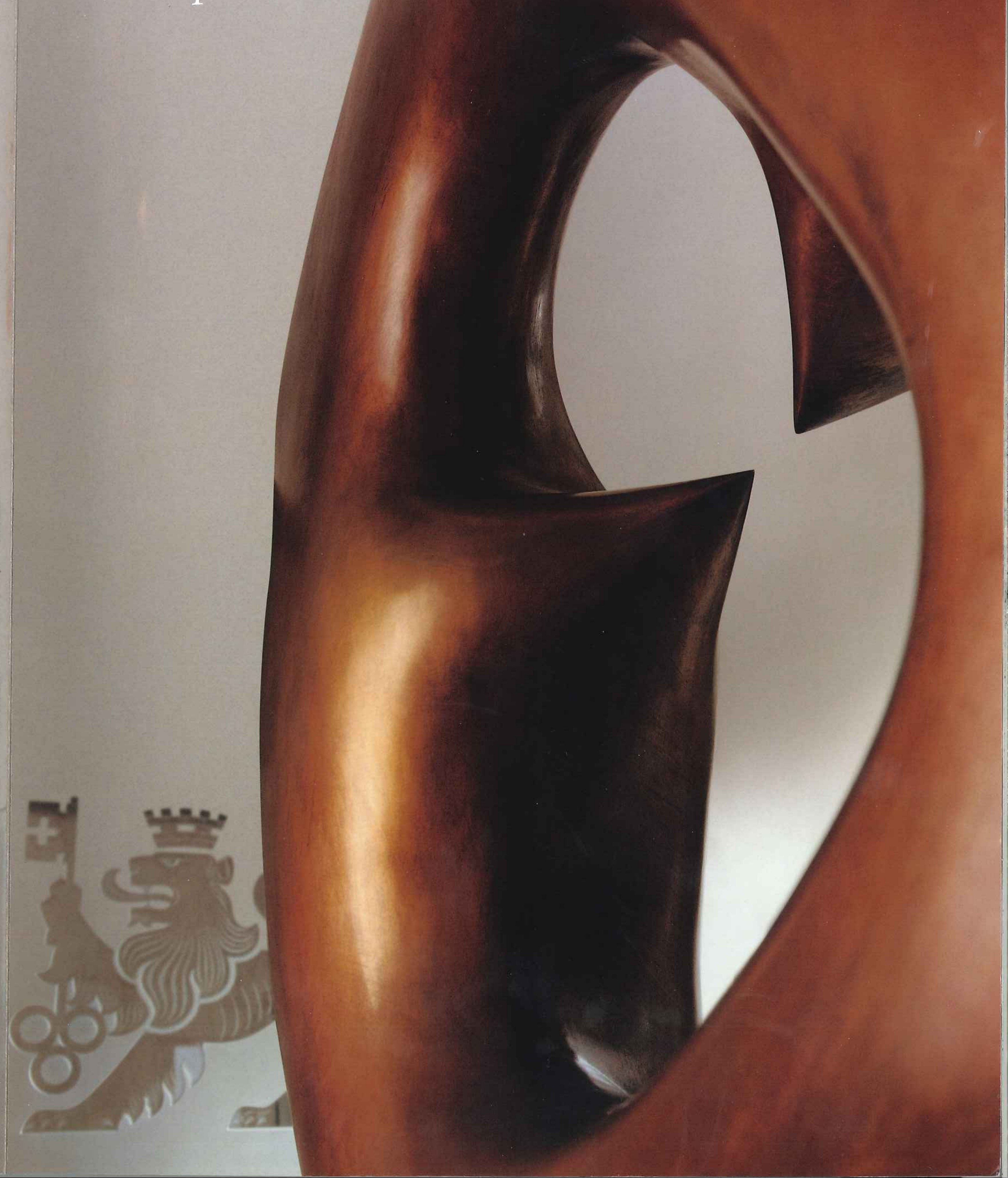
# London Merchant Securities plc
## *Annual Report & Accounts 2005*



London Merchant Securities plc Annual Report & Accounts 2005

# Highlights & Results



£35.3m Pre-tax profits before exceptional finance costs
(2004 – £17.2 m)

£42.7m Operating profit
(2004 – £39.8m)

£56.2m Net rental income
(2004 – £54.0m)

6.5p Dividend per share
(2004 – 6.4p)

14.3% Total property return
(2004 – 11.8%)

+7.5% Property value growth (like-for-like)

45.1% Gearing
(2004 – 35.7%)

6.3% Weighted average cost of debt
(2004 – 7.8%)

238p Adjusted shareholders' funds per share
(2004 – 229p)

+8.4% Adjusted shareholders' funds excluding exceptional finance costs

# Our Purpose

To produce high long-term rates of return to shareholders through investment in property, venture and development capital, employing a strategy of risk diversification. Implicit in this is the continuous flow of dividends with liquidity from venture and development capital realisations.

# Chairman's Statement
## Committed to delivering superior long-term returns to shareholders

Graham Greene

The results for 2004/05 reflect a year of good performance by the Group across all its property sectors and the Investment Division.

After the costs associated with restructuring the Group's debt, net assets before minority interests rose by 4.0% to £788 million (2004 – £758 million), while equity shareholders' funds rose by 3.1% to £732 million (2004 – £710 million). Adjusted net asset value per share rose to 238p (2004 – 229p). The balance sheet remains strong with gearing of 45% (2004 – 36%).

Pre-tax profits before exceptional finance costs were £35.3 million (2004 – £17.2 million), a rise of 105%. After the costs of the debt restructuring the Group made a loss for the year of £10.9 million (2004 – profit of £11.8 million). The return on equity for the year was 6.1% with a five year rolling average of 4.9% and a ten year rolling average of 17.0%.

We have made good progress on bringing forward a number of developments. The redevelopment at Dorset Square, London NW1, has started, while work on the new building at 105 Tottenham Court Road, London W1, and the phase II development at the Strathkelvin Retail Park, Glasgow, are about to begin. Several further planning applications have recently been made or are imminent. LMS has entered into a new joint venture relationship with The Miller Group in the acquisition and development of Swinton Shopping Centre, Manchester, and we look forward to a successful collaboration.

In the Investment Division the Group made further progress in reorganising the management of its activities and has seen profitable realisations in the UK and the US and maturation of companies. Inflexion plc, in which LMS acquired a 58.8% holding in February 2004, has had a successful year, growing net assets from £46.4 million to £52.9 million.

### Dividend

The Board is recommending the payment of a 4.5p final dividend per Ordinary share, making a total of 6.5p for the year compared to 6.4p in the previous year. This is the 30th year of increased dividends.

### Board and Management

In September 2004 we welcomed to the Board Dr Bernard Duroc-Danner, Chairman, President and Chief Executive of Weatherford International, one of the world's leading oilfield service companies. We are very pleased to have the benefit of his wise counsel and broad international business experience.

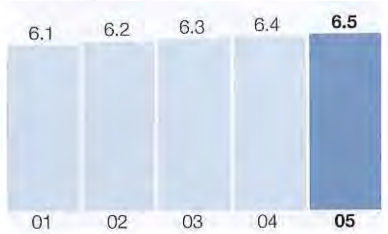
We have continued to strengthen the management of our property team and during the year we refurbished our offices to create a more modern working environment.

### Outlook

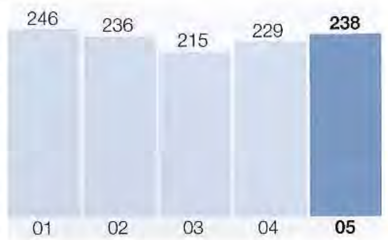
LMS is well positioned to respond to changes in the property market, with greater flexibility following our debt restructuring and a strong development pipeline. The outlook for the Investment Division continues to improve, and we are confident of a steady stream of profitable realisations over the next two to three years. Our investment approach continues to be driven by our commitment to deliver superior long-term returns to shareholders.

**10 year return on equity** %
Average


**Dividend per share** Pence




**Adjusted Shareholders' funds per share**
Pence




**Graham Greene** Chairman
23rd May 2005

# Chief Executive's Review
## Achieving our key objectives


Robert Rayne

In the year ended 31st March 2005 LMS achieved its key objectives. These were:

- to reach significant milestones in the Property Division's development programme;
- to guide Investment Division companies further towards maturity and to continue the restructuring started last year; and
- to reorganise the Company's financing, increasing flexibility for the future.

At the same time the Company continued to grow its asset base. Total gross property and investment assets, taking account of the surplus over book value of the trading properties and quoted investments, rose to £1.22 billion from £1.09 billion the previous year, an increase of over 11%.

**Property**

The capital value of the Company's property holdings rose to £991.3 million from £894.9 million in the prior year, with a like-for-like increase of 7.5% (8.5% excluding development sites). Net rental income rose to £56.2 million (2004 – £54.0 million), an increase of 4.1%. The total property return was 14.3% (2004 – 11.8%) with a five year annualised average of 12.7%.

Acquisitions during the year included 36-37 Featherstone Street and Monmouth House, 58-64 City Road, London EC1, for a total consideration of £14.2 million, both buildings forming part of our planned City Road redevelopment. On the retail side we entered into a joint venture with The Miller Group for the purchase and redevelopment of Swinton Shopping Centre, Manchester.

The principal disposals were three retail properties, in Peterborough, Leicester and Southampton (completed April 2005), all part of the Urbanfirst portfolio, for a total consideration of £13.1 million.

Significant new lettings were at 79-89 Pentonville Road, London N1, and, just after the year end, at 30 Gloucester Place, London W1, where the FA Premier League agreed a 15 year lease with a rent of approximately £0.9 million per annum.

Good progress has been made with the development programme. Work has started at 26-28 Dorset Square, London NW1 to provide 2,183 sq m (23,500 sq ft) of offices, and the redevelopment of 105 Tottenham Court Road, London W1, starts shortly. This 10,126 sq m (109,000 sq ft) building will be principally offices but also contains retail and residential units. Work on the next phase of development at Strathkelvin Retail Park in Glasgow is due to start in June 2005.

A planning application is about to be submitted for a residential development at Winchester Road, Swiss Cottage, and an application in respect of the eight acre site at Greenwich is also imminent. Under a new agreement, a revised application for phases II and III of the Fitzrovia project, pre-let to Arup, is due to be submitted in June and several further projects are in the pipeline.

**Investments**

At the year end the Investment Division book value was £220.6 million (2004 – £191.9 million). Investments are held in the books at the lower of cost or impaired value – they are not revalued above cost.

New investment during the year totalled £72.9 million, with sales proceeds of £61.2 million. Realised profits on disposals were £17.9 million (2004 – £7.5 million). The net result for the Investment Division (aggregating realised profits, income, valuation adjustments and LMS' share of fund administration costs) showed a significant improvement to £16.1 million (2004 – £3.2 million). In cash flow terms, there was net investment of £12.3 million compared to £22.7 million in the previous year.

Among the disposals were quoted oilfield service stocks, realisations from US funds and sales by Inflexion, LMS' 58.8% subsidiary.

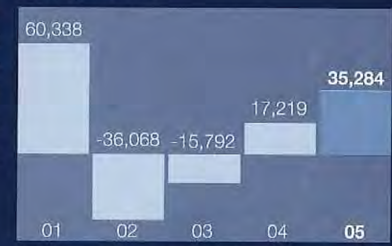
New investments were made in diverse sectors to achieve an appropriate spread of risk, including two US technology companies and two small investment banks. Follow-on investments were made in 11 companies, the largest being a further £10 million into ProStrakan, which has recently announced its intention to seek a London Stock Exchange listing.

Last year we began the transition to a new structure and management arrangements for the Investment Division. We have now taken a further step in this direction by reorganising the majority of our US direct investments into a new vehicle, San Francisco Equity Partners, managed by Scott Potter.

**Outlook**

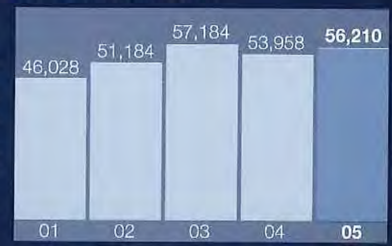
The themes for 2005/06 will be similar to those for the year just ended. We will drive the property development programme to realise the full potential of LMS' asset base, but we will also look for new acquisitions where the pricing and opportunity are right. In the Investment Division we will continue to work closely with our companies towards profitable realisation. In all parts of the business we will continue to focus on managing risk as we seek optimal returns for shareholders.

**Profit/(loss)*** £000

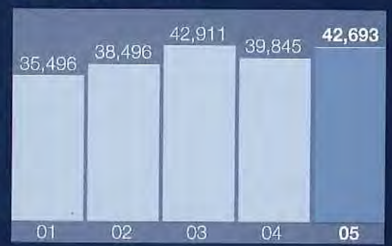



*2005 excludes exceptional finance costs

**Net rental income** £000




**Operating profit** £000




**Robert Rayne** Chief Executive
23rd May 2005

# Operating Review: *Property Division*

## Driving the property development programme to create value

### Performance

**Capital value** The capital value of the Group's property holdings at the year end was £991.3 million (2004 – £894.9 million). The like-for-like increase was 7.5% (8.5% excluding redevelopment properties).

**Income** Gross rental income was £60.8 million compared to £58.4 million in 2004. Net rental income for the year was £56.2 million, an increase of 4.1% over £54.0 million in the previous year.

The aggregate gross annual rate of rent reserved under all leases was £60.7 million, an increase of 7.2% (2004 – £56.6 million). The increase is accounted for by approximately £7 million of additions from acquisitions, rent reviews, renewals, new lettings and expiry of rent-free periods, offset by approximately £3 million attributable to voids and disposals.

Rent reviews and renewals settled throughout the year have produced an increase of approximately £1.3 million per year, 20% ahead of the rents previously passing.

Letting activity across the portfolio remained strong, securing some £3.2 million of additional income.

Voids in the portfolio were 4.3% at the year end (3.2% after the letting of 30 Gloucester Place, London W1), excluding properties held for redevelopment.

The average unexpired lease term is 13.9 years (12.8 years when breaks are taken into account). Assuming all lease breaks are exercised and all properties are vacant on the expiry of their existing leases, 70.7% of the contracted rent roll is secured for five years, 44.6% for ten years and 30.1% for 15 years.

**Total return** The total property return for the year was 14.3%. The annualised average for the last five years is 12.7% and for the last ten years 14.4%.

### Offices

Rent reviews were concluded during the year at 63 St James's Street, London SW1 and 80 Charlotte Street, London W1, where increases of 12% and 27% respectively were achieved on the previous rents passing.

New lettings include that of the 3,345 sq m (36,000 sq ft) premises at 78-89 Pentonville Road, London N1, and, subsequent to the year end, the letting to the FA Premier League of the 2,202 sq m (23,705 sq ft) office building at 30 Gloucester Place, London W1, at a rent equivalent to £40.75 per sq ft. The building will be substantially refurbished at a cost of £2.1 million prior to the tenant taking occupation. This forms part of our active programme of upgrading assets and improving their revenue potential wherever possible. Further projects include the refurbishment of the buildings at 85 Tottenham Court Road, London W1, and 33 Duke Street, London W1, at a combined cost of approximately £1.0 million, both of which are due to start shortly.

Investment acquisitions during the year included the freehold office building at 36-37 Featherstone Street, London EC1, for £1.7 million and Monmouth House, 58-64 City Road, London EC1, for £12.5 million. These buildings are adjacent to the City Road Estate which we acquired in 2002 and will form an important part of our redevelopment plans for this major site.

Voids for the office portfolio remain low at 3.1%, excluding redevelopment properties. A significant proportion of this is accounted for by the 2,600 sq m (28,000 sq ft) of offices at 85 Tottenham Court Road, London W1, which have been vacated by the BBC and where we now have plans for refurbishment, as noted above.

## Arup, Fitzrovia W1

Subject to planning consent, construction for the next two phases of a 13,239 sq m (142,500 sq ft) office building pre-let to Arup will commence in January 2006. The development costs are capped at £43 million and on completion, which is expected by mid 2009, the rent roll for the three phases will rise to £9.9 million pa.

## Strathkelvin II, Glasgow

Phase II of Strathkelvin Retail Park involves the construction of 4,180 sq m (45,000 sq ft) of new units and the refurbishment of the existing units to complement the 10,033 sq m (108,000 sq ft) unit completed in 2004. On completion, the Retail Park will consist of 27,405 sq m (295,000 sq ft) modern retail warehousing. The development cost is estimated at £7.8 million and on completion the total Park ERV will be £5.0 million pa.

Demand for Central London offices has been variable and most of the forecast growth in the West End has yet to materialise, but there is a good level of interest in quality product. We are confident that our speculative development schemes at 26-28 Dorset Square, London NW1, and 105 Tottenham Court Road, London W1 will be well received in the market.

Yields have continued to harden across the office portfolio in the face of investor appetite and a general shortage of suitable available stock. We remain committed to identifying and securing new investment and development opportunities.

### Retail and Leisure

The opening of the new 10,033 sq m (108,000 sq ft) B&Q Warehouse at Strathkelvin Retail Park, Glasgow, with an annual rental of £1.3 million, coupled with the completion of a round of rent reviews, has produced a new rent roll of £3.5 million pa (excluding income from the phase II redevelopment). A rent review at 96-98 Bishops Bridge Road, London W2, produced a 26% uplift.

At Lion & Lamb Yard, Farnham, a key letting to Starbucks at £60 Zone A was achieved, and Waitrose are now trading from the former Safeway store. There has been a further letting at the Kingston Rotunda of a 650 sq m (7,000 sq ft) ground floor unit, bringing the total space let to 96%. Other lettings during the year include the ground floor restaurant at the recently refurbished 27 High Street, Cardiff (let to ASK restaurants).

In December 2004 LMS purchased jointly with The Miller Group the 16,862 sq m (181,500 sq ft) Swinton Shopping Centre, Manchester, for £29.5 million. The property offers numerous asset management and development initiatives, some of which have already been implemented, including the letting of a prime unit at £50 Zone A (previously £43.50 Zone A). A planning application has also been submitted for a new 3,345 sq m (36,000 sq ft) retail development.

The principal sale during the period was of the Rivergate Centre, Peterborough for £11.1 million, a profit over book value of £1.2 million. Just after the year end 22 Hanover Buildings, Southampton, was sold for £0.9 million, a profit on cost in excess of £0.4 million.

Investor demand across the retail sector remains strong, driven by a considerable weight of institutional and private money. Although any sustained weakness in consumer spending should ultimately translate into a softening of yields, there are currently no signs of this. We continue to look for new opportunities, but will only acquire where we believe real value can be created; and at the same time we will look to sell those properties where we consider our asset management objectives have been achieved.

### Development Programme

**26-28 Dorset Square, London NW1** The comprehensive refurbishment of this building began in April 2005 and when finished it will comprise 2,183 sq m (23,500 sq ft) of high quality offices over five floors. The building is well situated, immediately adjacent to Marylebone mainline station. The development cost is £6.4 million with an ERV of £0.8 million per annum, and completion is due in mid-2006.

**105 Tottenham Court Road, London W1** Contractors have been instructed for the delivery of this 10,126 sq m (109,000 sq ft) landmark office building, with ground floor retail units fronting Tottenham Court Road and a small residential element. The design will create premium space on 1,765 sq m (19,000 sq ft) floor plates over five floors around a central atrium. Demolition work on the existing building is due to start in July 2005 and completion is expected in early 2007 with a development cost of £36 million and an ERV of £4.9 million per annum.

## 58-64 City Road, London EC1

The strategic acquisition of Monmouth House, a 3,860 sq m (42,000 sq ft) office building, for £12.5 million in January 2005 offers several options for the future. It is let entirely to Thomson Financial Limited and lies immediately to the south of the Group's holdings forming the City Road Estate, where proposals are currently being formulated for a substantial mixed use redevelopment.

**Strathkelvin Retail Park, Glasgow – Phase II** Construction of the second phase of the Strathkelvin Retail Park development is due to start in June 2005, producing 4,180 sq m (45,000 sq ft) of retail warehousing units. During this phase of the development the existing units will also be refurbished in keeping with the new B&Q Warehouse. Good interest for the new units has already been received from major retailers. The estimated development cost is £7.8 million, and the ERV of the new units will be £0.9 million per annum. On completion of this phase, the Park will have 27,405 sq m (295,000 sq ft) of premium retail warehousing space.

**Arup Project, London W1 – Phases II & III** A revised pre-letting agreement has been exchanged with Arup for 13,239 sq m (142,500 sq ft) of new offices on Howland Street, London W1, forming the second and third phases of the redevelopment of the Group's offices in this area. The planning application for the new scheme will be submitted in June 2005 with construction due to commence in January 2006. Phase II is due for completion in August 2007 and phase III in May 2009. LMS' estimated development cost is £43 million. On completion Arup will enter into a new 25 year lease at a rent of £6 million per annum.

**Greenwich Reach, London SE10** A planning application for the comprehensive regeneration of this riverside eight acre brownfield site will be made by the end of May 2005. Consent will be sought for approximately 83,600 sq m (900,000 sq ft) of residential accommodation, including high quality private and affordable apartments, together with approximately 6,970 sq m (75,000 sq ft) of retail, restaurants, cafés and waterfront cultural uses. Extensive repair and remedial work on the river walls is nearing completion.

**Winchester Road, London NW3** A planning application is about to be submitted for the demolition of an outdated parade of 1960's retail and residential units and their replacement by a landmark residential development of 90 apartments.

**City Road Estate, London EC1** Feasibility work is now in progress on the redevelopment potential for this prime site adjacent to Old Street roundabout. Preliminary studies indicate that the one acre site can accommodate a major mixed use development incorporating separate office and residential elements. As noted earlier, two adjacent properties which are important to the redevelopment were acquired during the year. The lease structure will permit vacant possession of the site to be obtained at the end of 2007, enabling work to start, subject to planning consent, in 2008.

**158-166 Brompton Road, London SW3** This building lends itself to residential conversion and negotiations have now commenced with the local authority for a scheme fronting Brompton Road and accessed via Cheval Place.

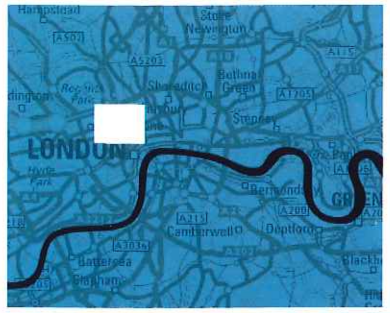
**Wigmore Triangle, London W1** Feasibility studies have been undertaken for a mixed use development on the Wigmore Triangle site which has the potential for 2,044 sq m (22,000 sq ft) of offices with ground floor retail.

**Brighton** In 2003 LMS acquired the Hippodrome, Brighton, with a view to assembling a development site adjacent to its existing holdings in Dukes Lane. A feasibility study for high quality retail units with residential apartments above is currently under review.

### Property Division Outlook

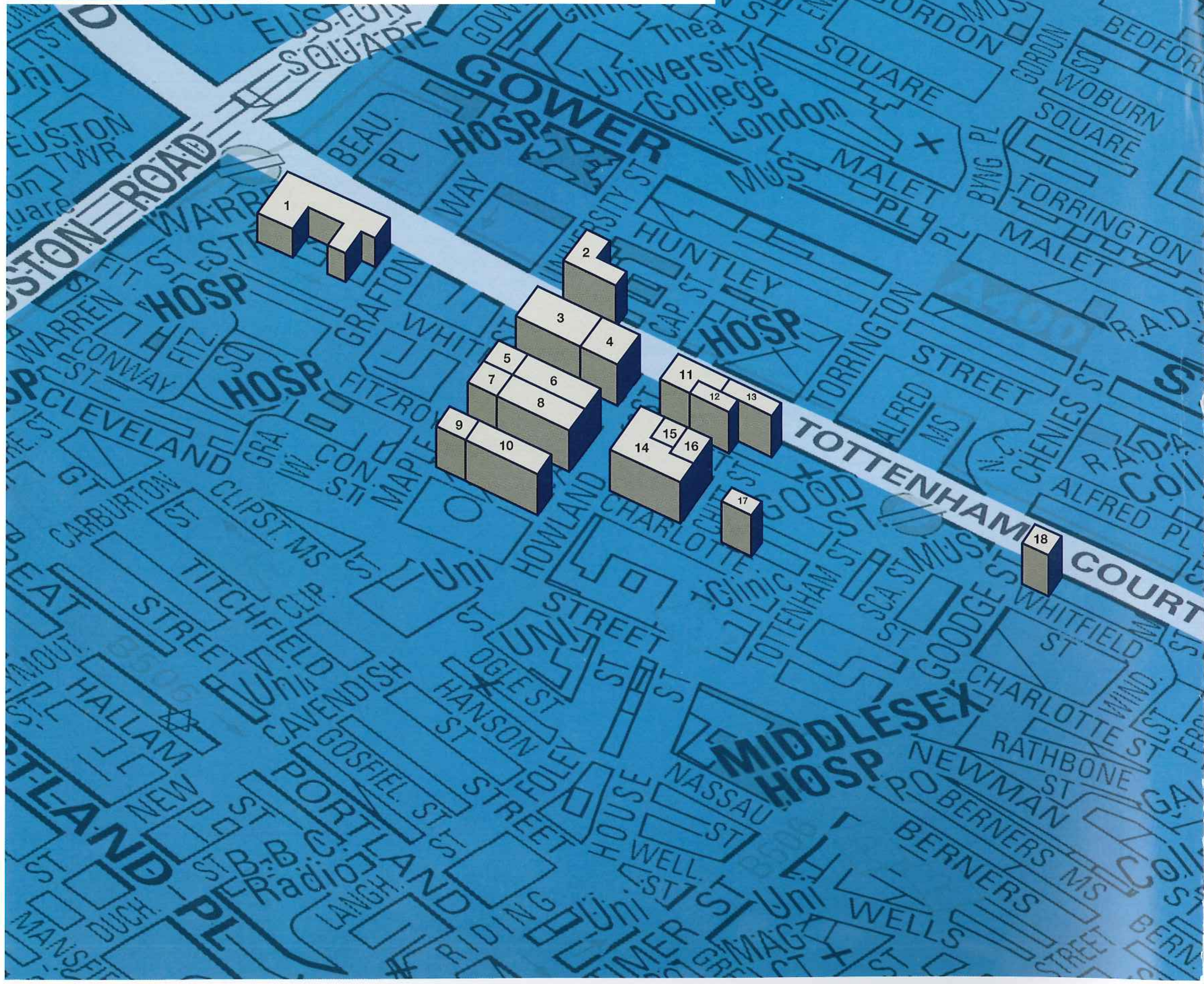
Improving demand in the West End occupier market, coupled with restricted supply of high quality new space, gives confidence in the timing of our significant development projects in this area. While the current development programme in London and other parts of the UK will demand significant resources, we will continue to identify assets in our portfolio and potential new acquisitions where there is the opportunity to improve their capital and revenue-producing potential.

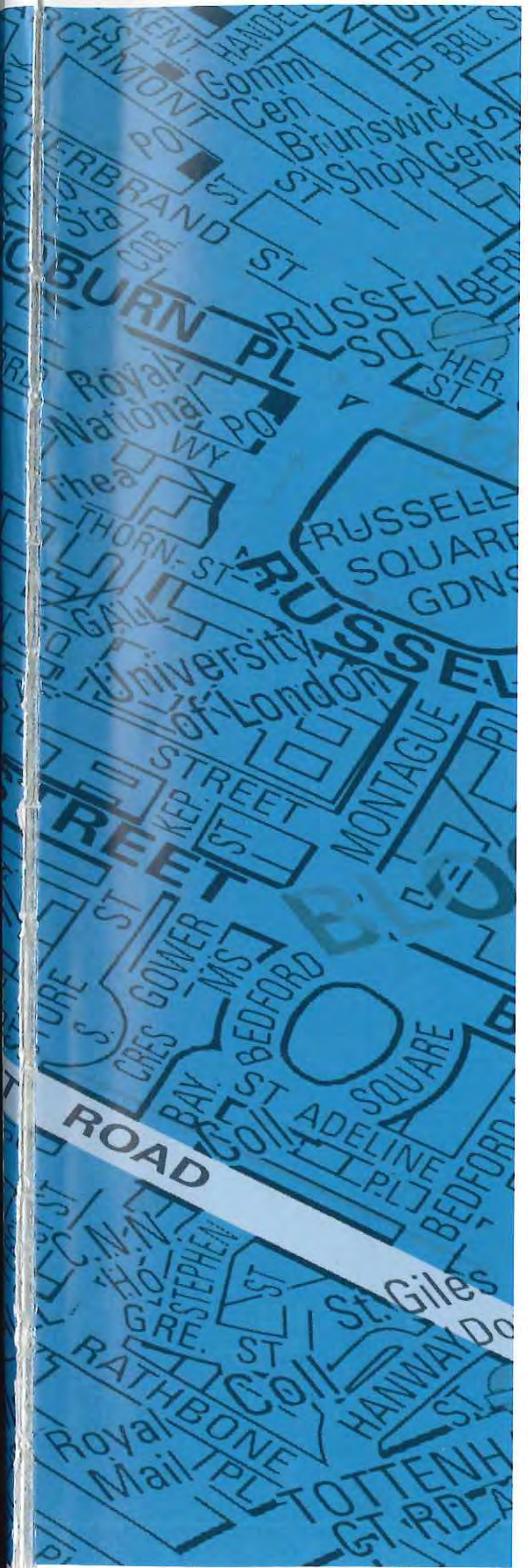
# *Focus on Fitzrovia:*
## Regeneration of one million sq ft




**Principal Fitzrovia Holdings**

| | | | |
|---|---|---|---|
| **1** | 120-134 Tottenham Court Road | **11** | 88-94 Tottenham Court Road |
| **2** | 163-170 Tottenham Court Road | **12** | 60 Whitfield Street |
| **3** | 105 Tottenham Court Road | **13** | 80-85 Tottenham Court Road |
| **4** | 95-100 Tottenham Court Road | **14** | 80 Charlotte Street and 23 Howland Street |
| **5** | 109-113 Whitfield Street | **15** | 71-81 Whitfield Street |
| **6** | 18-24 Howland Street and 9-18 Maple Place | **16** | 67-69 Whitfield Street and 8-15 Chitty Street |
| **7** | 18-24 Fitzroy Street | **17** | 76-78 Charlotte Street |
| **8** | 2-4, 6-10 and 12-16 Fitzroy Street | **18** | 61-63 Tottenham Court Road |
| **9** | 19-23 Fitzroy Street | | |
| **10** | 13 Fitzroy Street | | |






We are now embarking on the regeneration of many of our holdings in Fitzrovia. We are providing new, modern office, retail and residential space in a market of limited supply. Our two flagship developments in Fitzrovia are the new Arup office building and the redevelopment of 105 Tottenham Court Road.

## Arup II & III

Arup Phase I was completed in September 2003. For the next two phases a revised agreement for lease has been signed with Arup, for a single 13,239 sq m (142,500 sq ft) office building fronting Howland and Fitzroy Streets. A revised planning application for the new scheme will be submitted in June 2005.

## 105 Tottenham Court Road

Demolition of the existing building will commence in July 2005 with the main construction works to start in November 2005. The scheme, due to be completed in early 2007, will comprise 10,126 sq m (109,000 sq ft) of offices with ground floor retail units and a small residential block of seven flats.

# *Development potential:*
# Opportunities to create value

### Greenwich Reach SE10

A planning application for Greenwich Reach will be submitted in May 2005 for 1,000 apartments and 75,000 sq ft of commercial space.


## Construction

### 28 Dorset Square NW1

Construction of the new 23,500 sq ft office commenced in April 2005 and is expected to complete mid 2006.

### Strathkelvin II Glasgow

### 105 Tottenham Court Road W1

Demolition will commence in July 2005 with construction of the new building to start in November 2005 and completion in early 2007.

## Planning

### Greenwich Reach SE10

### Howland Street W1 – Arup Phase II and III

Commencing in January 2006 Phase II (57,000 sq ft) and Phase III (85,000 sq ft) of the redevelopment of offices pre-let to Arup is due for completion mid 2009.

### Strathkelvin II Glasgow

Development of 45,000 sq ft of new retail units and refurbishment of the existing units will be completed by June 2006.


## Brompton Road SW3

Feasibility studies are being carried out on this 25,100 sq ft building for a mix of office, residential and ground floor retail.


## Feasibility

### Winchester Road NW3

A planning application for 90 apartments will be submitted for Winchester Road in May 2005.

### Bishopbriggs Glasgow

### Wigmore Street Triangle, London W1

A scheme is being considered for a mixed use development with the potential for 2,044 sq m (22,000 sq ft) of offices with ground floor retail.

### City Road Estate EC1

Feasibility studies are being carried out for a potential 250,000 sq ft mixed use scheme.

### Brompton Road SW3

### Brighton

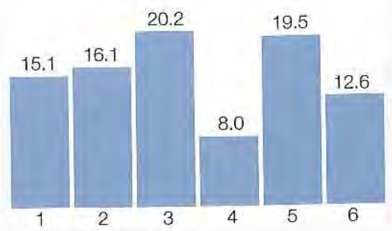
Feasibility studies are being carried out for an extension of the existing retail with elements of residential above.

## Bishopbriggs Glasgow

35 acres of agricultural land has been rezoned for 200 homes – under option to Taylor Woodrow Developments. There is potential for further land releases.

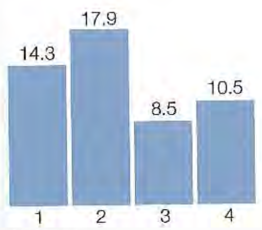

# Property Portfolio

**Total property returns by location** %*



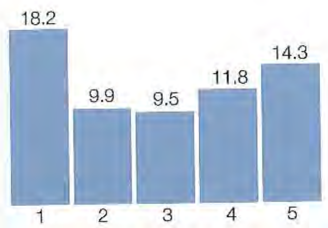

1 London, West End
2 Islington and Clerkenwell
3 Other Central London
4 Scotland
5 Other UK
6 United States

**Total property returns by use** %*



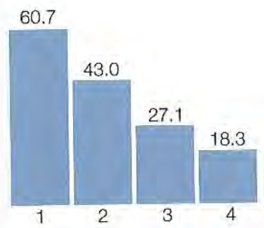

1 Office
2 Retail
3 Leisure
4 Other

**Total property returns** %*




1 2001
2 2002
3 2003
4 2004
5 2005

**Security of income** Gross rent roll £m pa




1 31st March 2005
2 Five years
3 Ten years
4 15 years

*To 31st March

## Principal properties as at 31st March 2005

**Values in excess of £60 million**

Strathkelvin Retail Park
Bishopbriggs, Glasgow
27,405 sq m (295,000 sq ft)

**Values in excess of £50 million**

13 Fitzroy Street, London W1
8,454 sq m (91,000 sq ft)

**Values in excess of £40 million**

The Rotunda, Kingston
15,607 sq m (168,000 sq ft)

The Angel Centre
St. John Street, London EC1
15,080 sq m (162,330 sq ft)

Myddelton Place
88 Rosebery Avenue, London EC1
9,323 sq m (100,350 sq ft)

**Values in excess of £30 million**

80 Charlotte Street and
23 Howland Street, London W1
12,372 sq m (133,180 sq ft)

19-35 Baker Street, London W1
8,626 sq m (92,850 sq ft)

Swinton Shopping Centre
Swinton, Greater Manchester
16,862 sq m (181,500 sq ft)

Greenwich Reach
Greenwich, London
3.1 hectare site

- London, West End
- Islington and Clerkenwell
- Other Central London
- Scotland
- Other UK
- United States

- Office
- Retail
- Residential
- Leisure

- Leasehold

**Values in excess of £20 million**

105 Tottenham Court Road
London W1
8,539 sq m (91,920 sq ft)

120-134 Tottenham Court Road
London W1
324 bed hotel and 2,500 sq m
(26,920 sq ft) retail

Lion & Lamb Yard
Farnham
6,605 sq m (71,105 sq ft)

2-4 and 6-10 Fitzroy Street, London
5,167 sq m (55,400 sq ft)

163-170 Tottenham Court Road
London WC1
3,344 sq m (36,000 sq ft)

City Road Estate, London EC1
8,918 sq m (96,000 sq ft)

80-85 Tottenham Court Road
London W1
4,357 sq m (46,900 sq ft)

**Values in excess of £15 million**

18-24 Howland Street and
9-18 Maple Place, London W1
5,295 sq m (57,000 sq ft)

63 St James's Street, London SW1
2,115 sq m (22,770 sq ft)

60 Whitfield Street, London W1
3,363 sq m (36,200 sq ft)

The Triangle Shopping Centre
Bishopbriggs, Glasgow
6,969 sq m (75,000 sq ft)

**Values in excess of £10 million**

275 Sacramento Street
San Francisco, California
6,772 sq m (77,200 sq ft)

88-110 George Street, London W1
2,345 sq m (25,235 sq ft)

160-166 Brompton Road
London SW3
2,332 sq m (25,100 sq ft)

58-64 City Road, London EC1
3,860 sq m (42,000 sq ft)

17-39 George Street, London W1
1,973 sq m (21,235 sq ft)

The Bargate Centre, Southampton
7,525 sq m (81,000 sq ft)

**Values in excess of £7.5 million**

The Quadrant Arcade, Bournemouth
7,673 sq m (82,775 sq ft)

1149 South Main Street, Walnut Creek
San Francisco, California
2,694 sq m (29,000 sq ft)

Dukes Lane, Brighton
2,278 sq m (24,523 sq ft)

5-8 Hardwick Street and
161 Rosebery Avenue, London EC1
3,180 sq m (34,230 sq ft)

City House
420-430 London Road, Croydon
13,052 sq m (140,500 sq ft)

151 Rosebery Avenue, London EC1
2,251 sq m (24,230 sq ft)

The Quadrant Arcade, Romford
6,364 sq m (68,500 sq ft)

24-40 Gloucester Place, London W1
2,202 sq m (23,705 sq ft)

Bush House, South West Wing
London WC2
9,618 sq m (103,530 sq ft)

2-12 Pentonville Road, London N1
2,443 sq m (26,300 sq ft)

**Values in excess of £5 million**

96 Bishops Bridge Road, London W2
790 sq m (8,505 sq ft)

22-66 Myddelton Square, London EC1

67-69 Whitfield Street and
8-15 Chitty Street, London W1
2,478 sq m (26,675 sq ft)

3706 Geary Boulevard
San Francisco, California
2,787 sq m (30,000 sq ft)

21-23 and 25-31 South Street, Romford
1,126 sq m (12,125 sq ft)

2-20 Winchester Road and
157a-173 Fellows Road
London NW3
880 sq m (8,400 sq ft)

26-28 Dorset Square, London NW1
1,983 sq m (21,350 sq ft)

340 Pine Street
San Francisco, California
4,989 sq m (53,705 sq ft)

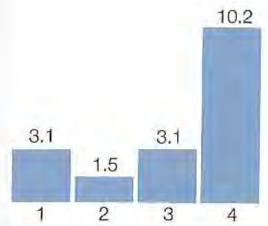
14 Pentonville Road, London N1
1,733 sq m (18,654 sq ft)

83 Farringdon Street, London EC4
1,325 sq m (14,263 sq ft)

Burlington Arcade, Bournemouth
1,208 sq m (13,000 sq ft)

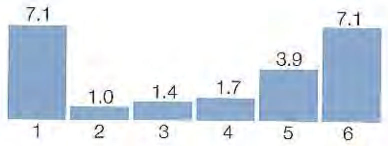
76-78 Charlotte Street, London W1
1,002 sq m (10,787 sq ft)

**Void rate by use %†**




1 Office
2 Retail
3 Leisure
4 Other

**Void rate by location %†**




1 London, West End
2 Islington and Clerkenwell
3 Other Central London
4 Scotland
5 Other UK
6 United States

† Excluding committed developments

# Property portfolio breakdown as at 31st March 2005

| Portfolio breakdown* | Values (£m) | | Percentage of portfolio | | Percentage like for like change | | Gross rent roll (£m pa) | |
|---|---|---|---|---|---|---|---|---|
| **London, West End** | **395.3** | | **39.9** | | **8.6** | | **23.0** | |
| Office | | 303.3 | | 30.6 | | 8.2 | | 17.7 |
| Retail | | 60.1 | | 6.1 | | 9.9 | | 3.7 |
| Leisure | | 16.1 | | 1.6 | | 8.1 | | 0.9 |
| Other | | 15.8 | | 1.6 | | 13.9 | | 0.7 |
| **Islington and Clerkenwell** | **173.9** | | **17.5** | | **6.8** | | **14.0** | |
| Office | | 157.8 | | 15.9 | | 6.9 | | 13.4 |
| Retail | | 2.8 | | 0.3 | | 12.8 | | 0.1 |
| Leisure | | 1.4 | | 0.1 | | 3.7 | | 0.1 |
| Other | | 11.9 | | 1.2 | | 4.2 | | 0.4 |
| **Other Central London** | **63.2** | | **6.4** | | **14.3** | | **3.2** | |
| Office | | 37.6 | | 3.8 | | 3.0 | | 1.8 |
| Retail | | 10.3 | | 1.0 | | 51.4 | | 0.5 |
| Leisure | | 10.6 | | 1.1 | | 14.0 | | 0.7 |
| Other | | 4.7 | | 0.5 | | 72.2 | | 0.2 |
| **Scotland** | **118.9** | | **12.0** | | **9.5** | | **5.9** | |
| Office | | 3.4 | | 0.3 | | 11.6 | | 0.2 |
| Retail | | 82.3 | | 8.3 | | 7.9 | | 4.6 |
| Leisure | | 3.3 | | 0.3 | | 4.3 | | 0.3 |
| Other | | 29.9 | | 3.1 | | 14.6 | | 0.8 |
| **Other UK** | **203.5** | | **20.5** | | **2.9** | | **12.1** | |
| Office | | 16.0 | | 1.6 | | (2.8) | | 2.1 |
| Retail | | 91.5 | | 9.2 | | 10.6 | | 5.5 |
| Leisure | | 64.5 | | 6.5 | | (0.4) | | 4.1 |
| Other | | 31.5 | | 3.2 | | (6.9) | | 0.4 |
| **US** | **36.5** | | **3.7** | | **7.8** | | **2.5** | |
| Office | | 16.2 | | 1.6 | | 7.4 | | 1.2 |
| Retail | | 20.3 | | 2.1 | | 8.0 | | 1.3 |
| **Total** | **991.3** | **991.3** | **100.0** | **100.0** | | **7.5** | **60.7** | **60.7** |

*Includes trading properties and share of joint venture property at valuation.

| Summary use breakdown | Values (£m) | Percentage of portfolio | Percentage like for like change | Gross rent roll (£m pa) |
|---|---|---|---|---|
| Office | 534.1 | 53.9 | 7.1 | 36.4 |
| Retail | 267.5 | 27.0 | 10.5 | 15.7 |
| Leisure | 95.7 | 9.6 | 2.6 | 6.1 |
| Other | 94.0 | 9.5 | 6.7 | 2.5 |
| | **991.3** | **100.0** | **7.5** | **60.7** |

# Operating Review: *Investment Division*

## A risk-diversified portfolio spanning industry sectors and different stages of development

### Performance

LMS' Investment Division portfolio is risk-diversified, containing holdings in quoted and unquoted companies at different stages of development in the UK and the US, together with a number of fund investments. Underlying trading in most of our investee companies has significantly improved over the last 12 months.

The Investment Division ended the year with a book value of £220.6 million (2004 – £191.9 million). The market value was £232.8 million (2004 – £200.6 million). During the year realisations generated £61.2 million, producing profits of £17.9 million (2004 – £7.5 million). The disposals included a number of companies held in fund portfolios, several quoted oilfield service stocks, Ridgeway Systems and Software, and TradePower Inc. They also included the disposal by Inflexion of the Ster Century cinema chain and most of its holding in ANT Limited.

New investment during the year totalled £72.9 million, of which just over one third was into funds, one third was follow-on financing for existing companies and the balance was investment into new companies. These cover a range of sectors, including technology (Penguin Computing and ModViz Inc. in the US) and investment banking (Merriman Curhan Ford & Co. in the US and Bridgewell Group Limited in the UK). Inflexion Fund 2 invested in three buyout transactions in the UK – Healthcare Knowledge International, Harrington Brooks (trading as All Clear Finance) and Ilchester Cheese Company Limited.

### Organisation and management

Last year we began the process of extending the management and reorganising the structure of the Investment Division. The first step was the acquisition in February 2004 of a 58.8% stake in Inflexion plc, an AIM-traded private equity investment company.

Shortly before the year end a further step in the restructuring of the Division was taken with the formation of San Francisco Equity Partners (SFEP). SFEP is managed by Scott Potter, who joined us at the beginning of 2003 as our US Investment Director. It will be our principal vehicle for direct investment in the US and most of the existing direct investments there have been transferred into the new fund.

### UK portfolio

**AssetHouse Technology Limited** AssetHouse is a software and services company providing solutions to telecommunications providers to enable the packaging and wholesaleing of digital content.

LMS first invested in AssetHouse in 2000 and has £7.6 million invested which is held at £4.6 million. LMS' fully diluted shareholding is 76%.

**Bridgewell Group Limited** Bridgewell is a relatively new London-based investment bank which is successfully developing its high quality corporate finance and securities businesses, and has won some notable mandates. It is well positioned to take advantage of the current changes in the investment banking environment and is growing its revenues rapidly.

LMS invested £2.5 million in a private placement in late 2004 and is one of the largest institutional shareholders. The investment is held at cost and LMS' fully diluted shareholding is 6%.

**Citizen Limited (Vio Worldwide Limited)** Rebranded in 2005 as 'Vio – The Digital Supply Chain' the company is a provider of software solutions to the printing, publishing and graphics arts industries, with many of the UK's leading printers, newspaper and magazine publishers amongst its customers.

The company has taken a proactive role in the development and adoption of industry standards and has used these to deliver automated large-file transportation and advertising delivery solutions. Following the acquisition of software company Portland PMS Limited, Vio now also provides solutions that automate the production and population (from databases) of adverts and catalogues.

LMS first invested in Vio in 2002 after the company had been acquired from BT. LMS has £9.4 million invested, held at cost. LMS' fully diluted shareholding is 84%.

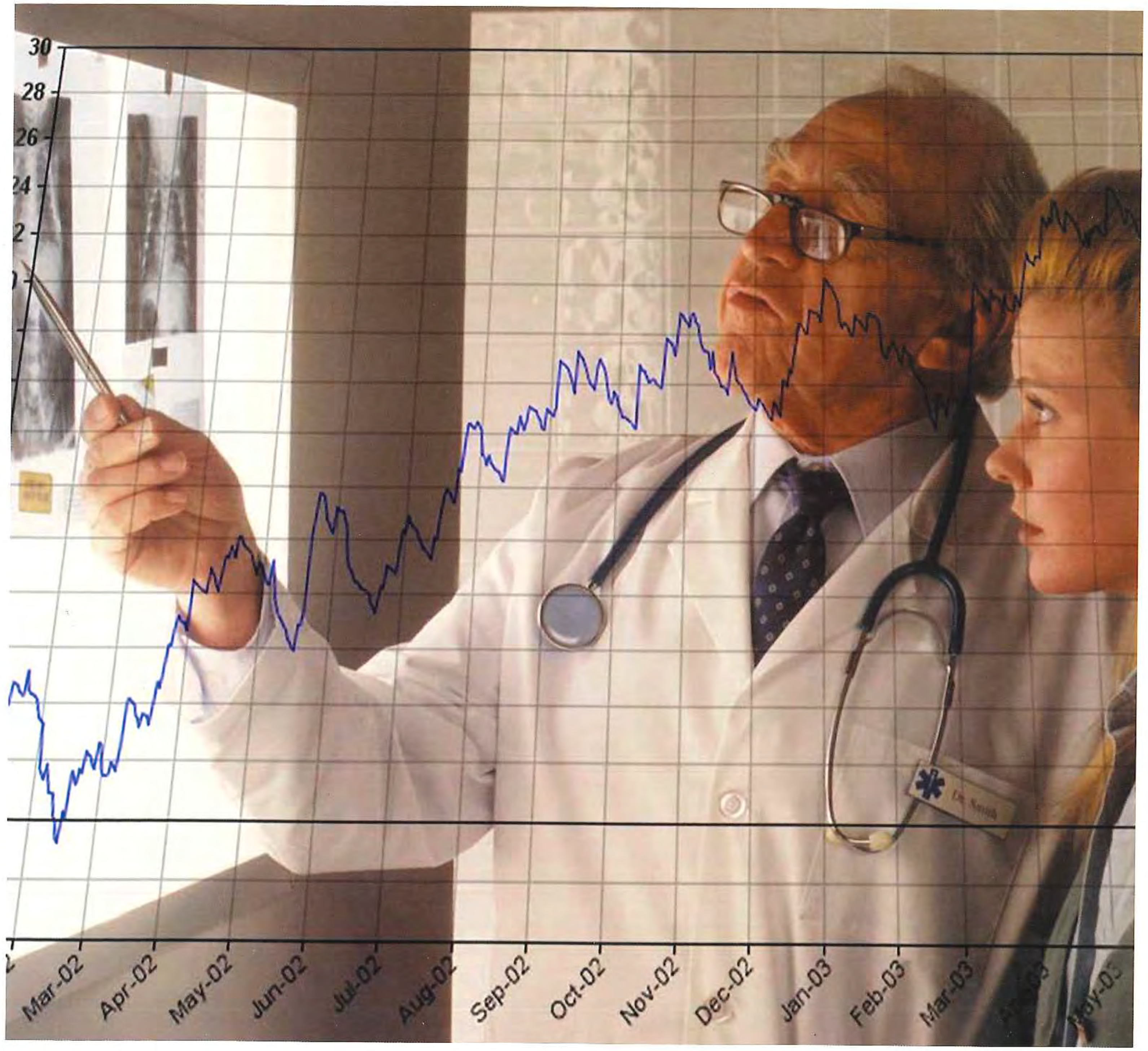
**Cityspace Limited** Cityspace provides digital urban infrastructure solutions. Cityspace networks now exist in over 20 UK cities as well as Brussels, Gothenburg and Moscow. They provide street level access to modern digital services working with local authorities, transportation systems and wireless operators.

In the last year, Cityspace has made good progress across the business. Highlights include the launch of the largest Wi-Fi hotzone in the UK covering Bristol city centre, the launch of a card based transaction network, Quickomat, in Sweden and the first trials of Cityspace Multipoint, a combined ATM and iPlus terminal.

LMS has £9.8 million invested in Cityspace, which is held at cost. The first investment was made in 1995. LMS' fully diluted shareholding is 75%.

## Inflexion

During the year Inflexion plc invested £9.0 million in three UK mid-market buy-out transactions. In April 2004 Inflexion led the £13 million management buy-out of Healthcare Knowledge International Ltd, the leading provider of value-added healthcare information services to hospitals in the UK and Spain. Inflexion Fund 2 invested £2.8 million and Inflexion plc co-invested £1.5 million.



## ITS

ITS specialises in high quality fabrication of equipment for the energy and water treatment industries, with a particular expertise in steam generation technology. With its joint venture partner it has successfully built and demonstrated a commercial scale plant for the recovery of heavy oil deposits using rapid thermal processing technology.

**CopperEye Limited** CopperEye is a provider of a revolutionary patented data indexing technology that delivers dramatic increase in data loading performance. The technology is applicable to relational databases and many data intensive software applications.

LMS first invested in CopperEye in 2001 and, at year end, LMS had £4.5 million invested in the company and has since invested a further £1.0 million. The investment is held at cost. LMS' fully diluted shareholding is 57%.

**Corizon Limited** Corizon provides software and services to enable enterprises to make better use of existing software applications. Their products bring together applications to create new user processes designed to improve productivity.

Corizon has had a successful year. It has continued to add value to its customers by increasing the number of projects where the Corizon suite is being used. Customers have measured real productivity improvements as a result. The company has added sales resources to expand its reach, predominantly in the UK. Revenues have grown by over 100%, year on year.

LMS has £3.8 million invested in Corizon, which is held at a book value of £1.8 million. LMS' fully diluted shareholding is 39%.

**Elateral Holdings Limited** Elateral is a provider of software and services that automate the production of printed and electronic marketing communications collateral. The Elateral application is delivered to customers as a hosted 'Software-as-a-Service' solution. The company's customers include global brand owners such as Nike, Cisco and Sony.

LMS first invested in Elateral in 2000 and has £7.0 million, invested in the company, held at £1.9 million. LMS' fully diluted shareholding is 37%.

**Energy Cranes International – ECI** Based in Aberdeen and Houston, ECI provides crane operation and management services to the offshore energy industry and also manufactures cranes under the American Aero and Titan brands. It is the largest business of its type in the world and is well positioned to provide the professional management of crane operations, including health and safety, which is required by the global offshore industry. ECI has turnover of approximately £80 million and EBITDA of around £5 million.

LMS has £18.7 million invested in ECI, which is held at cost. LMS' fully diluted shareholding is 95%.

**Entuity Limited** Entuity develops and markets 'Eye of the Storm', an enterprise network management software suite. The product provides real-time visibility of fault, performance and resource allocation across an entire corporate network.

Entuity closed the year with record revenues and its largest single licence sale. In addition the company has successfully increased the size of contracts for which it is bidding and winning. The company is continuing to invest in additional sales and marketing resources to further exploit its proven technology. Entuity continues to focus its efforts on the US market.

LMS has £7.0 million invested in Entuity, which is held at cost. The first investment was made in 2000. LMS' fully diluted shareholding is 68%.

**First Index Group Inc.** First Index provides sourcing services to the global custom manufactured parts industry. First Index sell products and services which allow major OEM manufacturers to identify, qualify and then obtain quotes from new suppliers, often in low cost countries such as China, India and Mexico. First Index also provides suppliers with a subscription based lead service to access quotes from OEM manufacturers.

The company has significantly increased sales resources focused on selling to large US OEMs. The results of this effort are likely to be seen in 2005/06. Further development of the low cost country sourcing network has taken place with increased resources in China and Eastern Europe.

LMS has £4.8 million invested in First Index, which is held at cost. The first investment was made in 2000. LMS' fully diluted shareholding is 40%.

**7 Holdings Limited (parent of 7 Global Limited)** 7 Holdings is the UK's leading provider of hosting services for software vendors providing 'Software-as-a-Service' via its subsidiary 7 Global.

7 Global is experiencing a significant increase in activity level amongst software vendors offering 'Software-as-a-Service'. The global software industry is increasingly turning to this form of delivery to provide a long-term annuity revenue stream and to lower the total cost of ownership for customers. 7 Global's strategy is to be partner of choice in the UK and it has recently received accreditation from Microsoft as a Gold Certified Partner.

LMS has invested £14.4 million in 7 Holdings, which is held at £11.4 million. LMS first invested in 7 Holdings in 2000. LMS' fully diluted shareholding is 79%.

**ProStrakan Group plc** ProStrakan is an emerging pharmaceutical company. ProStrakan's principal business is the commercialisation, discovery, research and development of prescription medicines. The group, which is headquartered in Galashiels, Scotland currently employs 270 people and generated pro forma product sales in 2004 of approximately £27 million.

## Penguin

Penguin is both a supplier of Linux servers, used principally in clusters for high performance computing, and, through its Skyld Software subsidiary, a leading vendor of cluster management software. It generated revenues of over $20 million in 2004 and is growing rapidly, with a strong customer base in public institutions and major corporations in the US.

LMS has £19.3 million invested in ProStrakan, held at cost with a fully diluted shareholding of approximately 9%. LMS supported the company since its first venture capital round in 1999. £10 million was invested in 2004/05 as part of an institutional funding round, following the acquisition of Proskelia, in August 2004. Proskelia was spun out of Aventis in 2002 and adds significant drug discovery and development skills as well as a strong pipeline, predominantly in the bone area, to the Group.

The Group has an established and growing speciality sales and marketing organisation principally in the UK, France, Spain and Germany. This provides a strong channel for growing sales of existing products and for future other product launches such as Tostrex for the treatment of male hypogonadism and Rectogesic for the treatment of pain associated with chronic anal fissures. ProStrakan's strategy is to build an international pharmaceutical company that is cash-generative, profitable and sustainable.

**Wesupply Limited** Wesupply is a leading provider of supply chain execution management software which is delivered to its customers as a hosted 'Software-as-a-Service' solution which allows rapid implementation and leads to fast pay-back.

The Wesupply application is used by a manufacturer to enable closer integration and collaboration between itself and its customers/suppliers. The company's products are very widely applicable and are used by customers in building materials wholesale, manufacturing, beverages, industrial, CPG (consumer packaged goods) and automotive industries.

LMS first invested in Wesupply in 2000 and has £10.0 million invested, held at £8.0 million. LMS' fully diluted shareholding is 75%.

### US Portfolio

**ITS** ITS specialises in high quality fabrication of equipment for the energy and water treatment industries, with a particular expertise in steam generation technology. It has strategic partnerships with a number of process development companies in the oil and gas and alternative energy industries, including a joint venture which has successfully built and demonstrated a commercial scale plant for the recovery of heavy oil deposits using rapid thermal processing technology.

LMS has £8.3 million invested in ITS, which is held at cost. LMS' fully diluted shareholding is 93%.

**Merriman Curhan Ford & Co (MCF Corporation).** MCF is a San Francisco-based investment bank, quoted on the American Stock Exchange, which in a short period has created a strong franchise not only in technology stocks but in several other growth sectors. It has taken advantage of the opportunity created by the disappearance of several of the traditional west coast investment banking firms. In addition to its research, securities broking, and corporate finance activities, MCF is now growing an asset management business. It has doubled revenues every year since starting in 2000.

LMS invested $6 million (£3.3 million) in August 2004 in a PIPE transaction. LMS' fully diluted shareholding is 8%.

**Method Products Inc** Based in San Francisco, Method was established in 2000 to use design, fragrance and environmentally friendly ingredients to redefine the household cleaning product category. It has subsequently expanded into other product areas such as laundry and air freshners. Method has been very successful in gaining distribution in key retail outlets in the US, particularly Target and most recently Walmart.

LMS initially invested $475,000 in Method in late 2003 and in December 2004 led a new funding round, investing a further $4 million (total investment £2.4 million, held at cost). LMS' fully diluted shareholding is 9%.

**ModViz Inc.** ModViz produces software which enables the visualisation of output from Linux clusters, where very large computing power is required, such as modelling oil and gas reservoirs and medical imaging. The software is currently being evaluated by several major oil companies, together with significant channel partners.

LMS invested $1million (£550,000) in 2004. LMS' fully diluted shareholding is 22%.

**Penguin Computing** Penguin is both a supplier of Linux servers, used principally in clusters for high performance computing, and, through its Skyld Software subsidiary, a leading vendor of cluster management software. It generated revenues of over $20 million in 2004 and is growing rapidly, with a strong customer base in public institutions and major corporations in the US.

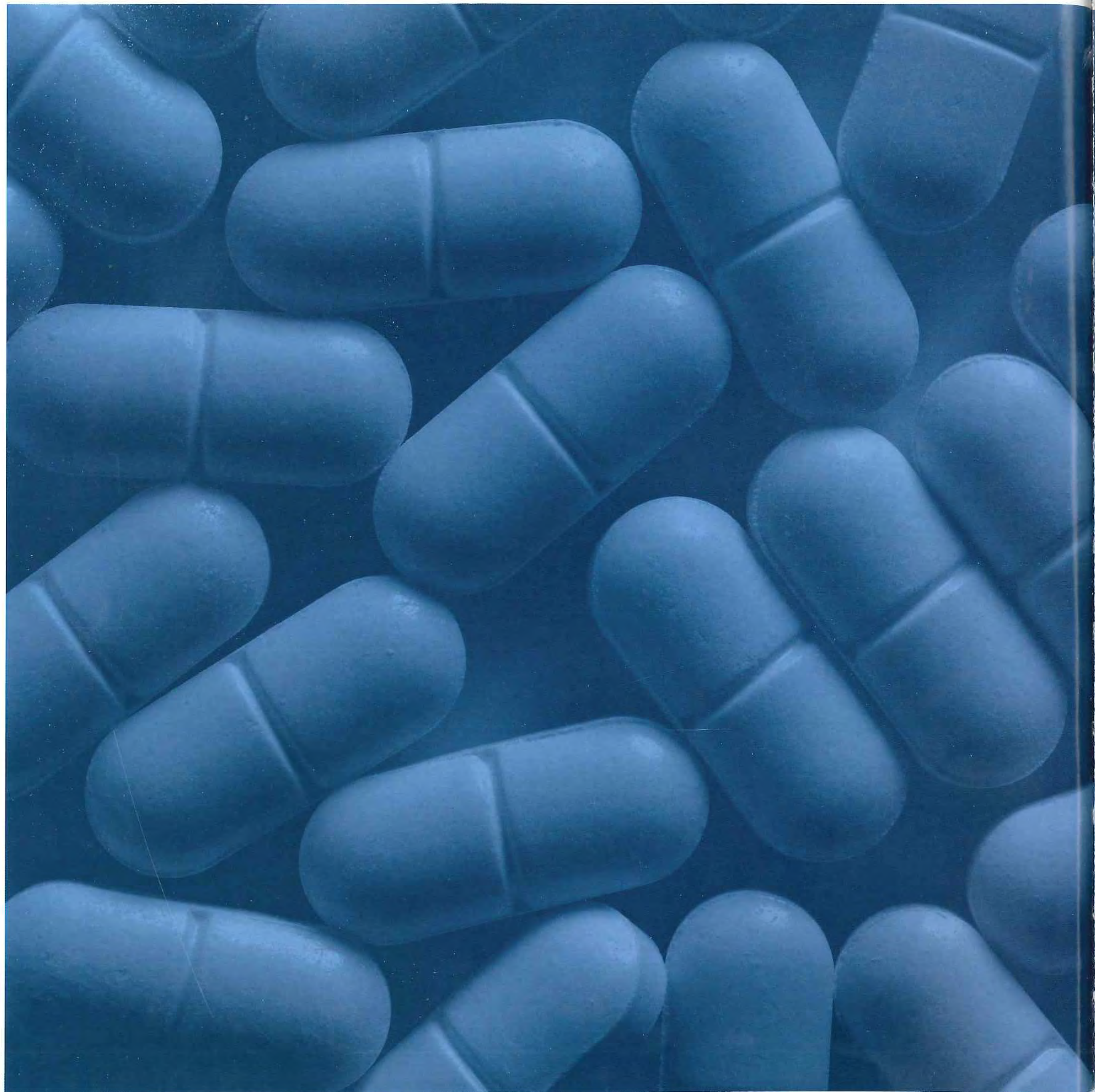
LMS led a funding round in October 2004, investing $5 million (£2.7 million). LMS' fully diluted shareholding is 22%.

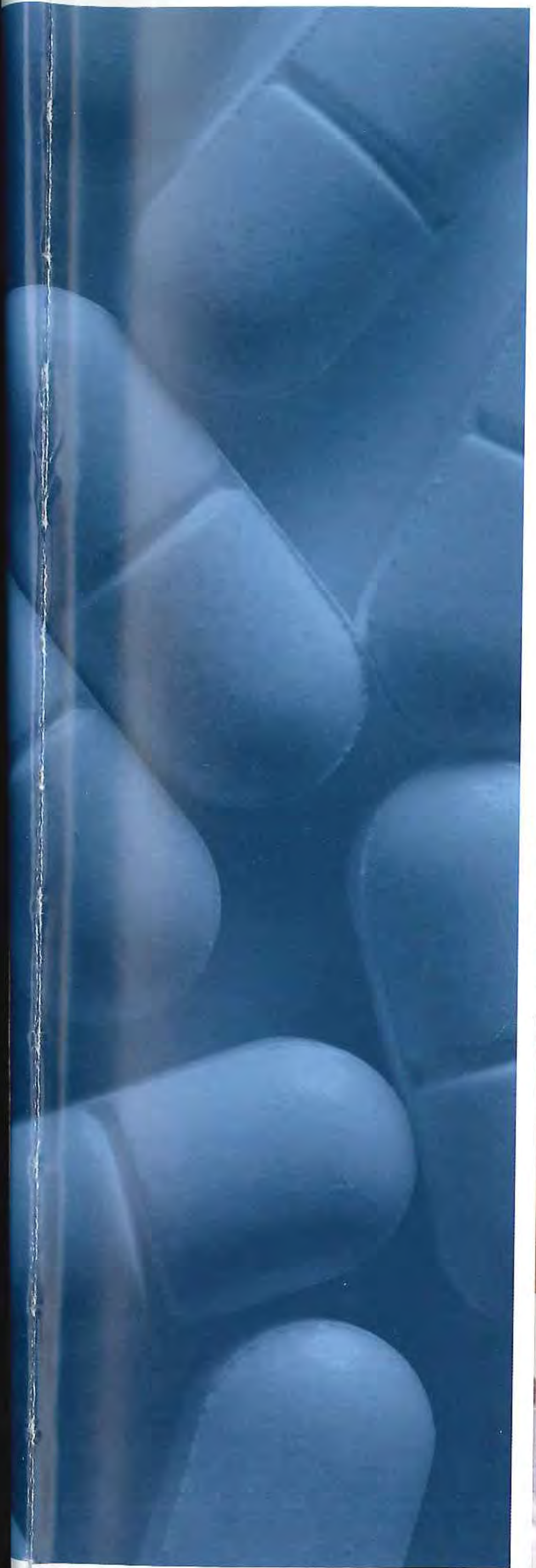
**Rave Motion Pictures** Rave builds and operates stadium cinema mega-plexes (12 to 20 screens) principally in the southern and mid-western United States. The theatre building programme is continuing and there are 18 theatres open with several more under construction or evaluation. Revenue in 2004 was about $100 million with significant growth expected in 2005.

LMS invested $10 million (£5.8 million) in Rave in 2002. LMS' fully diluted shareholding is 14%.

**Investment Division Outlook** The outlook for the Investment Division is favourable and the portfolio is on track for successful realisations, with the greater part of the value being achieved in two to three years' time. The steps taken to restructure and extend the management of the operation have had positive results and we intend to continue this process during the year ahead.

# *Focus on ProStrakan:*
# A maturing investment





ProStrakan's strategy is to build an international pharmaceutical company that is cash-generative, profitable and sustainable. This is to be achieved through selecting:

- major geographical markets and targeting specialist physicians;
- attractive products with growth potential of a scale appropriate to its resources; and
- the means of bringing new products to market.

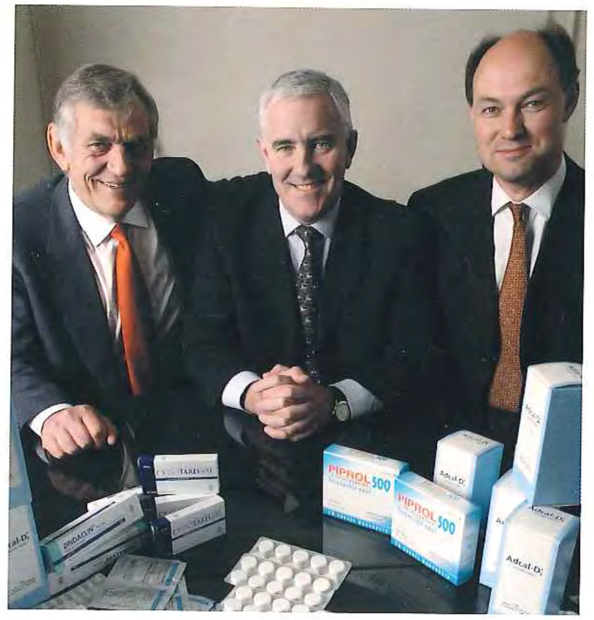
Such new products may come from ProStrakan's own product pipeline or may be in-licensed or acquired from third parties.

## New products

ProStrakan's discovery and development portfolio currently comprises six products undergoing clinical trials and a number of pre-clinical projects and discovery programmes. This pipeline is supported by ProStrakan's expertise in bone biology and medicinal and steroid chemistry.

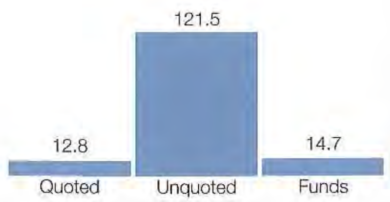
## Strong management

ProStrakan has an experienced management team with a proven track record in building pharmaceutical businesses and integrating acquisitions. The management team has demonstrated its ability to add value through organic growth as well as through acquisitions and product in-licensing activities.



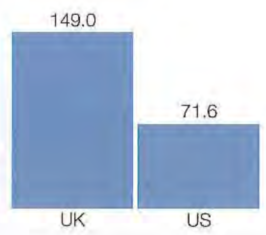
# Investment Portfolio Breakdown

**UK portfolio analysis by class** (book value) £m




**US portfolio analysis by class** (book value) £m


**Analysis by location** (book value) £m




**Analysis by sector** (book value) %


1 Communication 12.7
2 e-commerce 14.0
3 Health 10.3
4 Energy/Industrial 18.5
5 Media/Leisure/Retail 11.2
6 Software 20.3
7 Other technology 9.0
8 Financial services 4.0

## Largest investments UK quoted

| Company | Activity | Number of shares '000 | Book value £000 |
|---|---|---|---|
| Crown Sports plc | Health and fitness club owner/operator | 57,754 | 6,526 |
| DMATEK Limited | Security tagging technology | 4,076 | 2,422 |
| Gourmet Holdings plc | Speciality pub/restaurant operator | 10,454 | 1,162 |
| Bond International Software plc | Recruitment/HR software | 1,683 | 1,153 |
| Bloomsbury Publishing plc | Book and information publisher | 180 | 375 |
| Dunedin Enterprise Investment Trust plc | Investment trust | 124 | 369 |
| Civilian Content plc | Television and film production | 2,143 | 317 |
| Guinness Flight Venture Capital Trust | Venture capital trust | 175 | 100 |
| NMT Group plc | Medical safety devices | 153 | 95 |
| RWS Holdings Plc | Intellectual property and support services | 45 | 79 |
| Other | | | 174 |
| **Total UK quoted** | | | **12,772** |

## Largest investments US quoted

| Company | Activity | Number of shares '000 | Book value £000 |
|---|---|---|---|
| Weatherford International Inc | Oilfield services | 398 | 8,350 |
| Merriman Curhan Ford & Co | Investment banking | 4,615 | 3,335 |
| Covad Communications Inc | Business communication services | 2,585 | 1,642 |
| Digital Generation Systems Inc | Media delivery network | 1,984 | 1,355 |
| Virologic Inc | Drug discovery technology | 1,442 | 1,089 |
| Grant Prideco Inc | Oil and gas exploration products | 150 | 1,063 |
| AXS-One Inc | Enterprise software | 754 | 931 |
| Chyron Corporation | Broadcast media technology | 3,715 | 786 |
| B J Services Company | Oilfield services | 30 | 733 |
| Brooktrout Inc | Electronic information exchange | 80 | 476 |
| Epoch Holdings Corporation | Investment advisory and management company | 105 | 263 |
| Chordiant Software Inc | Multi-Channel CRM software | 231 | 205 |
| Indus International Inc | Enterprise asset management software | 100 | 129 |
| Other | | | 967 |
| **Total US quoted** | | | **21,324** |

| | Book value £000 |
|---|---|
| **Total UK and US quoted** | **34,096** |
| **Held by – Inflexion** | **11,043** |
| **Held by – LMS Capital** | **23,053** |

**Analysis by sector** (age of investment) Years


1 Communication 5.6
2 e-commerce 7.6
3 Health 6.1
4 Energy/Industrial 8.1
5 Media/Leisure/Retail 3.8
6 Software 4.2
7 Other technology 2.5

**Analysis by sector**
(principal new investments in 2005) %


1 Communication 4.0
2 e-commerce 6.1
3 Health 16.0
4 Energy/Industrial 4.9
5 Media/Leisure/Retail 4.5
6 Software 15.1
7 Funds 36.2
8 Financial services 13.2

# Largest investments UK unquoted

| Company | Activity | Book value £000 |
|---|---|---|
| ProStrakan Group Limited | Speciality pharmaceuticals | 19,260 |
| Energy Cranes International Limited* | Provider of crane and crane related services | 18,723 |
| 7 Global Limited* | Software hosting services | 11,446 |
| Cityspace Limited* | Urban information networks | 9,832 |
| Citizen Limited (Vio Worldwide Limited)* | Digital workflow management solutions | 9,400 |
| Offshore Tool & Energy Corporation (ITS)* | Oilfield services | 8,337 |
| Wesupply Limited* | Supply chain execution management software | 8,024 |
| Entuity Limited* | Network management software | 7,037 |
| First Index Group Limited | Manufacturing sourcing service | 4,788 |
| AssetHouse Technology Limited* | Content services infrastructure software | 4,683 |
| CopperEye Limited* | Database indexing technology and software | 4,520 |
| Harrington Brooks (Accountants) Limited | Debt management and consolidation services | 3,300 |
| netdecisions Holdings Limited | IT services | 2,993 |
| Bridgewell Group Limited | Investment banking | 2,508 |
| Elateral Holdings Limited | Marketing automation software | 1,874 |
| Corizon Limited | Application integration software | 1,795 |
| Healthcare Knowledge International Limited | Analytical software services | 1,638 |
| Other | | 1,368 |
| **Total** | | **121,526** |

# Largest investments US unquoted

| Company | Activity | Book value £000 |
|---|---|---|
| Rave Motion Pictures | Movie theatre operators | 5,804 |
| Penguin Computing Inc | Linux systems, software and services | 2,729 |
| Method Products Inc | Household cleaning products | 2,369 |
| Telespree Communications | Wireless telecommunications infrastructure | 1,222 |
| Envestnet Asset Management | Investment management services | 827 |
| Modviz Corporation | 3D interactive graphical software | 550 |
| Chyron Corporation (Debt) | Broadcast media technology | 500 |
| LifeMasters Supported SelfCare Inc | Comprehensive disease management services provider | 422 |
| Other | | 441 |
| **Total** | | **14,864** |

| | Book value £000 |
|---|---|
| **Total UK and US unquoted** | **136,390** |
| **Held by – Inflexion** | **4,939** |
| **Held by – LMS Capital** | **131,451** |

*Economic interest above 50%.

# Board of Directors


Graham Greene CBE


Peter Grant CBE


Bernard Duroc-Danner


Nick Friedlos


June de Moller


Donald Newell


Martin Pexton


Robert Rayne


James Wilson

**Graham Greene CBE***
Chairman

Mr Greene is aged 69 and was appointed a director in 1996 and Chairman in July 2000. He is Chairman of the Nomination Committee and is a member of the Remuneration and Audit Committees. He is a former director of Greene King plc, former member of the Board of the British Council and former Chairman of the Trustees of The British Museum. His career has included directorships with Guinness Mahon, Guinness Peat Group plc Jupiter International Green Investment Trust plc. For over 25 years Mr Greene was a publisher – the founding Chairman of Chatto, Bodley Head & Jonathan Cape Ltd and chairman and director of a number of publishing companies in the Commonwealth.

**June de Moller***

Mrs de Moller is aged 57 and was appointed a director in May 2002 and she brings to the Board her considerable business acumen and experience gained from a wide variety of companies. She is a member of the Nominations, Remuneration and Audit Committees. She is a non-executive director of J Sainsbury plc, and Archant Limited. She is a former Managing Director of Carlton Communications Plc and was previously a non-executive director of Cookson Group plc, BT plc and AWG plc.

**James Wilson***

The Hon J M Wilson is aged 52 and was appointed a director in April 2001 and he brings to the Board a wealth of experience in the private equity market. He is a member of the Nomination Committee. He is a founding partner of Boston Ventures, a leading US media and communications private equity firm. He is a director of Jobson Publishing LLC, PartMiner Inc., CAMP Systems Corp, Northstar Travel Media and World Publications.

**Peter Grant CBE***
Deputy Chairman

Mr Grant is aged 75 and has been a director since 1984. He was appointed Deputy Chairman of the Company in 1994. He is Chairman of the Remuneration Committee and a member of the Nomination and Audit Committees. He has substantial financial experience gained through a career in investment banking. He was with Lazard Brothers & Co., Ltd from 1952 to 1988, as a managing director from 1968 and as a Deputy Chairman from 1985. He was a director of Sun Life Assurance for 22 years and Chairman from 1983 to 1995. He has also been a director of BNP Paribas Holdings Ltd and Scottish Hydro (now part of Scottish and Southern Energy plc)

**Donald Newell***

Mr Newell is aged 62 and was appointed a director in 1998 and is Chairman of the Audit Committee and a member of the Remuneration and Nomination Committees. A Chartered Surveyor, he was Senior Partner of Hillier Parker May & Rowden until 1998. He was Co-Chairman of the Europe, Middle East and Africa division of CB Richard Ellis Services Inc. until December 2000. He is a past President of the British Council of Offices.

**Bernard Duroc-Danner***

Dr Duroc-Danner is aged 51 and was appointed a director on 1st September 2004 due to his depth of knowledge and experience in acquisitions and multinational business and, in particular in the energy sector in which the Company has significant investments. He is a member of the Nomination Committee. He has been Chairman, President and Chief Executive Officer of Weatherford International since 1998, one of the leading oilfield service companies in the world. Prior to this position he was President and Chief Executive Officer of EVI, Inc., Weatherford's predecessor company. He is also a director of a number of other oilfield service sector companies. He holds a Ph.D. in economics from Wharton (University of Pennsylvania) and has previously held positions at Arthur D. Little and Mobil Oil Inc.

**Martin Pexton**
Director of Corporate Development

Mr Pexton is aged 48, joined the Company in April 2002 and was appointed a director in October 2002. He is a member of the Nomination Committee. He is responsible for a wide range of corporate and management matters, including personnel and investor relations, and has overseen the strategic investment made in Inflexion plc. He is a non-executive director of Inflexion plc and Energy Cranes International Limited. He was formerly the director responsible for human resources at the international law firm Allen & Overy. Prior to joining Allen & Overy in 1990, he worked for Deloitte, Haskins & Sells and in the insurance and nuclear industries. He is a Fellow of the Chartered Institute of Personnel and Development and has an MBA from the London Business School.

**Nick Friedlos**
Finance Director

Mr Friedlos is aged 47 and was appointed Finance Director in January 2003. He is a member of the Nomination Committee. He is a non-executive director of Energy Cranes International Limited. He was Finance Director of Land Securities Trillium and was involved in its sale to Land Securities plc in 2000. Before joining Trillium in 1998, he worked for 12 years at PricewaterhouseCoopers in London and Birmingham, becoming a partner at Price Waterhouse in 1992.

**Robert Rayne**
Chief Executive

The Hon R A Rayne is aged 56 and first joined the Company in 1968 when he was initially involved in the development of LMS' properties in the US. He later returned to the UK with responsibility for LMS' properties in Scotland. He was appointed Investment Director in 1983, Joint Managing Director in 1998 and Chief Executive in May 2001. He is a member of the Nomination Committee. He has been on the boards of a number of public companies including First Leisure Corporation plc and Crown Sports plc. He is currently a non-executive director of Inflexion plc and NYSE quoted, Weatherford International Inc, an international oil services company, where he serves on the Audit Committee. He is also Chairman of Energy Cranes International Limited.

*Non-executive director.

# Senior Management


Simon Mitchley


Nick Groves


Michael Bennett


Scott Potter


Liz Horler


Chris Dancer


Nick Habgood


Brian Bank


John Townley


Steven Dykes


John Hartz


Simon Turner

## LMS SENIOR MANAGEMENT

**Simon Mitchley**
Company Secretary

Simon was appointed Company Secretary in February 2002, having joined the Company in 1995 as Deputy Company Secretary. He previously worked in the Secretariat departments of Forte plc and Royal Insurance plc.

**Liz Horler**
Group Financial Controller

Liz joined the Company at the end of January. She was formerly Financial Controller of Antisoma plc, a listed biotechnology company specialising in the development of anti-cancer drugs. Liz previously worked at Arthur Andersen, Chartered Accountants.

**John Townley**
Group Financial Planning Manager

John joined the Company in February 1997 as Deputy Group Accountant and was appointed Group Accountant in May 1998. In November 2004 he was appointed Group Financial Planning Manager. John previously worked at Moores Rowland, Chartered Accountants.

## PROPERTY SENIOR MANAGEMENT

**Nick Groves**
Group Property Manager

Nick joined the Company in June 1994 and was appointed as a director of the Company's principal property subsidiary in April 1999. He was appointed Group Property Manager in April 2002 and is responsible for the ongoing management of all UK property assets directly held by the Group, together with the strategic administration of the office portfolio. Prior to joining LMS Nick was associate partner at Gooch & Wagstaff.

**Chris Dancer**
Property Development Manager

Chris was appointed in May 2004 to manage the major property development projects. He previously worked at Berkeley Homes, where he was responsible for commercial aspects of mixed schemes. Prior to this he was Development Director at Clearwater Estates involved with the Group's Kingston Rotunda and the Greenwich Reach schemes. He also spent over six years at Wilson Connolly as Development Manager.

**Steven Dykes**
Head of Retail & Leisure

Steven joined LMS, as Development and Investment Manager in Scotland. He was appointed Head of Retail & Leisure in September 2003 with additional responsibility for existing retail and leisure interests in the UK, together with the sourcing of new investment and development opportunities. Prior to joining LMS Steven was Head of Retail at Knight Frank in Scotland.

## INVESTMENT UK SENIOR MANAGEMENT

**Michael Bennett**
Investment Manager

Michael joined the Company in May 1998. Before joining LMS Capital Michael worked as a consultant with McKinsey & Company and previously worked for British Telecom.

**Nick Habgood**
Investment Manager

Nick joined the Company in October 2000. He was previously Chief Executive of a company which developed a high security smart card operating system. Nick also spent seven years working for Mars Electronics (a division of Mars Inc.)

**John Hartz**
Inflexion plc, Joint Chief Executive

John, with Simon Turner, led the buy out of Daiwa's European private equity business in early 1999 and formed Inflexion raising third party funds focusing on the smaller UK mid market. In the early 1990's, John joined Apax Partners as a founding member of the buy-out group and previously worked for Price Waterhouse specialising in corporate recovery and business reorganisations.

**Simon Turner**
Inflexion plc, Joint Chief Executive

Prior to establishing Inflexion in 1999, Simon, together with John Hartz, was recruited by Daiwa Europe Limited to establish and co-head their new European private equity business. Simon started his career at Guinness Mahon Development Capital, where he specialised in mid-market investments with a particular focus on the media sector.

## INVESTMENT US SENIOR MANAGEMENT

**Scott Potter**
Fund Manager, San Francisco Equity Partners

Scott joined LMS in January 2003 with responsibility for the US private equity portfolio. San Francisco Equity Partners was formed in March 2005. Scott previously served as Senior Vice President, Field Operations for Inktomi Corporation, which acquired Quiver in 2002, the company where Scott was Chief Executive and in which LMS was a major investor. Scott was a former Executive Vice President of WorldRes Inc and a former corporate finance attorney for leading law firm, Venture Law Group.

**Brian Bank**
Investment Manager

Brian has been working with LMS since 2000 and is currently responsible for the Group's US indirect investment portfolio. He spent several years working as both an investment banker and international political-military analyst. Brian also spent three years consulting for Ernst & Young, where his focus was supply chain management within the high tech and health care industries.

# Financial Review


Nick Friedlos

- Adjusted Net Asset value per share 238p. Year on year growth 8.4% excluding the effect of exceptional finance costs
- Strong contribution from the Investment Division
- Debt successfully restructured
- Dividend covered by profit before exceptional finance costs

**Adjusted Net Asset value (see table A)**

Adjusted Net Asset value includes the excess of value over book on trading properties, net of tax where realisation is planned, and excludes deferred tax provided in respect of capital allowances where no tax payment is expected to crystallise. It also includes the excess of market value over cost on investments.

Adjusted Net Asset value at 31st March 2005 was 238p per share compared to 229p at 31st March 2004. The impact of the exceptional finance costs on Adjusted Net Assets per share was a reduction of 10p per share. Excluding the impact of the exceptional finance cost, year on year growth was 8.4%, including the impact it was 3.9%.

The 'triple net' asset value has increased from 204p per share to 218p per share over the year. The impact of the debt repurchase transaction at the triple net level was 2p per share.

**Operations**

**Operating profit** Operating profit for the year, including the Group's share of joint venture profits, was £42.7 million (2004 – £39.8 million), an increase of £2.9 million. £2.4 million of increase came from net rental income, primarily from acquisitions, new lettings and rent reviews.

Trading profits increased by £1 million compared to the prior year due to the sale of some small trading properties, principally on the Scottish estate.

Investment management income increased by £1.2 million principally as a result of the inclusion of Inflexion for a full year, compared to only two months in the previous year when it was acquired.

Administrative expenses increased by £1.7 million. The inclusion of Inflexion for a full year results in an increase of £2.2 million partly offset by £0.5 million reduction compared to the prior year in LMS expenses.

**Investment activities**

**Property division** Profits on the disposal of investment properties for the year were £1.4 million compared to £0.3 million in 2004. This arose principally on the sale of the Rivergate Centre in Peterborough.

**Investment division** Taking account of realised gains less net movements in provisions, the investment division activities produced a surplus for the year of £16.1 million (2004 – £3.2 million).

Realisations of investments produced profits for the year in excess of book value of £17.9 million (2004 – £7.5 million). The book values and historic cost of the investments disposed of were £43.3 million and £44.9 million respectively.

Provisions for estimated impairment in value in the investment division portfolio, net of write backs were £0.9 million (2004 – £3.7 million).

The Group's share of administration costs of the funds in which it invests as a limited partner was £1.1 million (2004 – £1.3 million).

**Net Asset Value** (Table A)

| | 2005 £m | 2005 Pence per share | 2004 £m | 2004 Pence per share |
|---|---|---|---|---|
| Shareholders' funds per balance sheet | **732.1** | **223p** | 710.0 | 217p |
| Deferred tax provision not expected to crystallise | **9.0** | | 8.0 | |
| Excess of value over book | | | | |
| – Trading properties at external valuation (2004 – directors' valuation) less tax on planned disposals | **31.5** | | 23.8 | |
| – Investments at market value | **10.9** | | 8.3 | |
| Adjusted net assets | **783.5** | **238p** | 750.1 | 229p |
| Contingent tax liability on disposal of properties at balance sheet value | **(47.5)** | | (41.0) | |
| Additional tax on disposal of investments and trading properties at valuation | **(9.3)** | | (4.3) | |
| Contingent tax asset on disposal of venture capital investments at balance sheet value | **8.8** | | 8.0 | |
| Mark to market of fixed rate borrowing (net of tax) | **(18.4)** | | (45.0) | |
| Triple net assets | **717.1** | **218p** | 667.8 | 204p |

### Net finance costs excluding exceptional costs

Net finance costs for the year before the exceptional costs were £24.9 million (2004 – £26.1 million). Interest payable, excluding amortisation of issue costs, net of interest receivable was £23.6 million (2004 – £23.7 million). Debt breakage costs (excluding the exceptional element) and exchange losses on dollar deposits amounted to £1.1 million in the current year compared to £2.3 million in the prior year. Breakage costs in the current year relate principally to the early repayment of a mortgage on the Group's US properties.

### Exceptional finance costs

Exceptional finance costs of £48.2 million relate to the costs of repurchase of the Group's 10% 2018 First Mortgage Debenture Stock. £8.0 million nominal value of this stock was repurchased in the market during 2004 and the remaining £92.0 million was repurchased in February 2005 following a Bondholders' EGM. The repurchase costs include the premium over nominal value to buy in the stock of £44.9 million, the write off of previously unamortised discount and issue costs of £2.9 million and transaction costs of £0.4 million.

### Taxation

The tax charge for the year excluding the impact of the exceptional finance costs, was £7.4 million (2004 – £3.9 million). The exceptional finance costs are tax deductible and give rise to a tax credit of £14.5 million. This produced an overall net tax credit for the year of £7.1 million. £11.4 million of the tax credit is carried forward as a deferred tax asset which is anticipated to be used over the next two to three years.

The effective tax rate for the year has been reduced from the 30% standard UK Corporation Tax rate principally as a result of a low effective rate of tax on capital profits.

### Property holdings

The Group's total property holdings, based on open market valuations by external valuers (2004 – trading properties valued by directors) was £991.3 million (2004 – £894.9 million) made up as follows:

| | Valuation 31st March 2005 £m | Valuation 31st March 2004 £m |
|---|---|---|
| Investment properties | **928.1** | 856.2 |
| Trading properties | **47.7** | 38.7 |
| Share of properties in joint ventures | **15.5** | – |
| Total | **991.3** | 894.9 |

**Investment properties** Investment properties are reflected in the balance sheet at £924.0 million (2004 – £853.6m) being the valuation shown above less adjustment of £4.1 million for the UITF 28 prepayment (2004 – £2.6 million). The surplus on revaluation of the Group's investment properties in the year to 31st March 2005 was £56.4 million net of exchange differences and UITF 28 movements, of which £51.9 million was attributable to the Group, and has been taken to reserves, and £4.5 million attributable to minorities.

Capital expenditure on the investment properties amounted to £23.8 million. Significant items included the acquisition of two properties as part of the City Road estate (£14.2 million), completion of the B&Q extension at Strathkelvin retail park (£3 million) and expenditure on development properties (£5.1 million).

**Trading properties** Trading properties are included in the balance sheet at cost, rather than valuation, although the revaluation surplus on these assets is included in the adjusted net asset calculation. These properties had a book cost at 31st March 2005 of £13.6 million (2004 – £12.5 million). The trading portfolio was valued by external valuers at 31st March 2005, having been valued by directors at previous year ends. Capital expenditure on the trading portfolio during the year amounted to £2.1 million.

**Net Indebtedness** (Table B)

| | 2005 £m | 2004 £m |
|---|---|---|
| External borrowings | | |
| – 10% First Mortgage Debenture Stock 2018 | **–** | 97.1 |
| – 6.5% Secured Bonds 2026 | **173.1** | 173.0 |
| – £140 million Revolving Bank Loan 2012 | **139.1** | – |
| – £60 million Revolving Bank Loan 2009 | **30.6** | – |
| – 9.69% Mortgage 2018 | **20.0** | 20.0 |
| – Other mortgages and unsecured loans | **29.8** | 38.3 |
| Net liquid resources | **(37.3)** | (57.5) |
| Net Indebtedness per balance sheet | **355.3** | 270.9 |
| Gearing | **45.1%** | 35.7% |
| Weighted average maturity of debt | **13.1 years** | 17.6 years |
| Weighted average interest rate | **6.3%** | 7.8% |

**Joint venture property** During the year the Group entered into a 50/50 joint venture with The Miller Group to acquire Swinton Shopping Centre. The Group's 50% share of the joint venture property asset is reflected in the balance sheet at external valuation. The resultant uplift over costs of £0.4 million has been taken to reserves, as noted above.

**Investment Division investments**

Investment Division investments are included in the balance sheet at cost less amounts written off and provision for estimated impairment in value. At 31st March 2005 these investments amounted to £220.6 million (2004 – £191.9 million). New investments during the year were £72.9 million. Disposals with a book amount of £43.3 million generated proceeds of £61.2 million. Write downs and write backs in the year amounted to £0.9 million.

Taking account of these movements the book amount of investments increased by £28.7 million and net additional cash invested was £12.3 million.

The most significant new investments were £26 million into funds, £5 million invested by Inflexion and £15 million in other UK and US investments. £10 million follow-on funding was made in ProStrakan and £17 million in the remainder of our portfolio of emerging growth companies.

**Cash flow**

Net indebtedness in the consolidated balance sheet increased by £84.4 million from £270.9 million at 31st March 2004 to £355.3 million at 31st March 2005. £45.0 million was the cash element of the exceptional costs of debt restructure, £36.3 million was the net cash outflow on other activities and £3.1 million was a non-cash movement relating principally to the debt restructure.

**Debt**

The Group's external borrowings, cash balances and net indebtedness, together with weighted average maturity and interest rate, are summarised in Table B.

During the year the Group has restructured its debt through the repurchase of the whole of its 10% 2018 First Mortgage Debenture Stock, and the arrangement of two new secured bank facilities.

The repurchase of the £100 million 10% 2018 First Mortgage Debenture Stock and refinancing will allow greater flexibility in the Group's financing in the future and will produce savings in annual interest costs.

The repurchase was financed through the arrangement of a new secured £140 million, seven year revolving bank loan. This loan reflects current market interest rates and is flexible, allowing amounts to be prepaid and redrawn during the term of the loan and for substitution of security to take place.

In July 2004, the Group arranged a secured £60 million, five year revolving bank loan. This was put in place for general corporate purposes.

The Group has swapped £112 million of its seven year interest rate exposure to fixed rates and has purchased interest rate floors in respect of £56 million at a LIBOR rate of 4.5%. Under the interest rate swaps the Group will pay an average rate, including margin, of 5.77% on the hedged portion of the loan. If the LIBOR benchmark were to fall below 4.5%, the Group would benefit in relation to that proportion of the principal for which it has purchased interest rate floors.

The weighted average interest rate of the Group's debt at 31st March 2005, taking account of its hedging arrangements is 6.3% (2004 – 7.8%). Taking account of hedging arrangements, £65.8 million of the Group's debt remains floating rate (2004 – £7.0 million).

The Group remains conservatively geared. At 31st March 2005 the balance sheet gearing is 45.1%, (2004 – 35.7%). Gross borrowings represented 39.9% of the value of the Group's property holdings.

The security of the Group's income and financing continues to be recognised and it is well positioned to fund existing and future activities. The Group's tenants are well diversified, 44% are rated, 27% at A minus or higher.

### Capital commitments

Capital commitments at 31st March 2005 are £99.0 million (2004 – £82.3 million). Of this, £52.5 million relates to property expenditure. £46.5 million of the overall commitment arises in the investment division and relates to commitments to participate in venture capital partnerships in the UK and US. Such commitments, which are usually called down over a three to four year period, have historically been funded from proceeds of realised investments from the partnerships or direct investments, although not necessarily in the same accounting period.

### Accounting issues

There have been no changes in accounting policies in the year.

Along with other listed companies the Group will be required to report in accordance with International Accounting Standards (IAS). The first financial period for which this will be required will be the Group's financial year to 31st March 2006 and the first reporting under IAS will be the interim results for the six months to 30th September 2005. The Group has established an internal working group, supported by appropriate external advice, to manage the transition process. Progress is monitored at both Audit Committee and Board level.

The Group has, on its web site, published preliminary guidance on the impact on its reported results of the transition. The principal changes for the Group compared to current UK Generally Accepted Accounting Practice ('UK GAAP') are:

- Property valuation changes will be reflected in the income statement rather than taken directly to reserves as under UK GAAP.
- Full balance sheet provision will be made for deferred tax, including the tax that would become payable on disposal of investment properties at open market value; this is a disclosure item only under UK GAAP although it is generally included in the 'triple net' measure of net assets used to analyse property companies.
- Interest rate derivatives will require to be shown at fair value in the balance sheet; this a disclosure item only under UK GAAP. This item is generally included as part of the 'triple net' measure.
- The Investment Division investments, currently shown in the balance sheet at historical cost less provision for impairment, will be recorded at fair value under IAS. The determination of fair value in relation to unquoted investments is highly judgemental and a conservative approach will be adopted.
- The Group will be required to consolidate certain of its Investment Division investments which, under IAS, are classified as subsidiaries, notwithstanding that these continue to be held as part of an investment portfolio with a view to ultimate realisation of gains. To date the Group has not consolidated such investments. It is not anticipated that the impact of this change on net assets at adoption will be material, it will however result in a more complex presentation in both the profit and loss account and the balance sheet.
- Other adjustments include recognition of the pension scheme deficit on the balance sheet, dividends accounted for on a cash basis, charging the cost of option schemes against income and certain other presentational changes.

The Group will ensure that investors are provided with sufficient information to understand the impact of IAS on its reported results.

**Nicholas Friedlos** Finance Director
23rd May 2005

# Report of the Directors

The directors submit their report and the financial statements of the Group for the year ended 31st March 2005.

### Results and dividends

The Consolidated Profit and Loss Account for the year is set out on page 40. An interim dividend of 2p per share was paid on the Ordinary shares on 17th January 2005. The directors recommend a final dividend of 4.5p per Ordinary share making 6.5p (2004 – 6.4p) per Ordinary share for the year. If the final dividend is approved, it will be paid on 28th July 2005 to the holders of the issued Ordinary shares on the register at the close of business on 3rd June 2005.

### Principal activities and business review

The principal subsidiary undertakings of the Group and their activities are shown in note 11 on page 53. Further details of these activities are given in the Chief Executive's Review and Operating Reviews on pages 4 to 21 and the Financial Review on pages 24 to 27.

### Property

The Group's investment properties were valued at 31st March 2005 on the basis explained in note 9 on page 52. The resultant surplus is shown in the note.

### Corporate governance

A report on the Company's policy on corporate governance is shown on pages 29 to 33.

### Environmental policy

A statement of the Group's environmental policy is shown on page 62.

### Health and safety policy

A statement of the Group's health and safety policy is shown on page 62.

### Directors

The directors of the Company, are those listed on page 22. Dr B J Duroc-Danner was appointed a non-executive director of the Company on 1st September 2004 and being the first Annual General Meeting since his appointment will offer himself for reappointment at the forthcoming Annual General Meeting in accordance with the Company's Articles of Association. In addition, Mrs J F de Moller and Mr M A Pexton will retire by rotation and offer themselves for re-election at the forthcoming Annual General Meeting in accordance with the Company's Articles of Association. The biographies of the directors are given on page 22.

### Directors' interests and service contracts

These are disclosed in the Remuneration Report of the Board of Directors shown on pages 34 to 38.

### Share capital

Details of changes in the issued share capital during the year ended 31st March 2005 are given in note 20 on page 59.

### Directors' authority to allot shares

The purpose of special resolution 8 set out in the Notice of the Annual General Meeting is to renew the power of the directors to allot up to 16,443,733 Ordinary shares of $27\frac{18}{41}$p each (in aggregate representing approximately 5% of the issued share capital of the Company at 17th May 2005) for cash as if the statutory pre-emption rights did not apply to such allotment. The power is to expire 15 months after the passing of the resolution or at the end of the next Annual General Meeting of the Company, whichever first occurs.

### Payment of suppliers

The Group does not have a formal policy for the payment of suppliers. However, most invoices are paid within 28 days of receipt. The amounts owed by the Company to suppliers at 31st March 2005 represented some 26 days' purchases.

### Auditors

A resolution concerning the reappointment of KPMG Audit Plc as auditors and their remuneration will be submitted to the Annual General Meeting.

### Political and charitable donations

It is the Group's policy not to make donations to the funds of political parties. The Group's main charitable contribution is through its support to The Rayne Foundation, which makes donations to charities independently of the Group. Employees select a charity of the year and undertake various fundraising activities. The 2005 charity of the year is Great Ormond Street Hospital Children's Charity and during 2004 it was The Place2Be. During the year the Group made charitable donations of £7,575.

### Substantial shareholdings

The Company has been notified of the following material interests of 3% or more of its share capital at 17th May 2005. Because of common non-beneficial interests some shares are included against the names of more than one shareholder as noted below:

| | Ordinary shares | Total of issued share capital % |
|---|---|---|
| Lady Rayne[1] | 74,786,553 | 22.74 |
| Michael Bernard Conn[2] | 55,546,539 | 16.89 |
| The Estate of Lord Rayne[3] | 47,720,624 | 14.50 |
| Robert Anthony Rayne[4] | 21,582,700 | 6.56 |
| Trustees of the Rayne Foundation[5] | 14,817,277 | 4.51 |
| HBOS plc | 12,363,671 | 3.76 |

1 Includes common interests held by Michael Bernard Conn, the Estate of Lord Rayne and the Trustees of the Rayne Foundation (non-beneficial).
2 Includes common interests held by Lady Rayne and the Estate of Lord Rayne (non-beneficial).
3 Includes common interests held by Lady Rayne and Michael Bernard Conn (non-beneficial).
4 Includes common interests held by the Trustees of the Rayne Foundation (non-beneficial).
5 Includes common interests held by Robert Anthony Rayne (non-beneficial).

The Company has not been notified of any non-material interests of 10% or more of its share capital at 17th May 2005.

By order of the Board

**Simon Mitchley** Company Secretary
23rd May 2005

# Corporate Governance

### Statement of Compliance and Explanation

The UK Listing Authority Listing Rules require the Company to report on its compliance with the principles and provisions of the Combined Code and to provide an explanation where it departs from the Combined Code. For the year ended 31st March 2005, the Board confirms that the Company has complied with the Principles and Provisions of the Combined Code with the exceptions explained in detail in this report. This report should be read in conjunction with the Directors' Remuneration Report on pages 34 to 38 and the biographies of the directors on page 22.

### The Board

**Responsibilities** The Board is collectively responsible for the success of the Company. The Board's main aim is to produce high long-term rates of return to shareholders. The Board is responsible for setting strategic aims, ensuring necessary resources are in place to meet its objectives, reviewing management performance, ensuring the integrity of financial information and financial controls, and the systems for managing risk. The Board is also responsible for ensuring that all information, including all price sensitive information reported by the Company, is presented as a balanced and understandable assessment of the Company's position and prospects. As such, the Company has a written policy on the disclosure of price sensitive information.

The Board has a formal schedule of matters reserved for its decision which includes major investment expenditure, financing and dividend policy. This schedule is reviewed annually. The Board has delegated authority to management to approve capital expenditure below defined thresholds. The levels of delegated authority are regularly reviewed by the Board. Some powers are delegated by the Board to its committees and full details of the committees' terms of reference can be obtained from the Company's web site (www.lms-plc.com).

**Internal control** The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. The Group's system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against misstatement or loss. The Audit Committee reviews the system and reports to the Board. Management continually monitors risk management processes and reports at each Board meeting on the chief risks affecting the Group.

The Board confirms that throughout the year under review and up to the date of the approval of this annual report and accounts there has been a process in place for identifying, evaluating and managing the significant risks faced by the Group. Further detail on the risk management and internal control procedures are described separately under the section on the Audit Committee on page 33.

### Financial statements

The Board is satisfied that in the financial statements and reports to shareholders it has presented a balanced and understandable assessment of the Company's position and prospects. A statement of the directors' responsibilities for the financial statements follows.

### Directors' Responsibility Statement

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and Group and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

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

The directors are responsible for keeping proper accounting records which 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 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

### Structure

The Board has nine directors, three executive and six non-executive, their details, experience and committee membership are given on page 22. The make up of the Board is specifically designed to provide a balance of skills and experience. The Board has Nomination, Remuneration and Audit Committees, and details of the committees of the Board, their responsibilities, membership and activities during the year are provided separately in this report. Directors' concerns which cannot be resolved are recorded in the Board minutes. There is appropriate insurance cover in respect of legal action against the directors.

### Chairman and Chief Executive

The roles of the non-executive Chairman and the Chief Executive are clearly established in writing and have been approved by the Board. The Chairman's key responsibilities are:

- the effective running of the Board;
- ensuring that the Board as a whole plays a full and constructive part in the development and determination of the Group's strategy and overall commercial objectives; and
- as the guardian of the Board's decision-making processes.

The Chief Executive's principal responsibilities are:

- running the Group's business and acting as chief spokesman for the Company;
- proposing and developing the Group's strategy and overall commercial objectives, which he does in close consultation with the Chairman and the Board; and
- implementing the decisions of the Board and its Committees, with the executive team.

## Non-executive directors

The non-executive directors provide support to management in developing proposals on strategy and scrutinise the performance of management. At the Board and Audit Committee meetings the non-executive directors satisfy themselves as to the integrity of financial information and financial controls, and systems of risk management. Through the Remuneration Committee non-executive directors are responsible for determining appropriate levels of remuneration of executive directors. As members of the Nomination Committee, non-executive directors have a key role in appointing and, where necessary, removing executive directors, and in succession planning.

**Independence** The Board has carefully considered directors' independence and has determined that all the non-executive directors discharge their duties in an independent manner, and constructively and appropriately challenge management and the Board. Their experience provides valuable benefit to the Board. Mr Grant, Dr Duroc-Danner, Mrs de Moller, Mr Newell and Mr Wilson are deemed independent. An explanation for the independence of directors who are deemed independent by the Company, notwithstanding the conditions of independence set out in A.3.1 of the Combined Code is given below:

- Mr Grant has been a director since 1984 and it is the Board's view that his experience and long-term perspective continues to provide a valuable contribution to the Board and that he has demonstrated he is independent in character and judgement. The Combined Code assumes a director who has served on the Board for more than nine years from the date of their first election is not independent. Mr Grant is the Deputy Chairman and, as the senior independent director he is the point of contact to shareholders as an alternative to the normal channels of communication through the Chief Executive or Chairman. No shareholders took advantage of his availability during the year. Mr Grant also conducts the performance evaluation of the Chairman.

- Mr Wilson is a founding partner of Boston Ventures, a leading US media and communications private equity firm. The Company co-invests with Boston Ventures and participates in its funds. Mr Wilson's wealth of experience in the private equity market has proved a great benefit and the Board is satisfied that no conflict of interest has arisen.

- Dr Duroc-Danner is Chairman, President and Chief Executive Officer of Weatherford International and he has a depth of knowledge and experience in acquisitions and multinational business and, in particular in the energy sector in which the Company has significant investments is of considerable benefit to the Board. The Board is satisfied that the independence of Dr Duroc-Danner is not compromised and that he has demonstrated he is independent in character and judgement, notwithstanding that Mr Rayne is a non-executive director of Weatherford International.

**Appointments** There is a transparent procedure for the appointment of new directors and the prime responsibility for the appointment of directors rests with the Board. The Nomination Committee is responsible for identifying and nominating candidates for the approval of the Board to fill Board vacancies as and when they arise as well as put in place plans for succession of the Chairman and the Chief Executive.

Further details of the role of the Nomination Committee are provided separately in this report.

None of the executive directors has a non-executive directorship in a FTSE 100 company. Full account of the Board's view would be taken if the issue arose and would be considered on a case by case basis. Mr Rayne has a non-executive directorship in a NYSE listed company and the fees in respect of this directorship are paid to the Company. Mr Pexton and Mr Rayne are non-executive directors of Inflexion plc and the fees in respect of their directorships are paid to the Company.

The terms of appointment of non-executive directors are available for inspection, and they set out expected time commitments. The external commitments of the non-executive directors were disclosed to the Board before their appointment. The commitments of the non-executive directors are reviewed as part of the performance evaluation explained in this report and the Board is satisfied that non-executive directors commit sufficient time to the fulfilment of their duties as directors of the Company.

**Attendance** The directors present at the Board and Committee meetings are set out in the table below:

| | Board | Audit | Remuneration | Nomination |
|---|---|---|---|---|
| Number of meetings held | 7 | 5 | 4 | 2 |
| G C Greene | 7 | 5 | 4 | 2 |
| P J Grant | 7 | 5 | 4 | 2 |
| B J Duroc-Danner[1] | 2 | N/A | N/A | – |
| N R Friedlos[2] | 7 | 5 | N/A | 2 |
| J F de Moller | 7 | 5 | 4 | 2 |
| D Newell | 7 | 5 | 4 | 2 |
| M A Pexton[2] | 7 | N/A | 4 | 2 |
| R A Rayne[2] | 7 | 4 | 4 | 2 |
| J M Wilson[3] | 7 | N/A | N/A | 2 |

All Board and committee papers are circulated in advance of the meetings to allow all directors time to make comments, if necessary, in advance of the meeting through the Chairman.

1 No Nomination Committee and four Board meetings have been held during the year since his appointment on 1st September 2004.
2 Executive directors are not members of the Audit or Remuneration Committees but attend when invited.
3 Includes part attendance of two meetings.

## Information and Development

The Chairman takes responsibility for ensuring the Board and its committees are provided with full and timely information to enable them to discharge their responsibilities. The Board ensures that all new directors are sufficiently apprised of the Company's business and their duties as directors on appointment and on an ongoing basis. New directors are provided with induction information and have access to management to allow them to familiarise themselves with the Company. New non-executives are available to meet major shareholders if requested. The Board and its committees are provided with internal and external briefings where appropriate to ensure their knowledge is continually updated. Briefings and presentations include tours of the Company's property portfolio and meetings with management of companies in which the Group invests. All directors have access to the advice of the Company Secretary and independent professional advice is available to directors in appropriate circumstances at the Company's expense.

## Performance evaluation

The Board has undertaken a comprehensive evaluation of its performance including its committees and individual directors. The evaluation of the Board and its committees was carried out through a questionnaire, facilitated by the Company Secretary. The evaluation covered structure, objectives, decision making, meeting processes, induction & training and relations with management. The conclusion of the evaluation demonstrated that the Board and its committees continued to operate effectively.

The evaluation of individual directors was carried out by interview. The Chairman undertook interviews separately of each non-executive director and the Chief Executive.

Evaluation of the other executive directors was undertaken by the Chief Executive. The conclusions of the evaluations were that the directors demonstrated commitment and continue to contribute effectively to their role.

The senior independent director carried out an appraisal of the Chairman's performance with the other non-executives. The evaluation concluded that the Chairman continued to demonstrate commitment and effective leadership of the Board.

## Re-election

The terms of appointment of non-executive directors are subject to the provisions of the Company's Articles of Association relating to retirement by rotation. All directors are subject to retirement by rotation at least every three years. The Nomination Committee considered the effectiveness of the contribution of the directors retiring by rotation and concluded that each makes a valuable and effective contribution to the Company and recommends to shareholders that their periods of appointment should continue for a further three years. The biographies of Dr Duroc-Danner, Mrs de Moller and Mr Pexton, who are seeking re-election are on page 22.

Non-executive directors are not appointed for specified terms as required by A.7.2 of the Combined Code. It is the Board's view that whilst limits on length of appointment help to ensure that fresh ideas and views are available to the Board, they have the significant disadvantage of losing the contribution of directors who have a wealth of understanding of the Group's business. Since 2002 two executive directors and two non-executive directors have been appointed.

## Going concern

After making enquiries, the directors are satisfied that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

## Shareholders

Led by the Chief Executive and the Finance Director, the Company conducts a continual programme of meeting equity and debt investors as well as analysts and a rating agency. During the year management met with 78 institutions. Meetings are conducted within the guidance provided by the UKLA Listing Rules on the dissemination of price sensitive information. Presentations are made to investors and analysts after the interim and year end results as well as during the year to improve understanding of particular areas of the business or to update them on current activities. These presentations, as well as a regular flow of news releases made through a Regulatory Information Service, are posted on the Company's web site (www.lms-plc.com).

The Chairman, the senior independent director and non-executive directors are available to attend meetings requested by major shareholders. The Board is regularly apprised of the views of investors, analysts and the media. Reports are made available to the Board on feedback received on an unattributable basis from analyst briefings and investor road shows carried out regularly by management.

## The Annual General Meeting

The Board believes that the Annual General Meeting is a good opportunity to communicate with all investors and the Company provides time for shareholders attending to meet and discuss matters with members of the Board outside the formal meeting.

At each Annual General Meeting all proxy votes are counted and, after each resolution has been dealt with on a show of hands, the level of proxies lodged and the number of votes is indicated. The number of proxy votes lodged, how they were voted and the result of the resolution voted at the Annual General Meeting, will be available on the Company's web site after the Annual General Meeting. Members of CREST are given the opportunity to vote electronically to maximise the number of votes cast.

All substantially separate issues are proposed as separate resolutions at the Annual General Meeting. All directors attend the Company's Annual General Meeting, where shareholders have the opportunity to put questions to the chairmen of the Audit, Remuneration and Nomination Committees.

Notice of the Annual General Meeting is sent to shareholders at least 20 working days before the meeting and this year the notice has been sent 26 days in advance to allow more time for proxy votes to be returned by institutional shareholders.

### Nomination Committee

The Board has a Nomination Committee of which a majority are independent non-executive directors. The members, appointed by the Board and chaired by Mr Greene, also comprise Dr Duroc-Danner, Mr Friedlos, Mr Grant, Mrs Moller, Mr Newell, Mr Pexton, Mr Rayne and Mr Wilson. Their experience is given on page 22.

The main role and responsibilities of the Nomination Committee is set in written terms of reference in accordance with best practice and are reviewed annually. The remit of the Nomination Committee is available on the Company's web site (www.lms-plc.com). The Nomination Committee carried out its responsibilities in accordance with its terms of reference, including reviewing its own performance and its terms of reference. The Committee considers the skills and experience of the Board and during the year recommended to the Board the appointment of Dr B J Duroc-Danner as a director of the Company, given his depth of knowledge and experience in acquisitions and multinational business and, in particular in the energy sector in which the Company has significant investments. No external search consultancy or open advertising was considered necessary. In addition the Nomination Committee considered the effectiveness of the contribution of the directors retiring by rotation and concluded that each makes a valuable and effective contribution to the Company and recommended that their periods of appointment should continue for a further three years.

### Remuneration Committee

The Board has a Remuneration Committee appointed by the Board and chaired by the senior independent director, Mr Grant. It also includes Mr Greene, Mrs de Moller and Mr Newell. Their experience is given on page 22. The Board believe that the interests of the Company are better served with Mr Greene as a member of the Remuneration Committee notwithstanding the requirement of the Combined Code that all members of the Remuneration Committee should be independent. Mr Greene is not involved in determining his own remuneration.

The main role and responsibilities of the Remuneration Committee is set in written terms of reference, which are reviewed annually. The remit of the Remuneration Committee is available on the Company's web site (www.lms-plc.com).

During the year the Remuneration Committee carried out its responsibilities in accordance with its terms of reference and its activities are described in the directors' remuneration report on pages 34 to 38.

No director was involved in deciding his or her own remuneration. No new long-term incentive schemes have been introduced nor have any significant changes requiring shareholder approval to existing schemes been made during the year.

### Audit Committee

**Membership** The Board has an Audit Committee of non-executive directors. The members are appointed by the Board and chaired by Mr Newell. It also includes Mr Grant, Mr Greene and Mrs de Moller. Their experience is given on page 22. The Board believe that the interests of the Company are better served with Mr Greene as a member of the Audit Committee and that his membership does not compromise the Committee's ability to discharge its duties properly. The Board consider that collectively the Audit Committee has significant financial experience and ability to discharge its duties properly, gained from managing business of similar or greater size and complexity and through extensive service on the Boards and Audit Committees of listed companies. The Company does not comply with C.3.1 of the Combined Code that states that all members of the Audit Committee must be independent and that at least one member of the Audit Committee should have recent relevant financial experience.

**Responsibilities** The role and responsibilities of the Audit Committee are set in written terms of reference, which are reviewed annually as part of the Committee's evaluation process. The terms of reference are available on the Company's web site (www.lms-plc.com). The main responsibilities are:

- the appointment of the Auditors, to assess the independence of the Auditors and to recommend the audit fee to the Board and pre-approve any fees in respect of non-audit services that do not impair the Auditors' independence or objectivity;
- to agree the nature and scope of the audit and to review the Auditors' quality control procedures;
- to review annually the requirements for an internal audit function and, if required, review the internal audit programme;
- to review managements' and any internal audit reports on the effectiveness of systems for internal financial control, financial reporting and risk management; and
- to review and challenge, where necessary, the actions and judgements of management in relation to the interim and annual financial statements before submission to the Board.

## Audit Committee (continued)

**Financial reporting** The Audit Committee has reviewed the significant financial reporting issues and judgements made in connection with the preparation of the Group's financial statements including significant accounting policies, any changes to them and any significant estimates and judgements. The Audit Committee has also reviewed the clarity and completeness of disclosures in the financial statements and considered whether the disclosures made were set properly in context. The review of the financial statements also included a review of the financial review, operating review and corporate governance statements relating to audit and risk management.

In addition, the Audit Committee has considered the impact of International Accounting Standards, as far as they are known, on the financial statements of the Group and have put in place a process to monitor the effectiveness of the systems to be implemented to meet the applicable requirements.

**Internal Control and Risk Management** The Audit Committee has a responsibility to review the Group's internal control system and risk management system and make appropriate recommendations to the Board. Management is responsible for the identification and evaluation of significant risks in the business together with the design and operation of a suitable system of control to manage those risks. Management is also responsible for ensuring that the risk profile of the business is kept under continuous review and that significant changes in the business or the external environment which affect the risk profile are identified and acted upon.

To enable it to do this, the Audit Committee reviews the risks identified and the system of control in place to manage those risks. It gives consideration in particular to the following:

- a review of the inherent risks in the business which have been identified by management;
- The appropriateness of the authority, resources and co-ordination of those involved in the identification, assessment and management of significant risks faced by the Group;
- the effectiveness of management's response to the significant risks which have been identified;
- a review of risk monitoring and reporting procedures in place; and
- the Group policies and employee procedures for the reporting and resolution of suspected fraudulent activities.

As part of its reporting, management provides the Audit Committee with risk indicators and recommendations for improvement in the system of risk management.

**Internal audit** The Audit Committee carried out its annual review of the requirement for an internal audit function. The Committee concluded that such a function was not required due to the size of the Group and number of employees.

The Board, on the recommendation of the Audit Committee, has adopted a policy whereby staff of the Company may, in confidence, raise concerns about possible improprieties in financial reporting or other matters. The Audit Committee is responsible for implementing and reviewing the policy.

**Auditors** In accordance with the Committee's terms of reference, the Audit Committee carries out an annual review of the independence of the Group's Auditors, KPMG Audit Plc. Senior members of the audit team are rotated on a regular basis. The Company has a policy on the provision of non-audit services by the Auditors. The implementation of the policy is continually monitored by the Audit Committee. The policy excludes the Auditors from providing services in relation to the outsourcing of internal audit and any other consultancy work that the Audit Committee considers is contrary to the ethical principles laid down by the Audit Committee. The Committee's considerations included the provision of non-audit services carried out by the Auditors (described on page 46) and was satisfied that they were objective and independent of the Group. The Committee reviewed the policy on the provision of non-audit services by the Auditors and the Board considers that the policy provides adequate protection of the Auditors' independence.

# Remuneration Report of the Board of Directors

### Remuneration Committee

The members of the Remuneration Committee are:

Mr P J Grant (Chairman)
Mr G C Greene
Mrs J de Moller
Mr D Newell

The Secretary of the Committee is Mr S C Mitchley. The Committee considered advice from the Hon R A Rayne and Mr M A Pexton, but they were not involved in discussions about their own remuneration.

### Policy on directors' remuneration

The Company's policy is to provide an overall remuneration package which will attract, retain and incentivise directors of the right calibre.

Non-executive directors receive a fee and necessarily incurred expenses. They do not participate in any bonus or incentive arrangements. Their remuneration is established by the Board by reference to market data.

The constituent elements of the remuneration package for each executive director are:

- base salary;
- annual performance-related bonus;
- long-term incentives.

The variable elements of each executive director's pay (annual bonus and long-term incentives) are intended to form a significant component of the total remuneration package.

### Basic salary

In recommending basic salaries for executive directors the Remuneration Committee takes into account information from an independent source on amounts paid in FTSE 250 companies with comparable market capitalisation.

### Annual bonus

Each executive director is eligible for an annual bonus based on the performance of the Company and of the individual, including those aspects of the business for which they are directly responsible. During the year ended 31st March 2005, the Chief Executive was eligible for a bonus of up to 100% and other executive directors could receive a bonus of up to 70% of basic salary. The measures used in assessing corporate performance include Total Shareholder Return, both in absolute terms and in relation to the FTSE 250 and FTSE Real Estate indices; realised profits and growth in net asset value.

### Long-term incentives

All executive directors participate in the Executive Share Option Scheme, which is designed to increase the alignment of their interests with those of other shareholders. The Company's policy is to make an annual grant of options up to a maximum value of one times basic salary, in order to provide a continuing incentive. The Remuneration Committee will take individual performance into account in recommending the level of any grant of options.

The performance condition for exercise of options granted from September 2004 onwards is that the Total Shareholder Return (TSR) over the first three year period after grant must exceed the arithmetic average of the TSR for the FTSE 250 and the TSR for the FTSE Real Estate index for the same period.

The Chief Executive, Mr R A Rayne, participates in the Carried Interest Plan, which applies to certain executives who have responsibility for investments made by the venture capital division, and was approved by shareholders in 2001. The Plan is intended to correspond to the incentive arrangements applicable in the venture capital industry. Mr Rayne is entitled to 7% of the pre-tax net capital gains realised on the cost of direct investments (i.e. excluding investment in funds) after a preferred return to LMS of 6.5%. The percentage of realised capital gains which may be allocated to participants in aggregate may not exceed 20%, after the return of capital. No payment was made to Mr Rayne under the Plan in the year ending 31st March 2005.

Executive directors, other than Mr Rayne, are eligible to participate with staff in the Company's Share Incentive Plan, which allows employees to be granted free shares and to purchase shares which are matched equally by shares bought by the Company. They are also eligible to participate alongside other employees in the Company's Sharesave Scheme, established under the Save As You Earn legislation. Under the Scheme employees make regular payments into a savings account which, after a predetermined period, can be used to purchase shares at a price set at the start of the savings period.

### Notice periods

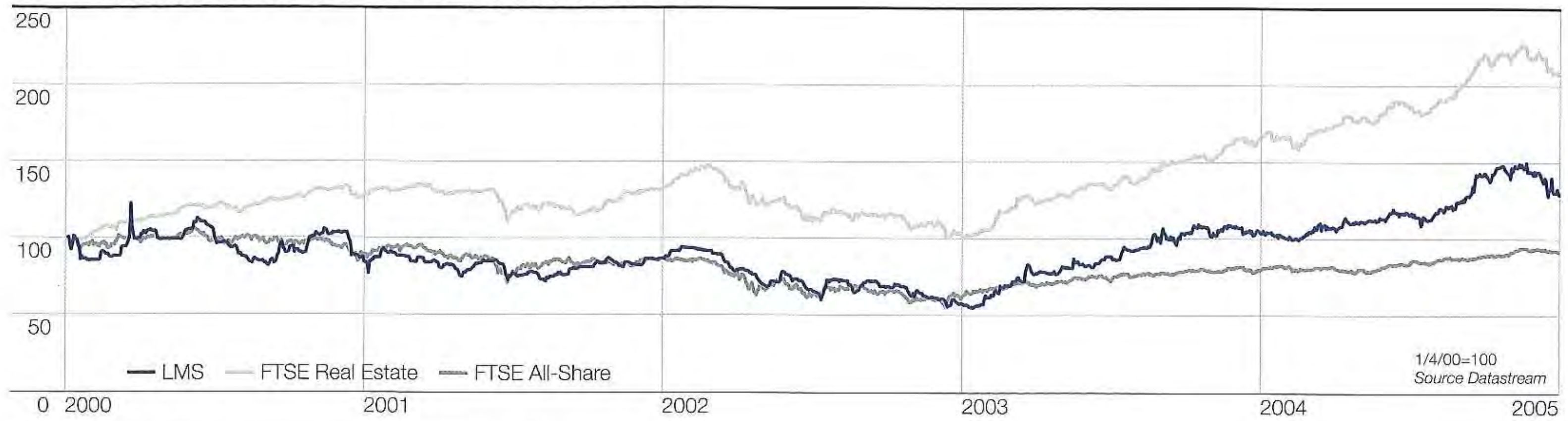
Executive directors' contracts are rolling contracts terminable with one year's notice. The appointment periods for non-executives are three years or until they are due for retirement by rotation, whichever is the earlier.

Executive directors' contracts contain no specific provision for payments on termination of employment, other than following a change of control, where there is provision for payment of 95% of annual salary and benefits. In determining the amount of any termination payment the Board will take into account the duty of the executive to mitigate loss.

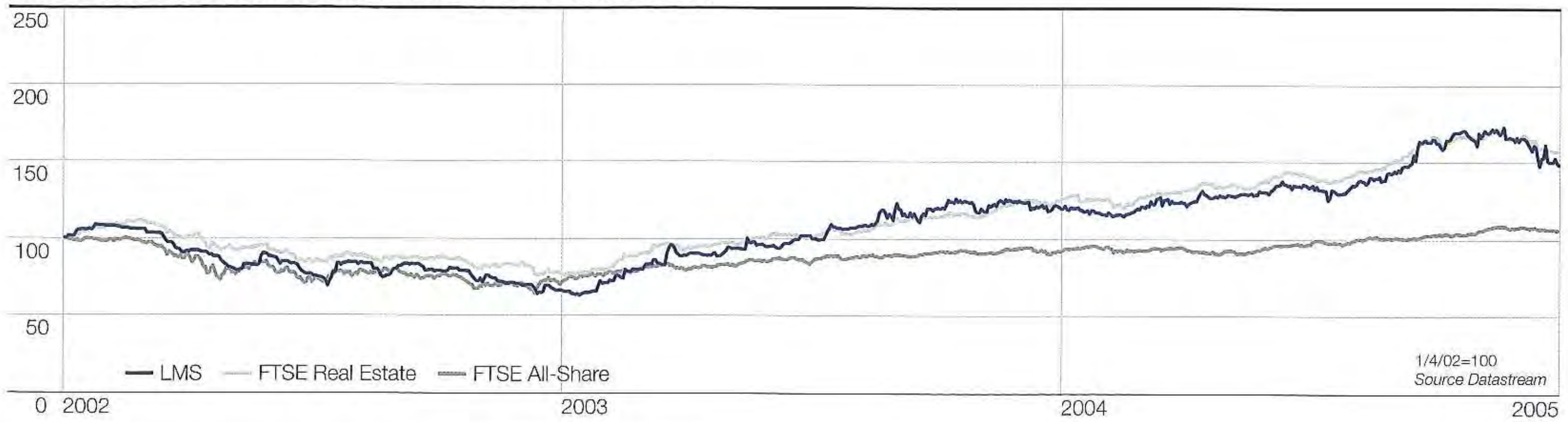
### Performance graphs

The graphs below show the total return for holders of LMS Ordinary shares for the five year, three year and one year periods ending 31st March 2005. Also shown are the total shareholder return for the FTSE All-Share Index and the FTSE Real Estate Index, which have been selected as broad-based comparative indices for quoted companies. In all cases dividends are assumed to have been reinvested at the date of payment.

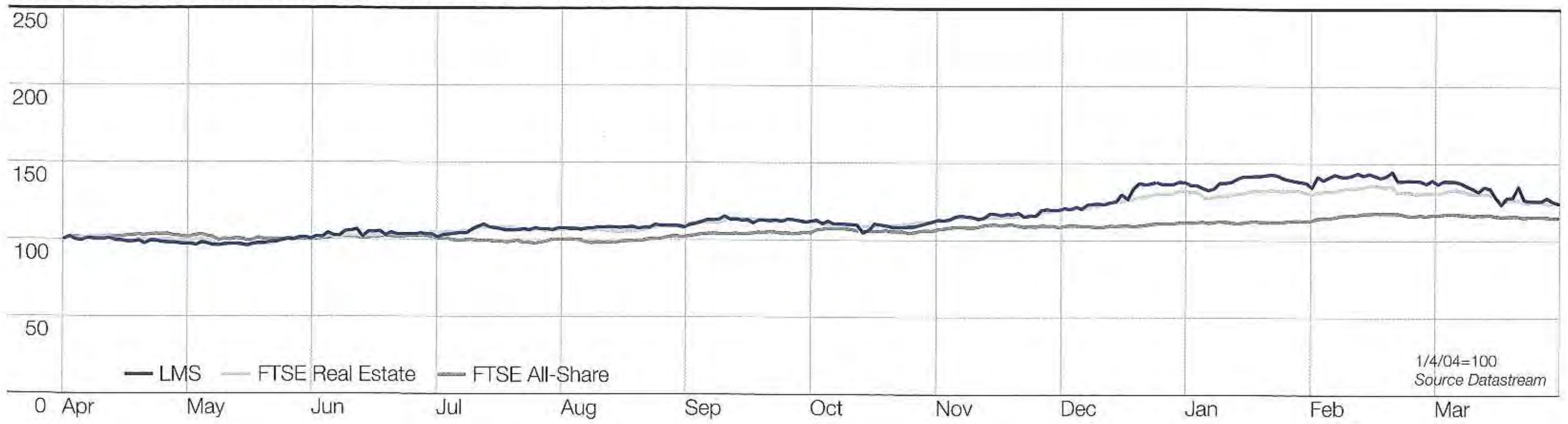
**Five Year Total Shareholder Return to 31st March 2005**




**Three Year Total Shareholder Return to 31st March 2005**




**One Year Total Shareholder Return to 31st March 2005**



### Executive directors' service contracts

The contracts of service for Mr R A Rayne, Mr M A Pexton and Mr N R Friedlos are dated 28th March 2003 and provide for termination on one year's notice. There are no specific provisions for compensation upon early termination of the contract, except following a change of control where there is provision for payment of 95% of annual salary and benefits.

### Non-executive directors' appointment letters

New letters of appointment were issued to all non-executive directors holding office on 1st May 2003. Dr Duroc-Danner's appointment letter is dated 1st September 2004. The appointment periods for non-executives are three years or until they are due for retirement by rotation, whichever is the earlier. Their appointment letters do not contain compensation provisions in the event of early termination.

***The auditors are required to report on the information contained in the following sections of the report***

### Directors' emoluments

| Name | Basic salary £000 | Fees £000 | Bonus £000 | Benefits[1] £000 | Total excluding pensions 2005 £000 | Total excluding pensions 2004 £000 | Share option gains 2005 £000 | Share option gains 2004 £000 |
|---|---|---|---|---|---|---|---|---|
| **Executive** | | | | | | | | |
| N G E Driver[2] | – | – | – | – | – | 556 | **520** | 9 |
| N R Friedlos | **240** | – | **151** | **21** | **412** | 341 | – | – |
| M A Pexton | **240** | – | **151** | **23** | **414** | 348 | – | – |
| Hon R A Rayne | **499** | – | **449** | **22** | **970** | 848 | – | – |
| **Non-executive** | | | | | | | | |
| Dr B J Duroc-Danner[3] | – | **18** | – | – | **18** | – | – | – |
| P J Grant | – | **60** | – | – | **60** | 60 | – | – |
| G C Greene | – | **125** | – | – | **125** | 125 | – | – |
| Mrs J de Moller | – | **30** | – | – | **30** | 30 | – | – |
| D Newell | – | **35** | – | – | **35** | 35 | – | – |
| Hon J M Wilson | – | **30** | – | – | **30** | 30 | – | – |
| **Total** | **979** | **298** | **751** | **66** | **2,094** | 2,373 | **520** | 9 |

Notes to the table

1 Benefits comprise car allowance, private medical insurance and Unapproved life insurance together with the value of shares granted under the Company's Share Incentive Plan.

2 Mr Driver retired as a director in March 2004. He was appointed as a consultant to the Company with effect from 1st April 2004 with a fee at the rate of £60,000 per annum and benefits of £2,000, bringing total emoluments for the year to £62,000.

3 Dr Duroc-Danner was appointed as a director during the year to 31st March 2005.

4 Mr W Millsom retired as a director in July 2002 but continued as a consultant to the Company. During the year to 31st March 2005 he received a fee of £178,000 and benefits of £2,000, bringing total emoluments for the year to £180,000.

5 The basic salaries payable to executive directors with effect from 1st April 2005 are as follows: Mr R A Rayne £499,000; Mr N R Friedlos £250,000; Mr M A Pexton £250,000.

6 The fees payable to non-executive directors with effect from 1st April 2005 are as follows: Mr G C Greene £132,500; Mr P J Grant £62,500; Mr D Newell £42,500; other non-executives £35,000.

## Directors' share options and long-term incentive awards

The number of shares subject to options/awards as at 31st March 2005 is set out below.

| Name and scheme | Exercise price (p) | Ordinary balance at 31st March 2005[1] | Deferred Ordinary balance at 1st April 2004[1] | First exercise date | Expiry/actual exercise date |
|---|---|---|---|---|---|
| **N R Friedlos** | | | | | |
| Executive | **104.0** | **229,175** | 229,175 | 1st Apr 2006 | 1st Apr 2013 |
| Executive | **137.5** | **207,401** | 207,401 | 29th Aug 2006 | 29th Aug 2013 |
| Executive[2] | **181.0** | **132,596** | – | 1st Sept 2007 | 1st Sept 2014 |
| SAYE | **130.0** | **7,096** | 7,096 | 1st Feb 2007 | 31st July 2007 |
| **M A Pexton** | | | | | |
| Executive[3] | **120.0** | **–** | 131,003 | 4th Sept 2005 | 4th Sept 2012 |
| Long-term incentive[3] | **120.0** | **–** | 393,013 | 25th Sept 2005 | 25th Sept 2012 |
| Executive | **137.5** | **166,666** | 166,666 | 29th Aug 2006 | 29th Aug 2013 |
| Executive[2] | **181.0** | **132,596** | – | 1st Sept 2007 | 1st Sept 2014 |
| SAYE | **130.0** | **7,096** | 7,096 | 1st Feb 2007 | 31st July 2007 |
| **Hon R A Rayne** | | | | | |
| Executive | **174.0** | **1,235,420** | 1,235,420 | 5th Jan 2004 | 5th Jan 2011 |
| Executive[3] | **120.0** | **–** | 411,563 | 4th Sept 2005 | 4th Sept 2012 |
| Executive | **137.5** | **359,635** | 359,635 | 29th Aug 2006 | 29th Aug 2013 |
| Executive[2] | **181.0** | **275,555** | – | 1st Sept 2007 | 1st Sept 2014 |

Notes to the table

1 Holdings of options are shown as at the beginning and end of the year. All options held as at 1st April 2004 were over Deferred Ordinary shares, but following the conversion of the Deferred shares into Ordinary shares in July 2004 these options were converted into options over Ordinary shares and re-priced as follows:

| First exercise date | Deferred Ordinary exercise price | Ordinary exercise price |
|---|---|---|
| 5th Jan 2004 | 149.0p | 174.0p |
| 4th Sep 2005 | 114.5p | 120.0p |
| 1st Apr 2006 | 96.0p | 104.0p |
| 29th Aug 2006 | 135.0p | 137.5p |

2 Executive options over Ordinary shares were granted to Mr N R Friedlos, Mr M A Pexton and Mr R A Rayne on 1st September 2004 at an exercise price of 181p.

3 The options and long-term incentive awards first exercisable on 4th September 2005 and 25th September 2005 respectively lapsed at 31st March 2005 due to non-achievement of the performance condition.

4 The performance condition for the executive options first exercisable in January 2004 is that in any three year period following the grant of the options Shareholders' funds must increase by a percentage greater than the increase in the Retail Prices Index plus 9%. The performance condition for the options first exercisable in September 2005, April 2006 and August 2006 is that in the first three year period following the grant of the options Shareholders' funds must increase by a percentage greater than the increase in the Retail Prices Index plus 9%. The performance condition for the options first exercisable in September 2007 is that the Total Shareholder Return (TSR) over the first three year period after grant must exceed the arithmetic average of the TSR for the FTSE 250 and the TSR for the FTSE Real Estate index for the same period.

5 The market price of an Ordinary share at 31st March 2005 was 206p and the range during the year was 164.5p to 240p.

## Pensions

Mr R A Rayne is a member of the LMS (1973) Pension Scheme, which is an Inland Revenue approved defined benefit scheme, of which the principal features for executive directors are a normal retirement age of 60 and a pension at normal retirement age after 20 years' service of two-thirds of final pensionable salary.

| | Age | Years of service | Accrued pension entitlement at age 60 at 31st March 2005 £000 | Accrued pension entitlement at age 60 at 31st March 2004 £000 | Transfer value at 31st March 2005 £000 | Transfer value at 31st March 2004 £000 | Employee contributions £000 | Change in transfer value during the year less employee contributions £000 |
|---|---|---|---|---|---|---|---|---|
| **Executive** | | | | | | | | |
| Hon R A Rayne | **56** | **30** | **287** | 269 | **7,158** | 6,553 | **29** | **576** |

Mr N R Friedlos and Mr MA Pexton each received pension contributions of £48,000 during the year.

## Directors' share interests

At 31st March 2005 the share interests of the directors and their families, as defined by the Companies Act 1985, in London Merchant Securities plc were as follows:

| | At 31st March 2005 Ordinary | At 31st March 2004 Ordinary | At 31st March 2004 Deferred Ordinary |
|---|---|---|---|
| **Beneficial** | | | |
| Dr B J Duroc-Danner | | – | – |
| N R Friedlos | **17,228** | 3,840 | 10,000 |
| P J Grant | **1,247** | 944 | 303 |
| G C Greene | **16,400** | – | 16,400 |
| Mrs J de Moller | **20,000** | – | 20,000 |
| D Newell | **10,000** | 10,000 | – |
| M A Pexton | **61,161** | 57,930 | – |
| Hon R A Rayne | **7,645,793** | 6,190,326 | 1,439,467 |
| Hon J M Wilson | **360,000** | – | 360,000 |
| **Non-beneficial**[1] | | | |
| P J Grant | **–** | 35,609 | 60,812 |
| G C Greene | **7,294,156** | 7,379,256 | 60,812 |
| D Newell | **–** | 35,609 | 60,812 |
| Hon R A Rayne | **21,582,900** | 21,582,700 | 200 |

Notes to the table
1 The total number of shares in the Company in which the directors were interested as Trustees at 31st March 2005 was 28,926,547. The total number of shares in which the directors were interested as Trustees at 31st March 2004, after eliminating duplications, was 28,961,956 Ordinary shares and 60,812 Deferred Ordinary shares.

Changes in directors' shareholdings between 31st March 2005 and 17th May 2005 were as follows:

| | Ordinary |
|---|---|
| **Beneficial** | |
| N R Friedlos | **236** |
| M A Pexton | **236** |

Approved by the Board on 23rd May and signed on its behalf by

**Simon Mitchley** Company Secretary

# Independent Auditors' Report

to the members of London Merchant Securities plc

We have audited the financial statements on pages 40 to 61. We have also audited the information in the directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of directors and auditors**

The directors are responsible for preparing the Annual Report and the directors' remuneration report. As described on page 29, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Group is not disclosed.

We review whether the corporate governance statement on pages 29 to 33 reflects the Company's compliance with the nine provisions of the 2003 FRC Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement and the unaudited part of the directors' remuneration report, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

**Basis of audit opinion**

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the directors' remuneration report to be audited.

**Opinion**

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31st March 2005 and of the loss of the Group for the year then ended; and
- the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

**KPMG Audit Plc** Chartered Accountants
Registered Auditor
23rd May 2005
London

# Consolidated Profit and Loss Account

for the year ended 31st March 2005

| | Notes | 2005 £000 | 2005 £000 | 2004 £000 | 2004 £000 |
|---|---|---|---|---|---|
| **Turnover** | | | | | |
| Group and share of joint venture | | | **64,930** | | 60,242 |
| Less: Share of joint venture | | | **(240)** | | – |
| Group total | 2 | | **64,690** | | 60,242 |
| **Group operating profit** | 2 | | **42,574** | | 39,845 |
| Share of operating profit of joint venture | | | **119** | | – |
| | | | **42,693** | | 39,845 |
| Investment income | | | **163** | | 707 |
| Profit on disposal of investment properties | | | **1,364** | | 302 |
| Profit on disposal of Investment Division investments | | | **17,930** | | 7,492 |
| Amounts written off Investment Division investments | | | **(2,000)** | | (4,994) |
| **Profit on ordinary activities before finance costs** | | | **60,150** | | 43,352 |
| Net finance costs (including exceptional cost of £48.213 million) | 6 | | **(73,079)** | | (26,133) |
| Profit on ordinary activities before taxation and exceptional finance costs | | **35,284** | | 17,219 | |
| Exceptional finance costs | | **(48,213)** | | – | |
| **(Loss)/profit on ordinary activities before taxation** | | | **(12,929)** | | 17,219 |
| Tax on profit on ordinary activities before exceptional finance costs | | **(7,364)** | | (3,909) | |
| Tax credit on exceptional finance costs | | **14,464** | | – | |
| **Tax on (loss)/profit on ordinary activities** | 7 | | **7,100** | | (3,909) |
| Profit on ordinary activities after taxation but excluding exceptional finance costs | | **27,920** | | 13,310 | |
| Exceptional finance costs after taxation | | **(33,749)** | | – | |
| **(Loss)/profit on ordinary activities after taxation** | | | **(5,829)** | | 13,310 |
| Equity minority interests | | | **(5,096)** | | (1,501) |
| Profit for the year excluding exceptional finance costs | | **22,824** | | 11,809 | |
| Exceptional finance costs after taxation | | **(33,749)** | | – | |
| **(Loss)/profit for the year** | | | **(10,925)** | | 11,809 |
| Equity dividends | | | **(21,366)** | | (15,593) |
| **Loss for the year transferred to reserves** | 21 | | **(32,291)** | | (3,784) |
| **Earnings/(loss) per share** | | | | | |
| – Basic | 8 | | **(3.61p)** | | 4.85p |
| – Basic excluding exceptional finance costs | | | **7.54p** | | 4.85p |
| – Diluted | 8 | | **(3.32p)** | | 3.61p |
| – Diluted excluding exceptional finance costs | | | **6.93p** | | 3.61p |

All operations are continuing in both the current and previous year.

# Balance Sheets

At 31st March 2005

| | Notes | Group 2005 £000 | Group 2004 £000 | Company 2005 £000 | Company 2004 £000 |
|---|---|---|---|---|---|
| **Fixed assets** | | | | | |
| Intangible assets – negative goodwill | | **–** | (392) | **–** | – |
| Investment properties | 9 | **923,964** | 853,614 | **375** | 23,875 |
| Other tangible assets | 10 | **1,768** | 609 | **–** | – |
| Investments – joint ventures | | | | | |
| Share of gross assets £16.526 million | | | | | |
| Share of gross liabilities £(12.418 million) | | **4,108** | – | **–** | – |
| Investments – consolidated subsidiary undertakings | 11 | **–** | – | **387,066** | 297,601 |
| Investments – Investment Division | 12 | **220,617** | 191,885 | **–** | – |
| | | **1,150,457** | 1,045,716 | **387,441** | 321,476 |
| **Current assets** | | | | | |
| Trading properties | 13 | **13,550** | 12,475 | **–** | – |
| Debtors | 14 | **30,193** | 17,705 | **674,551** | 671,861 |
| Cash and short-term deposits | 15 | **37,348** | 57,475 | **–** | 248 |
| | | **81,091** | 87,655 | **674,551** | 672,109 |
| **Creditors: amounts falling due within one year** | 16 | **(45,466)** | (43,289) | **(23,354)** | (19,809) |
| **Net current assets** | | **35,625** | 44,366 | **651,197** | 652,300 |
| **Total assets less current liabilities** | | **1,186,082** | 1,090,082 | **1,038,638** | 973,776 |
| **Creditors: amounts falling due after more than one year** | 17 | **(388,360)** | (323,896) | **(312,129)** | (270,078) |
| **Provisions for liabilities and charges** | 18 | **(9,730)** | (8,213) | **(56)** | (55) |
| **Net assets** | | **787,992** | 757,973 | **726,453** | 703,643 |
| **Capital and reserves** | | | | | |
| Called up share capital | 20 | **90,256** | 89,886 | **90,256** | 89,886 |
| Share premium account | 21 | **20,575** | 19,049 | **20,575** | 19,049 |
| Capital reduction account | 21 | **2,868** | 2,868 | **2,868** | 2,868 |
| Revaluation reserve | 21 | **385,315** | 335,007 | **224,763** | 155,615 |
| Profit and loss account | 21 | **233,072** | 263,151 | **387,991** | 436,225 |
| **Equity Shareholders' funds** | | **732,086** | 709,961 | **726,453** | 703,643 |
| **Equity minority interests** | | **55,906** | 48,012 | **–** | – |
| **Capital employed** | | **787,992** | 757,973 | **726,453** | 703,643 |
| **Shareholders' funds per share – Basic** | 8 | **223p** | 217p | | |
| **Shareholders' funds per share – Diluted** | 8 | **222p** | 212p | | |
| **Adjusted Shareholders' funds per share – Basic** | 8 | **238p** | 229p | | |
| **Adjusted Shareholders' funds per share – Diluted** | 8 | **237p** | 224p | | |

The accounts on pages 40 to 61 were approved by the Board of Directors on 23rd May 2005 and were signed on its behalf by

**Robert Rayne** Director

**Nicholas Friedlos** Director

# Consolidated Cash Flow Statement

for the year ended 31st March 2005

| | 2005 £000 | 2005 £000 | 2004 £000 | 2004 £000 |
|---|---|---|---|---|
| **Net cash inflow from operating activities** (see note 22 (1)) | | **40,532** | | 42,001 |
| **Returns on investments and servicing of finance** | | | | |
| Interest received | **2,164** | | 2,655 | |
| Interest paid | **(27,398)** | | (26,558) | |
| Exceptional finance costs | **(44,954)** | | – | |
| Investment income received | **163** | | 707 | |
| Dividends paid – minority Shareholders | **(461)** | | (1,336) | |
| Net cash outflow from returns on investments and servicing of finance | | **(70,486)** | | (24,532) |
| **Taxation paid** | | **(2,980)** | | (4,111) |
| **Capital expenditure and financial investment** | | | | |
| Property developments and acquisitions | **(25,511)** | | (18,954) | |
| Sales of investment property | **11,264** | | 26,647 | |
| Acquisition of other fixed assets | **(1,542)** | | (189) | |
| Disposal of other fixed assets | **–** | | 70 | |
| Purchases by Investment Division | **(73,986)** | | (46,863) | |
| Realisations by Investment Division | **61,684** | | 24,147 | |
| Net cash outflow from capital expenditure and financial investment | | **(28,091)** | | (15,142) |
| **Acquisitions and disposals** | | | | |
| Purchase of subsidiaries | **(1,201)** | | (7,811) | |
| Purchase of joint venture | **(3,688)** | | – | |
| Net cash acquired with subsidiary | **–** | | 17,428 | |
| | | **(4,889)** | | 9,617 |
| **Equity dividends paid** | | **(17,271)** | | (15,327) |
| **Cash outflow before management of liquid resources and financing** | | **(83,185)** | | (7,494) |
| **Management of liquid resources** | | | | |
| Decrease in short-term deposits (see note 22 (2)) | | **7,071** | | 18,598 |
| **Financing** | | | | |
| Issue of share capital | **1,896** | | 20 | |
| Debt due after more than one year: (see note 22 (2)) | | | | |
| – Repayment of mortgages | **(8,139)** | | (10,734) | |
| – Repurchase of 2018 debenture | **(100,000)** | | – | |
| – Drawdown of new loans | **169,824** | | – | |
| Debt due within one year: | | | | |
| – Repayment of bank loans | **(331)** | | (650) | |
| Net cash inflow/(outflow) from financing | | **63,250** | | (11,364) |
| **Decrease in cash in the year** | | **(12,864)** | | (260) |

# Other Statements

**Consolidated Statement of Total Recognised Gains and Losses**
for the year ended 31st March 2005

| | 2005 £000 | 2004 £000 |
|---|---|---|
| (Loss)/profit for the year | **(10,925)** | 11,809 |
| Unrealised surplus on revaluation of investment properties | **52,359** | 38,873 |
| Foreign exchange and other | **161** | (4,079) |
| Total recognised gains and losses relating to the financial year | **41,595** | 46,603 |

**Note of Consolidated Historical Cost Profits and Losses**
for the year ended 31st March 2005

| | 2005 £000 | 2004 £000 |
|---|---|---|
| (Loss)/profit on ordinary activities before taxation | **(12,929)** | 17,219 |
| Realisation of property revaluation surpluses of previous years | **2,907** | 4,951 |
| Historical cost (loss)/profit on ordinary activities before taxation | **(10,022)** | 22,170 |
| Historical cost (loss)/profit retained after taxation, minority interests and dividends | **(29,384)** | 1,167 |

**Reconciliation of Movements in Shareholders' Funds**
for the year ended 31st March 2005

| | Group 2005 £000 | Group 2004 £000 | Company 2005 £000 | Company 2004 £000 |
|---|---|---|---|---|
| (Loss)/profit for the year | **(10,925)** | 11,809 | **(46,679)** | 98,954 |
| Ordinary dividends | **(21,366)** | (15,593) | **(21,366)** | (15,593) |
| Retained (loss)/profit for the year | **(32,291)** | (3,784) | **(68,045)** | 83,361 |
| Other recognised gains and losses | **52,520** | 34,794 | **88,959** | (50,296) |
| Issue of shares | **1,896** | 20 | **1,896** | 20 |
| Movement in Shareholders' funds | **22,125** | 31,030 | **22,810** | 33,085 |
| Shareholders' funds at beginning of year | **709,961** | 678,931 | **703,643** | 670,558 |
| Shareholders' funds at end of year | **732,086** | 709,961 | **726,453** | 703,643 |

# Notes on the Accounts

## 1 Accounting policies

### Accounting convention

The accounts have been prepared under the historical cost convention, modified to include the revaluation of investment properties and subsidiary undertakings, and in accordance with applicable accounting standards and with the Companies Act 1985, except as noted below. The accounting policies have been applied consistently in dealing with items which are considered material in relation to the Group's accounts. The Group has also implemented the transitional provisions of FRS 17 'Retirement Benefits'.

### Basis of consolidation

Except as explained below, the consolidated accounts incorporate the results of the Company and its subsidiaries made up to 31st March. Subsidiary undertakings acquired during the year are accounted for using the acquisition method of accounting unless the criteria for merger accounting are met. In accordance with Section 230 of the Companies Act 1985 a separate profit and loss account for the Company is not presented with these accounts.

Investment Division investments that are subsidiary undertakings are carried at cost less amounts, if any, written off to reflect impairment in value, in accordance with the company's normal accounting policy for such investments, and are not consolidated as required by FRS 2 'Accounting for Subsidiary Undertakings'. These investments within the Group's portfolio are held for resale with a view to the ultimate realisation of capital gains, although not necessarily with a view to disposal within one year of acquisition. The Group's exposure to these companies is limited to its investment at the balance sheet date. Consequently, the directors consider that consolidation would not give a true and fair view of the Group's interest in these investments. This treatment reflects the application of the true and fair override to FRS 2. It is not practicable to determine the effects of the application of the true and fair override on the accounts. Additional information on the subsidiary undertakings not consolidated is given in note 12.

### Investment properties

In accordance with SSAP 19 'Accounting for Investment Properties', investment properties are revalued annually at open market value determined in accordance with the Appraisal and Valuation Manual of the Royal Institute of Chartered Surveyors. Revaluation surpluses and temporary deficits are included in the revaluation reserve, permanent deficits being taken through the profit and loss account.

No depreciation or amortisation is provided in respect of freehold investment properties and leasehold investment properties with over 20 years to run. This treatment, which is in accordance with SSAP 19, may be a departure from the requirements of the Companies Act concerning depreciation of fixed assets. However, these properties are not held for consumption but for investment and the directors consider that systematic annual depreciation would be inappropriate. The accounting policy adopted is therefore necessary for the accounts to give a true and fair view. Depreciation or amortisation is only one of many factors reflected in the annual valuation and the amount which might otherwise have been shown cannot be separately identified or quantified.

### Investment Division investments

Investments are stated at cost less amounts written off to reflect permanent diminution in value.

Those investments that are associated undertakings are carried at cost in accordance with the Group's normal policy and are not equity accounted as required by the Companies Act 1985. The directors consider that as these investments are held as part of the Group's portfolio with a view to the ultimate realisation of capital gains, equity accounting would not give a true and fair view of the Group's interest in these investments. It is not practicable to determine the effects of this departure (which is in accordance with FRS 9 'Associates and Joint Ventures') on the accounts.

### Other tangible assets

These comprise computers, furniture, fixtures and fittings, and improvements to Group occupied properties and are depreciated on a straight-line basis to estimated residual values over their estimated useful lives of between 3 and 5 years.

### Goodwill

Goodwill, including negative goodwill, arising on acquisition is calculated based upon a comparison of the fair value of the assets acquired and the fair value of the consideration given and other costs of acquisition.

The negative goodwill arising on the acquisition of Inflexion plc has been released to the profit and loss account as the Inflexion plc assets, to which the negative goodwill related, were realised.

### Trading properties

Trading properties are valued at the lower of cost and estimated net realisable value. Cost excludes interest.

### Interest and other outgoings on property developments

Interest and other outgoings on vacant properties prior to redevelopment are treated as revenue expenditure and written off as incurred. Interest costs on properties in development are written off as incurred.

### Debt instruments and interest rate derivatives

Debt instruments are stated at their net proceeds on issue. Issue costs are amortised to the profit and loss account over the life of the instrument and are included in interest payable.

## 1 Accounting policies continued

Amounts payable or receivable under interest rate derivatives are matched with the interest payable on the debt which the derivatives hedge. In the course of the Group's investment and financing activity underlying debt may be retired or redeemed such that an interest rate derivative becomes surplus. In these circumstances the derivative is marked to market or closed out. Any deficit/surplus arising is charged/credited to the profit and loss account and included in net interest payable.

### Foreign currencies

Transactions in foreign currencies are recorded at the rate of exchange at the date of transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date, and exchange differences are included in the profit and loss account.

The results and balance sheets of overseas operations are translated at the closing rates ruling at the balance sheet date. Exchange differences arising on translation of the opening net assets are dealt with through reserves.

Investment Division investments denominated in foreign currencies remain at the initial recorded amount and are not retranslated as these balances represent the historical cost of acquiring these investments.

### Net rental income

Rental income is recognised on an accruals basis. Rent increases arising from rent reviews are taken into account when such reviews have been settled with tenants.

### Operating lease incentives

Operating lease incentives include rent free periods and other incentives (such as contributions towards fitting out costs) given to lessees on entering into lease agreements.

In accordance with UITF Abstract 28 'Operating Lease Incentives', rent receivable in the period from lease commencement to the earlier of the first rent review to the prevailing market rate and the lease end date, is spread evenly over that period. The cost of other incentives is spread on a straight-line basis over a similar period.

### Cash and liquid resources

Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand.

Liquid resources are current asset investments which are disposable without curtailing or disrupting the business and are either readily convertible into known amounts of cash at or close to their carrying values or traded in an active market. Liquid resources comprise short-term cash deposits.

### Pensions

Contributions to the Group's pension and life assurance schemes are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives with the Group.

### UITF Abstract 17

The Group operates an Inland Revenue approved employee share option scheme and has taken advantage of the exemption given in UITF Abstract 17 'Employee Share Schemes' from recognising a charge in the profit and loss account for the discount on the options.

### Taxation

Corporation tax payable is provided on taxable profits at the current rate.

On disposal of an investment property the element of tax relating to the profit in the year is charged to the profit and loss account and the element relating to earlier revaluation surpluses is included in the Statement of Total Recognised Gains and Losses.

Deferred tax assets and liabilities arise from timing differences between the recognition of gains and losses in the accounts and their recognition in a tax computation.

In accordance with FRS 19 'Deferred Tax', deferred tax is provided in respect of all timing differences that have originated, but not reversed, at the balance sheet date that may give rise to an obligation to pay more or less tax in the future. Deferred tax is measured on a non-discounted basis. Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on the sale has been recognised in the accounts.

### Subsidiary undertakings valuation

The Company's investments in the shares of Group undertakings are stated at directors' valuation on a basis which takes account of the net assets of the undertakings at 31st March 2005 which will include, where applicable, the professional valuation of properties and the carrying value of Investment Division investments. Surpluses and temporary deficits arising from the directors' valuation are taken to revaluation reserve in the Company balance sheet, permanent diminutions in value are taken to the Company profit and loss account.

## 2 Segmental analysis of profit

| | Property 2005 £000 | Investment Division 2005 £000 | Total 2005 £000 | Property 2004 £000 | Investment Division 2004 £000 | Total 2004 £000 |
|---|---|---|---|---|---|---|
| **Turnover** | | | | | | |
| Gross rental income | **60,798** | **–** | **60,798** | 58,396 | – | 58,396 |
| Less: Share of joint venture | **(240)** | **–** | **(240)** | – | – | – |
| | **60,558** | **–** | **60,558** | 58,396 | – | 58,396 |
| Property trading income | **2,326** | **–** | **2,326** | 1,269 | – | 1,269 |
| Investment management income | **–** | **1,806** | **1,806** | – | 577 | 577 |
| | **62,884** | **1,806** | **64,690** | 59,665 | 577 | 60,242 |
| **Cost of sales** | | | | | | |
| Property outgoings | **4,348** | **–** | **4,348** | 4,438 | – | 4,438 |
| Property trading | **956** | **–** | **956** | 860 | – | 860 |
| | **5,304** | **–** | **5,304** | 5,298 | – | 5,298 |
| **Profit before administration costs** | | | | | | |
| Net rental income | **56,210** | **–** | **56,210** | 53,958 | – | 53,958 |
| Property trading profit | **1,370** | **–** | **1,370** | 409 | – | 409 |
| Investment management income | **–** | **1,806** | **1,806** | – | 577 | 577 |
| | **57,580** | **1,806** | **59,386** | 54,367 | 577 | 54,944 |
| **Administrative costs** | **(9,285)** | **(7,527)** | **(16,812)** | (9,850) | (5,249) | (15,099) |
| **Operating profit/(loss)** | **48,295** | **(5,721)** | **42,574** | 44,517 | (4,672) | 39,845 |
| Share of operating profit of joint venture | **119** | **–** | **119** | – | – | – |
| Investment income | **–** | **163** | **163** | – | 707 | 707 |
| Profit on disposal of properties and other investments | **1,364** | **17,930** | **19,294** | 302 | 7,492 | 7,794 |
| Amounts written off other investments | **–** | **(2,000)** | **(2,000)** | – | (4,994) | (4,994) |
| **Profit/(loss) on ordinary activities before finance costs and taxation** | **49,778** | **10,372** | **60,150** | 44,819 | (1,467) | 43,352 |

The Investment Division results include a full year's contribution from Inflexion plc compared to two months' contribution in the previous year when it was acquired. Included for Inflexion is the following:

| | 2005 £000 | 2004 £000 |
|---|---|---|
| Investment Division turnover | **1,735** | 216 |
| Administrative expenses | **(2,820)** | (569) |
| Operating loss | **(1,085)** | (353) |
| Investment income | **144** | 351 |
| Profit on disposal of investments | **6,409** | 64 |
| Amounts written back to investments | **2,774** | – |
| Profit on ordinary activities before finance costs | **8,242** | 62 |
| Finance income | **823** | 54 |
| **Profit on ordinary activities before taxation** | **9,065** | 116 |

| | 2005 £000 | 2004 £000 |
|---|---|---|
| **Operating profit is stated after charging** | | |
| Amortisation and depreciation of fixed assets | **378** | 152 |
| Auditors' remuneration (Group and Company) | **169** | 167 |
| Remuneration for other services to KPMG Audit Plc and its associates: | | |
| – Taxation advice | **90** | 339 |
| – Audit related services | **36** | 27 |
| – Due diligence on venture capital acquisitions | **–** | 33 |

## 3 Segmental analysis of net assets

| | Property 2005 £000 | Investment Division 2005 £000 | Total 2005 £000 | Property 2004 £000 | Investment Division 2004 £000 | Total 2004 £000 |
|---|---|---|---|---|---|---|
| Intangible assets – negative goodwill | **–** | **–** | **–** | – | (392) | (392) |
| Investment properties | **923,964** | **–** | **923,964** | 853,614 | – | 853,614 |
| Other tangible assets | **1,663** | **105** | **1,768** | 408 | 201 | 609 |
| Investments – joint ventures | **4,108** | **–** | **4,108** | – | – | – |
| Investments – Investment Division | **–** | **220,617** | **220,617** | – | 191,885 | 191,885 |
| Fixed assets | **929,735** | **220,722** | **1,150,457** | 854,022 | 191,694 | 1,045,716 |
| Trading properties | **13,550** | **–** | **13,550** | 12,475 | – | 12,475 |
| Debtors | **29,101** | **1,092** | **30,193** | 14,462 | 3,243 | 17,705 |
| Inflexion plc cash and short-term deposits | **–** | **19,870** | **19,870** | – | 14,629 | 14,629 |
| Creditors: amounts falling due within one year | **(43,669)** | **(1,797)** | **(45,466)** | (42,054) | (1,235) | (43,289) |
| Provisions for liabilities and charges | **(9,730)** | **–** | **(9,730)** | (8,213) | – | (8,213) |
| | **918,987** | **239,887** | **1,158,874** | 830,692 | 208,331 | 1,039,023 |
| Cash and short-term deposits | | | **17,478** | | | 42,846 |
| Creditors: amounts falling due after more than one year | | | **(388,360)** | | | (323,896) |
| Net assets | | | **787,992** | | | 757,973 |

£36.5 million (2004 – £34.5 million) of the investment properties and £Nil (2004 – £2.3 million) of the creditors falling due after more than one year are in the US. Of the Investment Division investments, £71.6 million (2004 – £70.7 million) are located in the US.

## 4 Employees, including executive directors

| | 2005 £000 | 2004 £000 |
|---|---|---|
| **Staff costs** | | |
| Wages and salaries | **6,900** | 5,707 |
| Social security costs | **853** | 764 |
| Pension contributions | **1,823** | 2,533 |
| | **9,576** | 9,004 |

The average number of employees of the Group was 81 (2004 – 85). The areas of the Group's operations in which they are employed were: Property Management 44 (2004 – 51), Investment Division 24 (2004 – 14) and 13 staff (2004 – 27) who were employed directly at the Group's properties and their cost recharged to tenants. The Investment Division allocation includes 10 people (2004 – 1) employed by Inflexion plc.

## 5 Pension costs

The assets of the pension schemes are held separately from those of the Group companies. The Group operates a defined benefit scheme which is contributory for members, provides benefits based on final pensionable salary and contributions are invested in a Unitised with Profit Policy with Sun Alliance and London Insurance Company Limited plus annuity policies held in the name of the Trustees.

With effect from 6th April 2001 the Company introduced a plan to pay contributions to personal pensions established with a specific provider. New employees are eligible to join this arrangement; the defined benefit scheme is closed to new entrants. Inflexion plc, the Group's 58.8% owned subsidiary, pays contributions to personal pensions for its employees.

The pension charge for the Group was £1.8 million (2004 – £2.5 million). The pension charge for the defined benefit scheme is assessed in accordance with the advice of a qualified actuary. The most important assumptions made in connection with the establishment of this charge were that interest will be earned on the fund at the rate of 5.5% per annum and that salaries will be increased at 4.5% per annum. The market value of assets of the scheme at 31st March 2005 was £7.4 million and the actuarial value of those assets on an ongoing basis represented 51.7% of the benefit of £14.2 million that had accrued to members allowing for expected future increases in earnings. Net of the related deferred tax asset the pension deficit is £4.8 million. The employer will pay an enhanced contribution designed to eliminate the underfunding over the next three to five years.

The Company has applied the phased transitional rules under FRS 17 'Retirement Benefits'. The additional disclosures required by FRS 17 have been based on the most recent actuarial valuation as at 1st November 2004. The assumptions used by the actuary for the purposes of the valuation are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale involved, may not necessarily be borne out in practice.

| | 2005 % per annum | 2004 % per annum | 2003 % per annum |
|---|---|---|---|
| Future salary growth | **4.5%** | 4.5% | 3.9% |
| Discount rate | **5.5%** | 5.4% | 5.4% |
| Rate of increase in pension payments | **5.0%** | 5.0% | 5.0% |
| Inflation rate | **3.0%** | 3.0% | 2.7% |

Using the above assumptions and the projected unit method of valuation, the Actuary has arrived at an estimate of the fair value of the scheme's assets and the present value of its liabilities to produce an overall scheme valuation. The fair value of the scheme's assets, which are not intended to be realised in the short-term, may be subject to significant change before they are realised; the present value of the scheme's liabilities, which is derived from cash flow projections over long periods, is inherently uncertain. The estimates arrived at were:

| | 2005 Long-term rate of return expected % per annum | 2005 Value £m | 2004 Long-term rate of return expected % per annum | 2004 Value £m | 2003 Long-term rate of return expected % per annum | 2003 Value £m |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| – Equities (UK and overseas) | **7.5** | **5.5** | 7.5 | 2.1 | 7.5 | 0.8 |
| – Bonds (Government and corporate) | **5.0** | **1.2** | 5.0 | 0.9 | 5.0 | 0.8 |
| – Property (UK) | **7.0** | **0.4** | 7.0 | 0.2 | 7.0 | 0.1 |
| – Cash (cash and deposits) | **4.7** | **0.2** | 4.5 | 1.2 | 4.5 | 0.1 |
| – Unitised with profits | **6.6** | **0.1** | 6.8 | 0.2 | 6.8 | 7.5 |
| Total market value of assets | **7.0** | **7.4** | 6.7 | 4.6 | 6.7 | 9.3 |
| Present value of scheme liabilities | | **(14.2)** | | (12.9) | | (17.0) |
| Deficit in scheme | | **(6.8)** | | (8.3) | | (7.7) |
| Related deferred tax asset | | **2.0** | | 2.5 | | 2.3 |
| Net pension liability | | **(4.8)** | | (5.8) | | (5.4) |
| **Equity Shareholders' funds** | | **732.1** | | 710.0 | | 678.9 |
| Net pension liability | | **(4.8)** | | (5.8) | | (5.4) |
| Equity Shareholders' funds including net pension liability | | **727.3** | | 704.2 | | 673.5 |
| **Reserves** | | | | | | |
| Profit and loss account excluding net pension liability | | **233.1** | | 263.2 | | 260.7 |
| Net pension liability | | **(4.8)** | | (5.8) | | (5.4) |
| Profit and loss account including net pension liability | | **228.3** | | 257.4 | | 255.3 |

## 5 Pension costs continued

| | 2005 £m | 2004 £m |
|---|---|---|
| **Analysis of the amount that would have been charged to operating profit** | | |
| Current service cost | **0.7** | 0.7 |
| Past service cost | **–** | – |
| Total operating charge | **0.7** | 0.7 |
| **Analysis of the amount that would have been credited/(charged) to other finance income/(expense)** | | |
| Interest on pension liabilities | **(0.7)** | (0.8) |
| Expected return on schemes' assets | **0.3** | 0.4 |
| Net charge | **(0.4)** | (0.4) |

**Movement in deficit during the year**

| | 2005 £m | 2004 £m |
|---|---|---|
| Deficit in scheme at 31st March 2004 | **(8.3)** | (7.7) |
| Current service cost | **(0.7)** | (0.7) |
| Contributions | **2.4** | 2.4 |
| Other finance income | **(0.4)** | (0.4) |
| Actuarial gain/(loss) | **0.2** | (1.9) |
| Deficit in scheme at 31st March 2005 | **(6.8)** | (8.3) |

There have been no refunds of surplus paid to the employer during the current year.

**History of experience gains and losses**

| | 2005 £m | 2004 £m | 2003 £m |
|---|---|---|---|
| Difference between the expected and the actual return on the schemes' assets | | | |
| – Amount | **0.2** | 1.8 | (1.6) |
| – Percentage of schemes' assets | **2.0%** | 38.4% | 17.2% |
| Experience gains and losses on the schemes' liabilities | | | |
| – Amount | **(0.3)** | (3.2) | (1.9) |
| – Percentage of the present value of the schemes' liabilities | **2.2%** | 24.5% | 11.0% |
| Effect of changes in assumptions underlying the present value of the schemes' liabilities | | | |
| – Amount | **0.3** | (0.5) | (1.7) |
| – Percentage of the present value of the schemes' liabilities | **2.3%** | 3.9% | 10.1% |
| **Total amount recognised in the Group statement of total recognised gains and losses (STRGL)** | | | |
| – Actuarial gain/(loss) | **0.2** | (1.9) | (5.2) |
| – Percentage of the present value of the schemes' liabilities | **1.2%** | 14.4% | 30.5% |

Actual return less expected return on pension scheme assets is the actual return on the assets less the expected return with allowance for contributions paid into and benefits paid out of the scheme during the year.

Experience gains and losses on the scheme liabilities are the difference between actuarial assumptions underlying the scheme liabilities and actual experience during the year.

Changes in assumptions underlying the scheme liabilities reflects the changes made to the actuarial assumptions since the last accounting date.

## 6 Net finance costs

| | 2005 £000 | 2004 £000 |
|---|---|---|
| Interest payable | | |
| – 10% 2018 First Mortgage Debenture Stock | **9,031** | 10,000 |
| – 6.5% Secured Bond 2026 | **11,375** | 11,375 |
| – Other mortgages and bank loans | **4,574** | 4,244 |
| – Amortisation of issue costs and discounts on issue of mortgages and bonds | **210** | 194 |
| – Bank loans and bank overdrafts | **812** | 597 |
| | **26,002** | 26,410 |
| Interest receivable | **(2,213)** | (2,540) |
| Exchange losses on dollar deposits | **182** | 1,099 |
| Mortgage breakage costs | **895** | 1,164 |
| | **24,866** | 26,133 |
| **Exceptional finance costs** | | |
| Costs of repurchase of 10% 2018 First Mortgage Debenture Stock | **48,213** | – |
| | **73,079** | 26,133 |

The exceptional finance costs relate to the repurchase of £100 million nominal value 2018 10% First Mortgage Debenture Stock, of which £8 million was repurchased in the market in June and October 2004 and the balance of £92 million was repurchased under the provisions of the amended Trust Deed following the Bondholders' EGM in February 2005.

## 7 Tax on (loss)/profit on ordinary activities

### Analysis of (credit)/charge for year

| | 2005 £000 | 2005 £000 | 2004 £000 | 2004 £000 |
|---|---|---|---|---|
| UK corporation tax | | | | |
| – charge on profit for the year before exceptional finance costs | | **4,457** | | 2,754 |
| – credit on exceptional finance costs – utilised in year | | **(3,103)** | | – |
| UK taxation on disposal of investment properties | | **2** | | 10 |
| Adjustments relating to prior years | | **(416)** | | (820) |
| | | **940** | | 1,944 |
| US taxation on disposal of venture capital investments | | **1,521** | | 454 |
| Other US taxation | | **–** | | 56 |
| Total current tax | | **2,461** | | 2,454 |
| Deferred tax | | | | |
| Origination and reversal of capital allowances and other timing differences | | **1,475** | | 664 |
| Deferred tax asset on exceptional finance costs to be utilised in future years | | **(11,361)** | | – |
| Release of deferred tax on sale of properties | | – | | (105) |
| Adjustments relating to prior years | | **325** | | 896 |
| Total deferred tax (credit)/charge | | **(9,561)** | | 1,455 |
| Tax charge before exceptional finance costs | **7,364** | | 3,909 | |
| Tax credit on exceptional finance costs | **(14,464)** | | – | |
| Total tax (credit)/charge for the year | | **(7,100)** | | 3,909 |

### Factors affecting the tax charge for the year

| | 2005 £000 | 2004 £000 |
|---|---|---|
| (Loss)/profit on ordinary activities before taxation | **(12,929)** | 17,219 |
| (Loss)/profit on ordinary activities before taxation and exceptional finance costs multiplied by the standard UK rate of corporation tax at 30% | **(3,879)** | 5,166 |
| Deferred tax asset on exceptional finance costs to be utilised in future years | **11,361** | – |
| Investment provisions, not available for tax relief | **372** | 676 |
| Investment property historical profits in excess of accounting profits | **872** | 1,879 |
| Capital profits sheltered by losses | **(3,816)** | (2,757) |
| US taxation on Weatherford share sales charged in 2003 | **(952)** | – |
| Capital allowances on investment properties | **(942)** | (952) |
| Adjustments to tax charge in respect of prior years | **(416)** | (820) |
| Other items | **(139)** | (738) |
| Current tax charge for the year before taxation on exceptional finance costs | **2,461** | 2,454 |

## 8 Earnings/(loss) per Ordinary share and Shareholders' funds per share

The monetary amounts and numbers of shares underlying the 'per share' performance calculations are summarised in the table below. The calculations are set out in notes (a) to (d).

| | 2005 Basic | 2005 Diluted | 2004 Basic | 2004 Diluted |
|---|---|---|---|---|
| **Earnings per share** | | | | |
| Weighted average shares in issue (See (a) below) | **302.7m** | **329.2m** | 243.6m | 327.6m |
| Earnings (See (c) below) | | | | |
| – Before investment profits/(losses) | **3.64p** | **3.35p** | 4.18p | 3.11p |
| – Investment profits/(losses) | **3.90p** | **3.58p** | 0.67p | 0.50p |
| | **7.54p** | **6.93p** | 4.85p | 3.61p |
| – Exceptional finance costs loss | **(11.15p)** | **(10.25p)** | – | – |
| – Total | **(3.61p)** | **(3.32p)** | 4.85p | 3.61p |
| **Shareholders' funds per share** | | | | |
| Shares in issue at 31st March (See (b) below) | **328.9m** | **334.3m** | 327.6m | 334.5m |
| Shareholders' funds (See (d) below) | | | | |
| – Balance sheet | **223p** | **222p** | 217p | 212p |
| – Adjusted | **238p** | **237p** | 229p | 224p |

### (a) Calculation of basic and diluted weighted average shares in issue

| | 2005 '000 | 2004 '000 |
|---|---|---|
| **Basic** | | |
| Weighted average Ordinary shares in issue | **302,747** | 243,637 |
| Weighted average Deferred Ordinary shares in issue | **25,777** | 83,938 |
| Adjustment in respect of shares issuable under share option schemes | **931** | 12 |
| Adjustment in respect of shares held as trustees by LMS QUEST Trustee Limited on which no dividends are payable | **(270)** | (12) |
| **Diluted** | | |
| Weighted average number of shares in issue | **329,185** | 327,575 |

### (b) Calculation of basic and diluted shares in issue at 31st March

| | 2005 '000 | 2004 '000 |
|---|---|---|
| **Basic** | | |
| Shares in issue at 31st March | **328,933** | 327,584 |
| Adjustment in respect of shares under option | **5,625** | 7,282 |
| Adjustment in respect of shares held by trustees by LMS Quest | **(270)** | (320) |
| **Diluted** | | |
| Shares in issue | **334,288** | 334,546 |

### (c) Calculation of earnings per share before and after investment activity

| | 2005 '000 | 2004 '000 |
|---|---|---|
| Investment profits and losses | | |
| Income profits, losses and write downs on fixed asset investments and investment properties | **17,294** | 2,800 |
| Debt breakage costs | **(275)** | (1,164) |
| Taxation attributable to above | **(1,441)** | 33 |
| Minority interests | **(3,785)** | (37) |
| Total investment profits and losses | **11,793** | 1,632 |
| Total other profits and losses (excluding exceptional finance costs) | **11,031** | 10,177 |
| | **22,824** | 11,809 |
| Exceptional finance costs | **(33,749)** | – |
| (Loss)/profit for the year | **(10,925)** | 11,809 |

## 8 Earnings/(loss) per Ordinary share and Shareholders' funds per share continued

### (d) Shareholders' funds and adjusted Shareholders' funds per share

| | 2005 £000 | 2004 £000 |
|---|---|---|
| Shareholders' funds per balance sheet | **732,086** | 709,961 |
| Deferred tax from capital allowances on investment properties | **9,018** | 8,062 |
| Group share of excess of market value over book value of investments | **10,920** | 8,289 |
| Group share of revaluation surplus on trading properties net of tax on planned disposals | **31,461** | 23,832 |
| Adjusted Shareholders' funds | **783,485** | 750,144 |

## 9 Investment properties

| | Group Freehold £000 | Group Leasehold unexpired term over 50 years £000 | Group Leasehold unexpired term of 50 years or less £000 | Group Total £000 | Company Freehold £000 |
|---|---|---|---|---|---|
| At 31st March 2004 | 770,224 | 81,310 | 2,080 | 853,614 | 23,875 |
| Amount included in prepayments under UITF 28 | 2,626 | – | – | 2,626 | – |
| Open market value at 31st March 2004 | 772,850 | 81,310 | 2,080 | 856,240 | 23,875 |
| Exchange difference | (946) | – | – | (946) | – |
| Transfers | (5,300) | 3,300 | 2,000 | – | – |
| Additions at cost | 23,581 | 204 | – | 23,785 | – |
| Disposals | (9,852) | – | – | (9,852) | (23,500) |
| Surplus on revaluation | 51,045 | 7,442 | 430 | 58,917 | – |
| Open market value at 31st March 2005 | **831,378** | **92,256** | **4,510** | **928,144** | **375** |
| Amount included in prepayments under UITF 28 | (4,180) | – | – | (4,180) | – |
| At 31st March 2005 | **827,198** | **92,256** | **4,510** | **923,964** | **375** |

The historical cost of Group investment properties at 31st March 2005 was £370.3 million (2004 – £354.4 million). The historical cost of the Company's investment properties at 31st March 2005 was £0.04 million (2004 – £3.7 million).

Included in Group freehold above are properties with a value of £36.5 million located in the US (2004 – £34.5 million).

All investment properties have been valued at 31st March 2005 on the basis of 'Open Market Value' in accordance with the Approved Valuation Manual of the Royal Institution of Chartered Surveyors.

96.1% by value of the properties have been valued by Cluttons, Chartered Surveyors. The remaining 3.9% located in the US, have been valued by C H Elliott & Associates, San Francisco. The Group's joint venture property asset, Swinton Shopping Centre, which is not included in the table above, has been valued by Colliers CRE.

## 10 Other tangible assets

| | Group £000 |
|---|---|
| Cost at 31st March 2004 | 1,762 |
| Depreciation at 31st March 2004 | (1,153) |
| Net book value at 31st March 2004 | 609 |
| Additions at cost | 1,563 |
| Disposals at net book value | (26) |
| Depreciation charge for the year | (378) |
| Total movements in the year | 1,159 |
| Cost at 31st March 2005 | **3,259** |
| Depreciation at 31st March 2005 | **(1,491)** |
| Net book value at 31st March 2005 | **1,768** |

Other tangible assets comprise computers, office equipment, furniture, fixtures and fittings and office improvements.

## 11 Investments – consolidated subsidiary undertakings

| | Company £000 |
|---|---|
| At 31st March 2004 at valuation | 297,601 |
| Additions at cost | 506 |
| Surplus on revaluation | 88,959 |
| At 31st March 2005 at valuation | **387,066** |

**Principal consolidated subsidiary undertakings**

**Property investment companies – 100% owned by Group**

340 Pine Street, Inc – USA*
Urbanfirst Limited
British Commercial Property Investment Trust Limited
Caledonian Property Investments Limited*
Central London Commercial Estates Limited*
Greenwich Reach 2000 Limited
Kensington Commercial Property Investments Limited*
LMS Leisure Investments Limited
LMS Properties Limited
LMS Shops Limited*
LMS Offices Limited
LMS Retail and Leisure Limited
Palaville Limited*
Rainram Investments Limited
St. James' Real Estate Company Limited*
The New River Company Limited*
West London & Suburban Property Investments Limited

**Property investment companies – 55% owned by Group**

Portman Investments (Baker Street) Limited*
Portman Investments (Farnham) Limited*

**Property trading companies – 90% owned by Group**

City Shops Limited*

**Property trading companies – 100% owned by Group**

Caledonian Properties Limited*
Corinium Estates Limited*
LMS Residential Limited
LMS (Winchester Road) Limited

**Investment Division companies – 100% owned by Group**

LMS Capital Limited
LMS Capital (Bermuda) Limited – Bermuda*
LMS Tiger Investments Limited*
Lion Investments Limited*
Westpool Investment Trust plc

**Investment Division companies – 58.8% owned by Group**

Inflexion plc*
Inflexion Managers Limited*
Inflexion Partners Limited*
Inflexion General Partner Limited*

**Other subsidiary companies – 100% owned by Group**

LMS Industrial Finance Limited
LMS Industrial Finance II Limited
London Merchant Securities, Inc. – USA*
LMS Services Limited

*Indicates subsidiary undertakings held indirectly.

Only the details of subsidiary undertakings principally affecting the profit and loss or the amount of assets of the Group are given. A full list of Group companies will be included in the Company's annual return. All subsidiaries have an accounting year ended 31st March and, unless stated otherwise, are all incorporated in the United Kingdom. Holdings are of Ordinary shares with the exception of £6.3 million of Preference shares in Urbanfirst Limited.

## 12 Investments – Investment Division

| | Fund investments £000 | Listed investments £000 | Unlisted investments £000 | Inflexion investments £000 | Total £000 |
|---|---|---|---|---|---|
| **Group** | | | | | |
| At 31st March 2004 | 38,411 | 27,372 | 110,465 | 15,637 | 191,885 |
| Additions at cost | 23,738 | 8,501 | 32,976 | 7,735 | 72,950 |
| Reclassification | (289) | 1,758 | (1,469) | – | – |
| Amounts (written down)/written back | 707 | (2,312) | (2,108) | 2,774 | (939) |
| Disposals | (17,430) | (12,266) | (8,413) | (5,170) | (43,279) |
| At 31st March 2005 | **45,137** | **23,053** | **131,451** | **20,976** | **220,617** |

The fund investment, listed investment and unlisted investment categories shown above comprise the portfolio of investments managed by the Group's wholly owned Investment Division. The Inflexion investments are owned and managed by Inflexion plc, the Group's 58.8% owned subsidiary. The Inflexion investments comprise:

| | £000 |
|---|---|
| Listed investments | **11,043** |
| Inflexion plc's interest in its managed funds | **4,994** |
| Unlisted co-investment | **4,939** |
| | **20,976** |

As is common practice in the venture and development capital industry, the investments are structured using a variety of instruments including Ordinary shares, Preference and other shares carrying special rights, options and warrants and debt instruments with and without conversion rights. The investments are held for resale with a view to the realisation of capital gains. Generally, the investments do not pay significant income.

A list of the principal capital investments is included on pages 20 and 21.

FRS 13 requires disclosure of the fair value of the Group's investments. In the case of listed investments this is disclosed based on the quoted market value at the balance sheet date. In respect of investment in funds, fair value is based on external managers' valuations. In respect of unlisted investments against which write downs have been made, the written down value is considered to be the same as fair value.

In respect of all other unlisted investments the determination of fair value in excess of cost is highly judgemental. Unless there is an imminent transaction which indicates a fair value materially in excess of cost, the fair value of these investments is taken as cost. The fair value disclosures are shown below.

| | Fund investments £000 | Listed investments £000 | Unlisted investments £000 | Inflexion investments £000 | Total £000 |
|---|---|---|---|---|---|
| Fair values per FRS 13 | | | | | |
| At 31st March 2005 | **46,331** | **30,135** | **131,451** | **24,923** | **232,840** |
| At 31st March 2004 | 41,623 | 31,546 | 110,465 | 16,965 | 200,599 |

At 31st March 2004 £76.4 million of the Group's investment related to nine subsidiary undertakings which were not consolidated. During the financial year to 31st March 2005, one of these was sold and a further four underwent restructuring and are no longer subsidiaries. At 31st March 2005 four of the Group's investments, with a book amount of £36.8 million, were subsidiaries which were not consolidated. Information on these investments is given below. The percentage holding assumes the exercise of all conversion and dilution rights that are entitled to be exercised at 31st March 2005.

## 12 Investments – Investment Division continued

It is not practicable to state the impact of the non-consolidation of the subsidiaries on the Group's accounts due to the number of individual transactions over which many of the holdings were acquired and the need to determine asset values, including goodwill, retrospectively at each stage.

| Investment | Activity | Percentage holding % | Most recent audited accounts | Most recent audited net assets £000 | Most recent audited net profit/(loss) £000 |
|---|---|---|---|---|---|
| Energy Cranes International Limited | Crane manufacture and crane-related services to the offshore energy industry | **95** | 31.12.04 | 18,804 | 453 |
| Offshore Tool and Energy Corporation ('ITS') | Specialist engineering design and fabrication for the energy industry | **93** | 31.12.02 | 798 | (4,838) |
| Entuity Limited | Network management software | **68** | 31.12.03 | (18) | (1,969) |
| AssetHouse Technology Limited | Content services infrastructure software | **76** | 31.05.04 | 347 | (1,100) |

## 13 Trading properties

| | Group 2005 £000 | Group 2004 £000 |
|---|---|---|
| Trading properties | **13,550** | 12,475 |

As at 31st March 2005 the trading properties have been valued by Cluttons (39%), CKD Galbraith (42%), and Montagu Evans (19%) at £47.7 million (2004 – directors' valuation £38.7 million). The valuations were performed on the basis of 'Open Market Value' in accordance with the Approved Valuation Manual of the Royal Institute of Chartered Surveyors.

## 14 Debtors

| | Group 2005 £000 | Group 2004 £000 | Company 2005 £000 | Company 2004 £000 |
|---|---|---|---|---|
| Rents and service charges receivable | **4,088** | 4,053 | **211** | 43 |
| Amounts owed by subsidiary undertakings | **–** | – | **664,997** | 669,710 |
| Other debtors | **6,117** | 6,219 | **369** | 90 |
| Pension prepayment | **1,424** | 756 | **–** | – |
| Other prepayments and accrued income | **5,904** | 5,614 | **26** | 28 |
| Corporation tax | **1,299** | 780 | **1,662** | 1,990 |
| Deferred tax asset | **11,361** | 283 | **7,286** | – |
| | **30,193** | 17,705 | **674,551** | 671,861 |

The deferred tax asset is anticipated to be recovered over approximately two to three years. All other Group and Company debtors fall due within one year.

## 15 Cash and short-term deposits

| | Group 2005 £000 | Group 2004 £000 | Company 2005 £000 | Company 2004 £000 |
|---|---|---|---|---|
| Short-term deposits | **32,872** | 40,260 | **–** | – |
| Bank and cash balances | **4,476** | 17,215 | **–** | 248 |
| | **37,348** | 57,475 | **–** | 248 |

Group cash and short-term deposits include £19.9 million (2004 – £14.6 million) held by Inflexion plc.

## 16 Creditors: amounts falling due within one year

| | Group 2005 £000 | Group 2004 £000 | Company 2005 £000 | Company 2004 £000 |
|---|---|---|---|---|
| Bank overdrafts | **164** | 118 | **93** | – |
| Bank loans | **4,625** | 4,956 | **–** | – |
| Rents received in advance | **11,929** | 11,533 | **322** | 309 |
| Amounts owed to subsidiary undertakings | **–** | – | **4,519** | 3,964 |
| Other taxes and social security | **930** | 1,167 | **77** | 75 |
| Dividends payable | **14,838** | 10,741 | **14,838** | 10,741 |
| Other creditors | **6,480** | 5,169 | **1,660** | 3,035 |
| Accruals | **6,500** | 9,605 | **1,845** | 1,685 |
| | **45,466** | 43,289 | **23,354** | 19,809 |

Bank loans are secured on investment properties.

## 17 Creditors: amounts falling due after more than one year

| | Group 2005 £000 | Group 2004 £000 | Company 2005 £000 | Company 2004 £000 |
|---|---|---|---|---|
| 6.5% Secured Bond 2026 | **173,066** | 172,974 | **173,066** | 172,974 |
| 10% First Mortgage Debenture Stock 2018 | **–** | 97,104 | **–** | 97,104 |
| £140 million Revolving Bank Loan 2012 | **139,063** | – | **139,063** | – |
| £60 million Revolving Bank Loan 2009 | **30,641** | – | **–** | – |
| 9.695% Mortgage 2018 | **20,000** | 20,000 | **–** | – |
| 7.135% Mortgage 2010-2015 | **9,576** | 10,450 | **–** | – |
| 6.675% Mortgage 2010-2015 | **3,955** | 5,170 | **–** | – |
| 6.68% Mortgage 2010-2015 | **3,699** | 3,754 | **–** | – |
| 7.22% Mortgage 2010-2015 | **–** | 3,671 | **–** | – |
| 6.7% Mortgage 2014 | **2,351** | 2,384 | **–** | – |
| 8.25% Mortgage 2020 | **–** | 2,320 | **–** | – |
| Floating rate Mortgage 2017 | **2,000** | 2,000 | **–** | – |
| 6.57% Mortgage 2010-2015 | **1,885** | 1,885 | **–** | – |
| Unsecured loans | **1,547** | 1,547 | **–** | – |
| | **387,783** | 323,259 | **312,129** | 270,078 |
| Other creditors | **577** | 637 | **–** | – |
| | **388,360** | 323,896 | **312,129** | 270,078 |

During the year the Group has repurchased the whole of the £100 million nominal value of its 10% 2018 First Mortgage Debenture Stock.

The Group has established two new bank loans:

- £140 million bank loan available on a revolving basis for a seven year term expiring 14th March 2012. The loan is secured on a portfolio of the Group's investment properties and by a guarantee from the Company. This loan was used to finance the repurchase of the debenture stock, and was fully drawn at 31st March 2005.
- £60 million bank loan available on a revolving basis for a five year term expiring 21st July 2009. The loan is secured on a portfolio of the Group's investment properties. This loan was used for general corporate purposes. At 31st March 2005 £29 million was available but undrawn on the loan.

The Secured Bond of £175 million is secured on all the assets of the Company and nine of its property owning subsidiaries.

## 17 Creditors: amounts falling due after more than one year continued

The maturity profile of the Group's borrowing is shown below.

| | Group 2005 £000 | Group 2004 £000 | Company 2005 £000 | Company 2004 £000 |
|---|---|---|---|---|
| **Borrowings** | | | | |
| Repayable after more than five years | **357,142** | 323,259 | **312,129** | 270,078 |
| Repayable within four to five years | **30,641** | – | **–** | – |
| Repayable within one year (note 16) | **4,789** | 5,074 | **93** | – |
| | **392,572** | 328,333 | **312,222** | 270,078 |

**Unamortised discount and issue costs**

Unamortised discount and issue costs at 31st March 2005 amounted to £3.3 million (2004 – £5.0 million). £2.9 million of unamortised discount in relation to the 10% 2018 First Mortgage Debenture Stock was written off in the year as part of the exceptional cost of repurchasing the debt. The balance at 31st March 2005 relates to:

– £175 million Bonds 2026 (£1.9 million)

– £140 million bank loan 2012 (£0.9 million)

– £60 million bank loan 2009 (£0.4 million)

– Other (£0.1 million)

**Interest rates**

The Group's Bonds and mortgages, with the exception of the £2 million mortgage maturing 2017, are fixed rate.

The five year and seven year revolving bank loans are floating rate loans. The Group has put in place interest hedging arrangements in respect of a proportion of its seven year rate exposure.

The initial drawdown of the seven year bank loan was made on 14th March 2005, for an initial three month interest period at a rate including margin of 5.6013% to 14th June 2005. The hedging arrangements are effective 14th June 2005 and are in place until 14th March 2012. The arrangements comprise interest rate swaps in respect of £112 million of principal and the purchase of £56 million of interest rate floors at a LIBOR rate of 4.5%. The combined cost of the swaps and floors in respect of the hedged portion of the debt, including margin, is a weighted average of 5.77%. £56 million of the interest rate swaps were in place prior to the year end.

The interest rate profile of the Group's financial liabilities (grossed up for unamortised discount and issue costs) is:

| | £m | Interest rate 2005 | £m | Interest rate 2004 |
|---|---|---|---|---|
| **Year end position:** | | | | |
| Fixed rate | **218.1** | **6.69%** | 326.3 | 7.80% |
| Floating rate | **177.8** | **5.78%** | 7.0 | 6.83% |
| | **395.9** | **6.28%** | 333.3 | 7.80% |
| **Following completion of hedging:** | | | | |
| Fixed rate | **330.1** | **6.38%** | 326.3 | 7.80% |
| Floating rate | **65.8** | **5.87%** | 7.0 | 6.83% |
| | **395.9** | **6.30%** | 333.3 | 7.80% |

The weighted average cost of borrowings taking account of the hedging arrangements is 6.3%.

## 18 Provisions for liabilities and charges

| | Group 2005 £000 | Group 2004 £000 | Company 2005 £000 | Company 2004 £000 |
|---|---|---|---|---|
| Provision for deferred taxation on accelerated capital allowances and other timing differences | | | | |
| At 31st March 2004 | **8,213** | 6,622 | **55** | 54 |
| Release of prior year deferred tax asset | **(283)** | – | **–** | – |
| Provision during the year | **1,800** | 1,591 | **1** | 1 |
| At 31st March 2005 | **9,730** | 8,213 | **56** | 55 |

The Group's share of the unprovided amount of tax on capital gains which would become payable if the investment properties were sold at the values at which they are included in the accounts is £47.5 million (2004 – £41.0 million). The deferred taxation relating to capital allowances which would be released in such circumstances, assuming that no balancing charge would be incurred, is £9.0 million (2004 – £8.0 million).

The Group has capital losses available to offset future capital profits based on realisations in prior periods. In addition, were the Group to dispose of its investment portfolio at book value it would realise further capital losses. This has not been reflected in the balance sheet.

## 19 Financial instruments

FRS 13 disclosures relating to the Group's long-term financial assets and liabilities

| | £ sterling 2005 £m | US dollars 2005 £m | Total 2005 £m | £ sterling 2004 £m | US dollars 2004 £m | Total 2004 £m |
|---|---|---|---|---|---|---|
| **Investment Division investments (note 12)** | | | | | | |
| At FRS 13 fair value | **153.0** | **79.8** | **232.8** | 122.6 | 78.0 | 200.6 |
| At cost less amounts written off | **(149.0)** | **(71.6)** | **(220.6)** | (121.2) | (70.7) | (191.9) |
| Surplus | **4.0** | **8.2** | **12.2** | 1.4 | 7.3 | 8.7 |
| Less: taxation | **–** | **(0.4)** | **(0.4)** | – | (0.4) | (0.4) |
| | **4.0** | **7.8** | **11.8** | 1.4 | 6.9 | 8.3 |
| **Short-term borrowings** | | | | | | |
| Denomination of short-term borrowings | **4.8** | **–** | **4.8** | 5.1 | – | 5.1 |
| **Long-term borrowings** | | | | | | |
| Denomination of long-term borrowings | **387.8** | **–** | **387.8** | 321.0 | 2.3 | 323.3 |
| **Total borrowings** | **392.6** | **–** | **392.6** | 326.1 | 2.3 | 328.4 |
| Weighted average interest rate of financial liabilities | **6.3%** | **–** | **6.3%** | 7.8% | 8.3% | 7.8% |
| Weighted average period for which interest rates on the financial liabilities are fixed | **13.1 years** | **–** | **13.1 years** | 17.7 years | 16.3 years | 17.6 years |

The Group has not included short-term debtors and creditors on the disclosures relating to FRS 13, with the exception of short-term borrowings. Cash deposits held by the Group are denominated £34.0 million sterling, £3.1 million US dollars, £0.2 million euros and are predominantly held on short-term floating rate deposit accounts with a range of banks.

## 19 Financial instruments continued

### Mark to market of long-term borrowing adjustment

| | Book value 2005 £m | Fair value 2005 £m | Excess over book value 2005 £m | Book value 2004 £m | Fair value 2004 £m | Excess over book value 2004 £m |
|---|---|---|---|---|---|---|
| 6.5% Secured Bond 2026 | **173.1** | **193.1** | **20.0** | 173.0 | 189.9 | 16.9 |
| 10% First Mortgage Debenture Stock 2018 | **–** | **–** | **–** | 97.1 | 136.6 | 39.5 |
| £140 million Revolving Bank Loan 2012 | **139.1** | **139.1** | **–** | – | – | – |
| £60 million Revolving Bank Loan 2009 | **30.6** | **30.6** | **–** | – | – | – |
| 9.695% Mortgage 2018 | **20.0** | **30.0** | **10.0** | 20.0 | 30.3 | 10.3 |
| 7.135% Mortgage 2010-2015 | **9.6** | **10.0** | **0.4** | 10.5 | 11.2 | 0.7 |
| 6.675% Mortgage 2010-2015 | **3.9** | **4.1** | **0.2** | 5.2 | 5.4 | 0.2 |
| 6.68% Mortgage 2010-2015 | **3.7** | **3.9** | **0.2** | 3.7 | 4.0 | 0.3 |
| 7.22% Mortgage 2010-2015 | **–** | **–** | **–** | 3.7 | 4.0 | 0.3 |
| 6.7% Mortgage 2014 | **2.4** | **2.5** | **0.1** | 2.4 | 2.4 | – |
| 8.25% Mortgage 2020 | **–** | **–** | **–** | 2.3 | 3.1 | 0.8 |
| Floating rate Mortgage 2017 | **2.0** | **2.0** | **–** | 2.0 | 2.0 | – |
| 6.57% Mortgage 2010-2015 | **1.9** | **1.9** | **–** | 1.9 | 2.0 | 0.1 |
| Unsecured loans | **1.5** | **1.5** | **–** | 1.5 | 1.5 | – |
| | **387.8** | **418.7** | **30.9** | 323.3 | 392.4 | 69.1 |
| Less: taxation | | | **(9.3)** | | | (20.8) |
| Less: minority share | | | **(3.2)** | | | (3.3) |
| Group share of fair value adjustment (net of taxation) | | | **18.4** | | | 45.0 |

Fair values of the liabilities have been calculated at the year end by taking market value, where available, or estimated early repayment costs for mortgages. However, the Group is under no obligation to redeem borrowings until maturity at which time they are repayable at their nominal value.

## 20 Called up share capital

| | Authorised 27$\frac{18}{41}$p Ordinary | Authorised 27$\frac{18}{41}$p Deferred Ordinary | Authorised 27$\frac{18}{41}$p Unclassified | Allotted, called up and fully paid 27$\frac{18}{41}$p Ordinary | Allotted, called up and fully paid 27$\frac{18}{41}$p Deferred Ordinary |
|---|---|---|---|---|---|
| **Number of shares** | | | | | |
| At 31st March 2004 | 272,850,398 | 83,984,203 | 7,609,843 | 243,636,971 | 83,947,574 |
| Issued during the year | – | – | – | 30,346 | 1,317,925 |
| Conversion | 85,302,128 | (83,984,203) | (1,317,925) | 85,265,499 | (85,265,499) |
| **Number of shares** | | | | | |
| At 31st March 2005 | **358,152,526** | **–** | **6,291,918** | **328,932,816** | **–** |
| **Nominal value** | | | | | |
| At 31st March 2005 | **£98,273,559** | **–** | **£1,726,441** | **£90,255,956** | **–** |
| | | | **£100,000,000** | | |

During the year 7,805 Ordinary shares were issued for consideration of 195.5p each; 19,125 Ordinary shares were issued for consideration of 189.5p each and 3,416 Ordinary shares were issued for consideration of 120.0p each under the LMS Executive Share Option Scheme. During the year 961,656 Deferred Ordinary shares were issued for consideration of 149.0p each and 356,269 Deferred Ordinary shares were issued for consideration of 114.5p each under the LMS Executive Share Option Scheme.

As provided for in the Company's Articles of Association, at the conclusion of the Annual General Meeting on 21st July 2004 the Deferred Ordinary shares converted into the same number of Ordinary shares. On conversion all options over Deferred Ordinary shares became options over Ordinary shares.

In accordance with the Rules of the LMS Executive Share Option Scheme on the conversion, adjustments were made to the exercise prices of options to re-price the options as if they had originally been granted over Ordinary shares.

Options to subscribe for shares under the Company's share option scheme are listed in the table below which shows both the adjusted price and the previous price. Performance conditions exist for options granted under the LMS Executive Share Option Scheme. These are explained in the remuneration report on pages 34 to 38.

## 20 Called up share capital continued

### Executive Share Option Scheme

| Number | Class | Previous exercise price | Adjusted exercise price | Date from which exercisable | Expiry date |
|---|---|---|---|---|---|
| 164,020 | Ordinary | 180½p | 195½p | 27th July 2003 | 27th July 2010 |
| 357,787 | Ordinary | 178½p | 189½p | 27th July 2003 | 27th July 2010 |
| 5,630 | Ordinary | 134p | 161½p | 5th January 2004 | 5th January 2011 |
| 1,263,562 | Ordinary | 149p | 174p | 5th January 2004 | 5th January 2011 |
| 377,112 | Ordinary | 96p | 104p | 1st April 2006 | 31st March 2013 |
| 1,617,431 | Ordinary | 135p | 137½p | 1st August 2006 | 28th August 2013 |
| 1,739,849 | Ordinary | – | 181p | 2nd September 2007 | 2nd September 2014 |

1,682,935 options granted in 2002 expired unexercised on 31st March 2005 due to performance conditions not being met.

### Savings-Related Share Options Scheme

| Number | Class | Exercise price | Date from which exercisable | Expiry date |
|---|---|---|---|---|
| 139,262 | Ordinary | 65¼p | 1st April 2005 | 30th September 2005 |
| 8,265 | Ordinary | 122½p | 1st September 2006 | 31st March 2007 |
| 70,401 | Ordinary | 104½p | 1st September 2006 | 31st March 2007 |
| 85,451 | Ordinary | 104½p | 1st September 2008 | 31st March 2009 |
| 19,299 | Ordinary | 130p | 1st February 2007 | 31st July 2007 |
| 56,077 | Ordinary | 130p | 1st February 2009 | 31st July 2009 |
| 28,386 | Ordinary | 130p | 1st February 2011 | 31st July 2011 |

In March 1998, the Company established a qualifying employee share ownership trust (QUEST) to acquire Ordinary and Deferred Ordinary shares of the Company for supply to employees exercising options under the LMS Savings-Related Share Option Scheme. The Trustee of the QUEST is LMS QUEST Trustee Limited, which is a wholly-owned subsidiary of the Company. All employees of the Company, including executive directors of the Company (except The Hon R A Rayne), are potential beneficiaries under the QUEST. At 31st March 2005, the QUEST held 270,689 Ordinary shares at a cost and valuation of £0.2 million.

## 21 Reserves

| | Share premium account £000 | Capital reduction account £000 | Revaluation reserve £000 | Profit and loss account £000 | Total £000 |
|---|---|---|---|---|---|
| **Group** | | | | | |
| At 31st March 2004 | 19,049 | 2,868 | 335,007 | 263,151 | 620,075 |
| Premium on issue of shares during the year | 1,526 | – | – | – | 1,526 |
| Surplus on revaluation of Investment properties – Group share | – | – | 52,359 | – | 52,359 |
| Realisation of revaluation surpluses of previous years | – | – | (2,907) | 2,907 | – |
| Exchange difference | – | – | 856 | (695) | 161 |
| Retained loss for the year | – | – | – | (32,291) | (32,291) |
| At 31st March 2005 | **20,575** | **2,868** | **385,315** | **233,072** | **641,830** |
| **Company** | | | | | |
| At 31st March 2004 | 19,049 | 2,868 | 155,615 | 436,225 | 613,757 |
| Premium on issue of shares during the year | 1,526 | – | – | – | 1,526 |
| Surplus on revaluation of: | | | | | |
| Investment properties | – | – | – | – | – |
| Subsidiary undertakings | – | – | 88,959 | – | 88,959 |
| Realisations of revaluation surpluses of previous years | – | – | (19,811) | 19,811 | – |
| Retained loss for the year | – | – | – | (68,045) | (68,045) |
| At 31st March 2005 | **20,575** | **2,868** | **224,763** | **387,991** | **636,197** |

The cumulative amount of goodwill written off in prior years is not material to the Group.

The Company's loss for the year amounted to £46.7 million (2004 – profit £99.0 million).

## 22 Notes to consolidated cash flow statement

### (1) Reconciliation of operating profit to net cash inflow from operating activities

| | 2005 £000 | 2004 £000 |
|---|---|---|
| Group operating profit | **42,693** | 39,845 |
| Share of operating profit of joint venture | **(119)** | – |
| | **42,574** | 39,845 |
| Depreciation | **378** | 152 |
| Other non-cash movements | **148** | (1) |
| Increase in stocks | **(1,075)** | (987) |
| (Increase)/decrease in debtors | **(1,746)** | 37 |
| Increase in creditors | **253** | 2,955 |
| Net cash inflow from operating activities | **40,532** | 42,001 |

### (2) Analysis of movement in net debt

| | 31st March 2004 £000 | Cash flow £000 | Other non-cash changes £000 | Exchange movements £000 | 31st March 2005 £000 |
|---|---|---|---|---|---|
| Bank and cash balances* | 17,215 | (12,818) | – | 79 | **4,476** |
| Bank overdrafts | (118) | (46) | – | – | **(164)** |
| | | (12,864) | | | |
| Debt due within one year | (4,956) | 331 | – | – | **(4,625)** |
| Debt due after more than one year | (323,259) | (61,685) | (2,903) | 64 | **(387,783)** |
| | | (61,354) | | | |
| Short-term deposits* | 40,260 | (7,071) | – | (317) | **32,872** |
| Net debt | (270,858) | (81,289) | (2,903) | (174) | **(355,224)** |

*Totalled on balance sheet as cash and short-term deposits.

### (3) Reconciliation of net cash flow to movement in net debt

| | 2005 £000 | 2004 £000 |
|---|---|---|
| Decrease in cash in the year | **(12,864)** | (260) |
| Cash (inflow)/outflow from (increase)/decrease in debt financing | **(61,354)** | 11,384 |
| Cash inflow from decrease in liquid resources | **(7,071)** | (18,598) |
| Change in net debt resulting from cash flows | **(81,289)** | (7,474) |
| Translation differences | **(174)** | (696) |
| Other non-cash changes | **(2,903)** | (194) |
| Movement in net debt in the year | **(84,366)** | (8,364) |
| Net debt at 31st March 2004 | **(270,858)** | (262,494) |
| Net debt at 31st March 2005 | **(355,224)** | (270,858) |

## 23 Capital commitments

| | Group 2005 £000 | Group 2004 £000 |
|---|---|---|
| Property division | **52,455** | 28,088 |
| Investment Division – commitments by LMS Capital | **31,427** | 38,148 |
| – commitments by Inflexion plc | **15,129** | 16,034 |
| Total | **99,011** | 82,270 |

Group companies have agreed to subscribe £15 million in total in cash for B Ordinary shares in Inflexion plc at a price per share equal to 90% of Inflexion's consolidated net asset value per issued Ordinary share at the time of subscription. The timing of these subscriptions will be at the investing company's option but not later than 30th September 2009, and only during the 30 day period following the publication of Inflexion plc's preliminary statement of results for each of the financial years up to and including the year ending 31st March 2009.

## 24 Contingent liabilities

Guarantees have been given in respect of warranties on the sale of certain subsidiaries and other liabilities in the ordinary course of business. The Company has no guarantees (2004 – nil) relating to the borrowings of subsidiaries.

# Environmental Statement

We, the Board and employees of London Merchant Securities plc understand that our various activities can have an impact on the natural environment, and on the people who live and work in the areas in which we operate. Impacts can arise from the development of land, from the operation of buildings which we own and from the activities of companies in which we invest.

We also understand that the way in which we conduct these activities can make a substantial difference to the extent of the environmental impact: sensitive building design and management can minimise ecological impacts, transport use, the use of energy, and of water; waste minimisation and recycling can be facilitated, and resource inputs minimised and controlled. Where we invest in other companies, by asking the right questions we can have an influence on the environmental performance of our investees.

We are aware that we are working within a society which is becoming increasingly concerned about environmental issues, and we wish to assure all those who have an interest in our environmental performance – our investors, industry regulators, local communities, and society at large – that we appreciate their views, and are committed to addressing these issues within our business operations.

In particular, having considered the scope and nature of our activities and, our current approach to environmental issues, we believe that there are certain key areas on which we should initially concentrate our efforts. Therefore, we are currently committed to the following:

- To continue to ensure that environmental issues are considered for property development projects.
- To consider environmental impact of property management procedures to identify opportunities to improve the environmental standards of building use.
- Periodically to revisit our risk assessment and management processes and our due diligence process for acquisitions, divestment and venture capital investment to ensure that due account is taken of environmental issues.
- To make associated organisations and tenants, where possible, aware of our environmental requirements and review external communication.
- Furthermore, we also commit to report our progress in these initiatives in due course, and to review the policy as appropriate.

# Health & Safety Statement

The Group's Health and Safety policy has been actively managed through the year not only with a view to minimising and controlling risks but also as a means of improving efficiencies. Staff involvement has been encouraged and various strategies for compliance with current legislation, which have been developed, are under constant review in order to achieve continuous improvement in Health & Safety performance. Regular Health and Safety reports are considered by the Executive Committee and the Board.

Our statement of general policy is:

- To provide adequate control of the health and safety risks arising from our work activities.
- To consult with our employees on matters affecting their health and safety.
- To provide and maintain safe plant and equipment.
- To ensure safe handling and use of substances.
- To provide information, instruction and supervision for employees.
- To ensure all employees are competent to do their tasks, and to give them adequate training.
- To prevent accidents and cases of work-related ill health.
- To maintain safe and healthy working conditions.
- To review and revise this policy as necessary at regular intervals.
- To ensure the safety of visitors to our buildings; and
- To undertake our responsibilities as landlords for communal areas under our control in buildings forming part of the Group's property portfolio.

# Five Year Summary

| | 2005 £000 | 2004 £000 | 2003 £000 | 2002 £000 | 2001 £000 |
|---|---|---|---|---|---|
| **Group balance sheet** | | | | | |
| Investment properties | **923,964** | 853,614 | 821,944 | 809,153 | 736,884 |
| Other tangible assets | **1,768** | 609 | 547 | 542 | 655 |
| Investments – joint ventures | **4,108** | – | – | – | – |
| Investments – Investment Division | **220,617** | 191,885 | 162,640 | 170,450 | 192,719 |
| Intangible assets – negative goodwill | **–** | (392) | – | – | – |
| Cash and short-term deposits | **37,348** | 57,475 | 77,833 | 107,532 | 190,015 |
| Other net liabilities | **(1,723)** | (13,109) | (10,092) | (20,374) | (26,512) |
| Long-term loans | **(388,360)** | (323,896) | (334,187) | (281,479) | (274,783) |
| Provision for liabilities and charges | **(9,730)** | (8,213) | (6,622) | (6,893) | (6,455) |
| Net assets | **787,992** | 757,973 | 712,063 | 778,931 | 812,523 |
| Equity minority interests | **(55,906)** | (48,012) | (33,132) | (58,305) | (58,830) |
| Equity Shareholders' funds | **732,086** | 709,961 | 678,931 | 720,626 | 753,693 |
| Represented by | | | | | |
| Called up share capital | **90,256** | 89,886 | 89,881 | 89,516 | 89,334 |
| Reserves | **641,830** | 620,075 | 589,050 | 631,110 | 664,359 |
| | **732,086** | 709,961 | 678,931 | 720,626 | 753,693 |
| **Group profit and loss account** | | | | | |
| Net rental income | **56,210** | 53,958 | 57,088 | 51,184 | 46,028 |
| Profit/(loss) before taxation and exceptional finance costs | **35,284** | 17,219 | (15,792) | (36,068) | 60,338 |
| Exceptional finance costs | **(48,213)** | – | – | – | – |
| Profit/(loss) before taxation | **(12,929)** | 17,219 | (15,792) | (36,068) | 60,338 |
| Profit/(loss) for the year excluding exceptional finance costs | **22,824** | 11,809 | (25,520) | (46,918) | 36,096 |
| Exceptional finance costs after taxation | **(33,749)** | – | – | – | – |
| Profit/(loss) for the year | **(10,925)** | 11,809 | (25,520) | (46,918) | 36,096 |
| Earnings/(loss) per Ordinary share | **(3.61p)** | 4.85p | (10.47p) | (19.26p) | 15.45p |
| Earnings/(loss) per Ordinary share excluding exceptional finance costs | **7.54p** | 4.85p | (10.47p) | (19.26p) | 15.45p |
| Dividends per Ordinary share | **6.5p** | 6.4p | 6.3p | 6.2p | 6.1p |
| Shareholders' funds per share | **223p** | 217p | 207p | 221p | 231p |
| Diluted Shareholders' funds per share | **222p** | 212p | 207p | 220p | 231p |

Note
1 The figures for the year ended 2001 are as restated to incorporate the implementation of FRS 19, which requires the Group to provide in full for deferred taxation.

| | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| **Return on equity** | | | | | |
| LMS overall | **6.1%** | 6.9% | (3.7%) | (2.4%) | 14.2% |
| LMS overall (excluding exceptional finance costs) | **10.9%** | 6.9% | (3.7%) | (2.4%) | 14.2% |
| Property* | **12.8%** | 9.4% | 3.9% | 6.7% | 16.0% |
| Investment Division* | **4.6%** | (1.2%) | (28.1%) | (34.4%) | 7.9% |
| Market price at 31st March | | | | | |
| Ordinary shares | **206p** | 171.75p | 99.5p | 157p | 158.5p |
| Deferred Ordinary shares | **–** | 166p | 89p | 140p | 129.5p |

*Excluding exceptional finance costs.

# Shareholder Information

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*No. 7064*

**Registrars and transfer office**

Capita Registrars Plc
The Registry, 34 Beckenham Road
Beckenham, Kent BR3 4TU
www.capitaregistrars.com
*Shareholder enquiries*
Telephone 0870 1623100
Email ssd@capitaregistrars.com

**Trustee for 6.5% Secured Bonds 2026**

The Law Debenture Trust
Corporation p.l.c.
London

**Low cost share dealing service**

A low cost execution only share dealing service is available through Cazenove for buying and selling the Company's shares.

**LMS Single Company ISA**

A Single Company ISA is available to Shareholders through Abbey National plc. An application form can be obtained from the Company at the Registered Office. If you have any other queries relating to the Single Company ISA please contact the Abbey National ISA Helpline on 0845 6000181.

## Financial Calendar

**Ex-dividend date**

1st June 2005

**Record date**

3rd June 2005

**Final date for receipt of DRIP forms**

30th June 2005

**AGM**

21st July 2005

**Final dividend payment date**

28th July 2005

**Interim results**

November 2005

## Glossary of Terms

**ERV:**
Estimated rental value.

**FRS:**
Financial Reporting Standard.

**Gross annual rate of rent:**
Contracted rent roll.

**HR:**
Human Resources.

**Interest cover:**
Net rental income divided by net interest expense.

**LIBOR:**
The London Interbank Offered Rate, is the rate of interest at which banks could borrow funds from other banks.

**Linux clusters:**
Linux operating system software used to combine independent computers into a unified system through software and networking.

**PIPE:**
Private Investment in Public Equity.

**Pre-let:**
A lease signed with a tenant prior to completion of a development.

**Realised IRR:**
Internal Rate of Return in respect of cash invested in venture capital investments and cash returned on exit within the period.

**STRGL:**
Statement of Total Realised Gains and Losses.

**Total property return:**
Net rental income, profit on sales and capital growth, adjusted for capital expenditure during the year, expressed as a percentage of the opening book value.

**Total return on equity:**
Closing Shareholders' funds plus equity dividends in respect of the year, divided by the opening Shareholders' funds.

**UITF:**
Urgent Issues Task Force.

**Wi-Fi hotzone:**
An area with Wireless Fidelity high frequency local area network.

**Zone A:**
A means of analysing the rental value of retail space by dividing it into zones parallel with the main frontage. The most valuable zone, Zone A, is at the front of the unit.

## Advisers

**Auditor**

KPMG Audit Plc, London

**Banker**

Barclays Bank plc

**Broker**

JP Morgan Cazenove

**Solicitors**

Clifford Chance
Berwin Leighton Paisner
CMS Cameron McKenna

**Valuers**

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CH Elliot Associates, San Francisco
CKD Galbraith
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