London Merchant Securities plc
Annual Report and Accounts 2003

Cover: The Rotunda, Kingston-upon-Thames

Highlights and Results 2002/03

+10.5%
Net rental income
£56.6m (2002 £51.2m)

9.5%
Total property return
(2002 9.9%)

+1.6%
Investment property values (like for like)
£823.1m (2002 £809.2m)

+14.6%
Operating profit
£41.5m (2002 £36.2m)

£11.0m
Net realised venture capital profit
(2002 £1.2m)

£50.0m
Venture capital write-downs
(2002 £57.7m)

–8.6%
Net assets
£712.1m (2002 £778.9m)

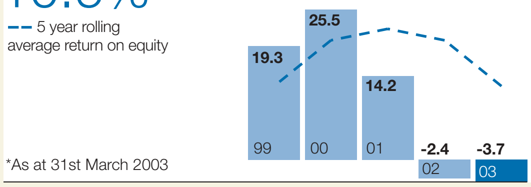
36.9%
Gearing
(2002 23.3%)

–6.1%
Shareholders' funds per share
207.3p (2002 220.8p)

LMS's objective is the long-term enhancement of shareholder value through dividends and capital appreciation. This is achieved through property development and investment and venture capital in the UK and US.

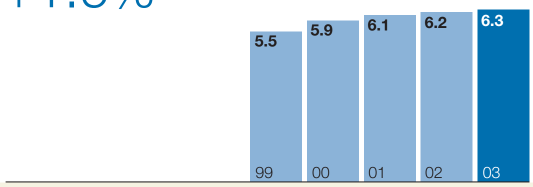
Return on equity %

10.6%*



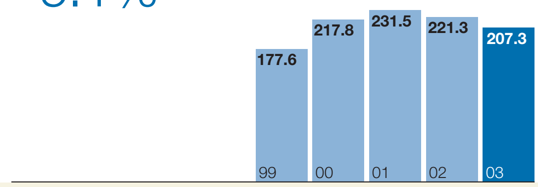
Dividend per share pence

+1.6%



Shareholders' funds per share pence

–6.1%



The Chairman's Statement

The Group remains committed to the strategy of delivering good long-term shareholder returns through dividends and capital appreciation. The Board is recommending an increase in dividend for the 28th year in succession.

The property portfolio has again performed well but set against this we have experienced a further year of difficult conditions in the venture capital market. In consequence, an increased operating profit at £41.5 million plus profits on disposal of property and venture capital investments of £17.5 million have been offset by £50.0 million of venture capital provisions.

The Group's net assets at the year end were £712.1 million, a decline of 8.6% year-on-year arising from the provisions in the investment division. The balance sheet remains strong with £77.8 million of cash and net debt of £262.5 million. Gearing is conservative at 36.9%.

Property

The year saw a strong performance from the property portfolio with net rental income of £56.6 million (2002 – £51.2 million), an increase of 10.5%. At the same time operating profit increased to £41.5 million (2002 – £36.2 million), up by 14.6%.

Total property return for the year was 9.5% (2002 – 9.9%) with a five year average of 15.6%.

The investment property assets increased in value to £823.1 million, up 1.6% on a like for like basis. This satisfactory performance reflects the careful diversification of risk over the last few years. The portfolio mix is now a blend of offices, largely in London, and retail and leisure property across prime UK towns.

Venture capital

The investment climate and the world's stock markets were again affected by depressed economies and considerable geopolitical uncertainty especially in the Middle East. The book value of the investments at the year end was £162.6 million (2002 – £170.4 million). The Group realised £11.0 million profit from its investment portfolio but considered it prudent to offset this with £50.0 million of provisions for the full year (2002 – £57.7 million). The investment portfolio, similar to the property division, reflects management's view of diversified risk. It comprises investments in both the US and the UK with a spread of early stage and second round technology investments, development capital and mature company buy-outs.

Share buybacks

The LMS Board has considered at length the arguments for buying in the Company's shares given the current large discount to net asset value. It has concluded that it should not pursue this course, for several reasons.

The Group is committed to the strategy of delivering long-term enhancement of shareholder returns through dividends and capital appreciation.

Firstly, buying in our shares would increase our gearing. This is lower than in many comparable property companies and in these uncertain times we believe that this is a real source of strength and flexibility. Secondly, on a related point, we believe there are some real opportunities for adding value within and around our core property holdings. We may be constrained in pursuing these if our financial strength and flexibility are significantly reduced. Thirdly, the Board has determined to maintain our present dividend policy. We believe this is valued by both institutional and individual shareholders. Finally, buying in shares would reduce the free float and increase illiquidity.

Dividend

The Board is recommending the payment of a 4.3p final dividend per Ordinary share, making a total of 6.3p for the year, compared to 6.2p in the previous year.

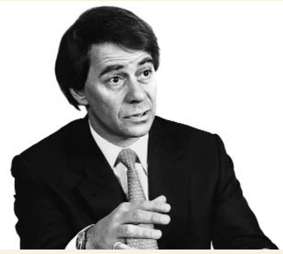
Board and management

At the corporate level we are delighted to welcome to the Board, Martin Pexton, previously with Allen & Overy, who was appointed Corporate Development Director, and Nick Friedlos, who has joined as Finance Director from Land Securities Trillium. We have also made a number of management appointments in the property and venture capital divisions during the year. We recognise that the quality of a company's management is a crucial factor in delivering performance for shareholders.

Outlook

Against the background of a year of high activity, with significant acquisitions and disposals, the Group's property portfolio is well positioned for further growth. In the venture capital division, the book values attributable to the current investment portfolio provide a conservative base for the generation of future profits. With the additions to management, the strong balance sheet and the underlying asset base, the Board remains committed to its strategy for delivering long-term enhancement of shareholder returns.

Graham Greene Chairman
10th June 2003



Chief Executive's Review

2002/03 was a year of significant change for the Group, including important transactions in both the property and venture capital divisions and some strong additions to the management team.

With some £850 million of investment and trading property and £162 million of venture capital assets the Group has £1,012 million of assets with net debt of £262.5 million. It is well positioned for future growth and to develop the assets within its property and investment portfolios.

Property

The Group's properties are predominantly in the West End of London, Islington and Clerkenwell and on the retail high streets of leading towns and cities in the UK. We have made the strategic decision to exit our direct property holdings in the US and this will be done when the market allows us to realise proper value for these properties.

During the year we acquired the minority shareholdings in Urbanfirst Limited and in the Kensington Commercial Properties (KCP) joint companies, together with the underlying freehold interest in KCP. Urbanfirst was formed in 1994 as a partnership with, and under the management of, Rod Pearson and Peter Smith. At 31st March 2003, after the purchase of the minority, the Group has produced a net IRR in excess of 16% over an 8.5 year period and added a valuable retail portfolio to our core holdings. Our joint venture with CGNU in KCP dates back to 1960 and has also been very successful; the addition of these freeholds has increased our total freehold ownership to 89% of property assets.

Property purchases include:
- the City Road properties, a group of income-producing properties which comprise a redevelopment opportunity in five to ten years. In the meantime these properties are let and producing a satisfactory return on capital;
- a 1,035 sq m office block adjacent to our core holdings in Fitzrovia with a residential block adjacent to it;
- a group of retail units in Peterborough;
- properties adjacent to our Southampton holdings;
- a further unit adjoining our Cardiff holdings;
- a leisure and retail development site in Brighton.

These provide good income and capital growth opportunities going forward.

Left to right
Robert Rayne
Nicholas Driver
Nicholas Friedlos
Martin Pexton

Sales were made where we felt full value had been achieved and future growth was limited; specifically retail units in Altrincham, Bournemouth, Chelmsford, Ealing, Leeds, Leicester, Northampton, Nottingham, Staines and Walsall. These sales realised some £69 million and generated a profit on cost of £17 million (25%). This pruning is a constant exercise throughout the portfolio, while the main thrust will be to maintain our current mix of offices, retail and leisure, whilst at the same time increasing in size the property assets owned by the Group.

Developments were completed in Kingston – 15,056 sq m of leisure/retail, now 91% let and trading very satisfactorily – and Whitfield Street – 3,363 sq m of offices which is now fully let. Properties in the course of development remain limited to those pre-let and comprise 18,952 sq m of offices in Fitzrovia and a 9,569 sq m extension at the Strathkelvin Retail Park in Scotland.

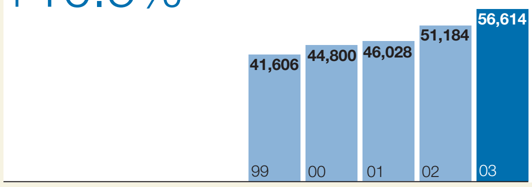
The Group is soundly financed to complete our immediate development programme and the balance sheet enables further expansion.

We remain robust in our strategy to secure good quality covenant tenants – our average lease length, based on income, remains in excess of 14 years (13.8 years taking into account breaks). The property assets remain well let and are currently reversionary, with significant development opportunities.

The asset management team in the property division has been reorganised into three geographical areas and a retail portfolio, with the addition of two new asset managers, Ian Mayhew from DTZ and Julian Diamond from Urbanfirst. We have also reorganised the management of our building team, including the appointment of John Turner from Capita as Head of Building Surveying and Alan Donnachie from SHL as Facilities Manager.

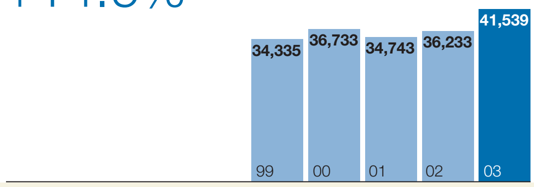
Net rental income £000

+10.5%



Operating profit £000

+14.6%



Chief Executive's Review

Investments

The investment division's long-term objectives remain to produce high rates of return and a flow of liquidity. Since the spectacular, if unrealistic, venture capital years of 1998-2000, during which time LMS generated some £300 million of liquidity, the markets have adjusted to more realistic levels and it has been prudent to make provisions against some of our portfolio companies.

In the past five years the Group has produced realised profits of £223.7 million, offset by realised losses of £34.6 million and write-downs of £132.9 million. In the medium term this division is self-funding and has grown from its net asset level of £11.7 million in 1980 to the year end book value of £162.6 million and a market value of £166.8 million.

The current year saw some small profitable realisations from the oil field service sector, producing profits of £8.2 million and gains from the technology sector producing £6.8 million of profit. Total profits on realisations of £15.9 million were offset by realised losses of £4.9 million, principally in the technology sector. In addition, provisions relating to potential permanent diminution in value and write-offs totalled £50.0 million.

We are pleased to have recruited Scott Potter to lead our US venture team. Scott, a lawyer, was previously CEO of Quiver, one of our venture companies, which was sold to Inktomi and produced a good return for the Group.

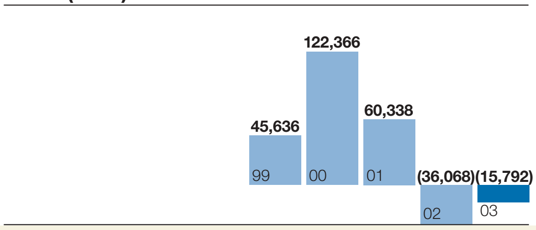
The environment remains difficult and uncertain and although most of the companies continue to grow sales, the lead times are long and the resultant cash burn periods indicate lower long-term returns. The venture capital investments are shown in the balance sheet at the lower of cost or written down value, properly reflecting today's environment. This division remains higher risk but should, we believe, continue to achieve high long-term returns.

Summary

Your management is realistic about the difficulties that face both property and investment companies in the current economic and geopolitical environment. We remain resolute that total returns to shareholders are best provided by the combination of predictable revenue and earnings from property, financed with matching long-term debt, and equity-funded high-growth investments.

Returns in each of our chosen sectors of property and venture capital are achieved through strategic risk diversification.

Profit/(Loss) before tax £000



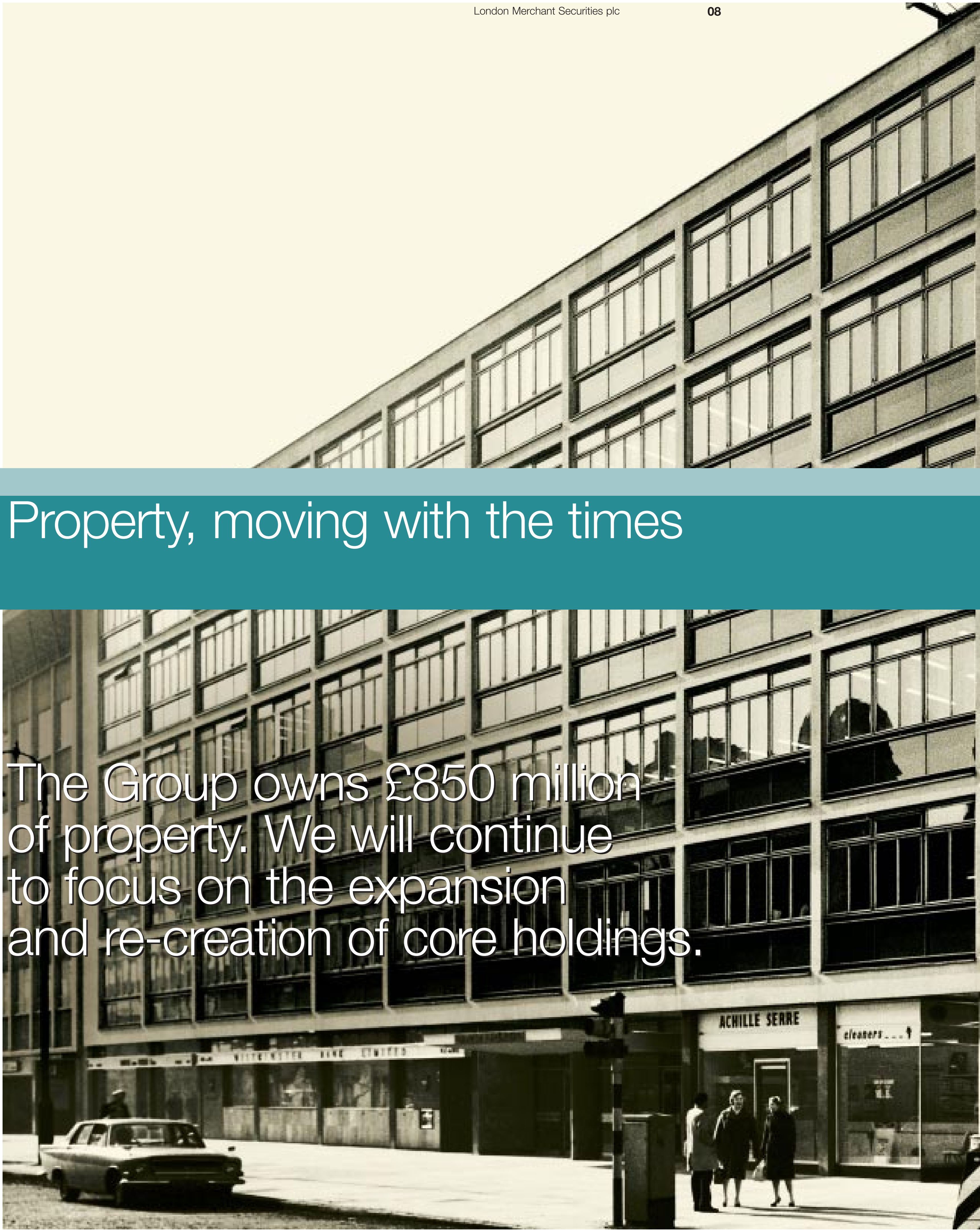
Our mix of office, retail and leisure properties reflects our view of appropriate property risk management. The balance of US/UK early stage and development stage investments in the venture capital division provides a similar risk management profile.

It is our view that the difficult times will persist for a further period and steps are being taken to balance the future development opportunities in the property portfolio with the expected liquidity from the venture capital division. Although this process is more of an art than a science, the inherent growth in the assets of both divisions augurs well for the future.

Robert Rayne Chief Executive
10th June 2003

Property, moving with the times

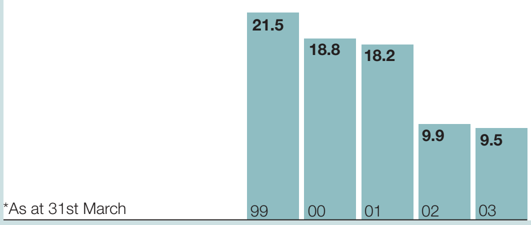
The Group owns £850 million of property. We will continue to focus on the expansion and re-creation of core holdings.



Left 105 Tottenham Court Road, soon after completion in 1960.

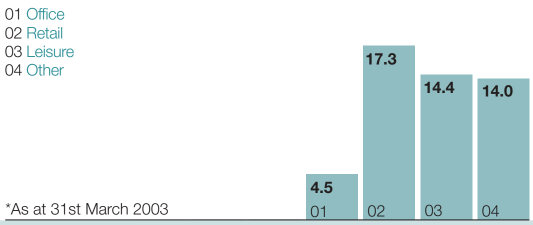
Right Proposed redevelopment of the same property.

Total property return %*



*As at 31st March

Total property return by use %*



*As at 31st March 2003

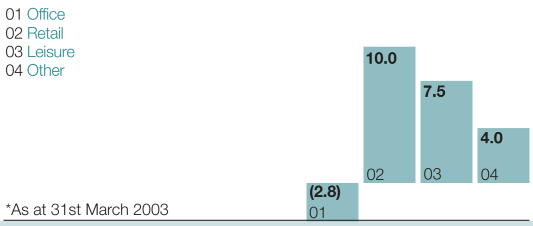
Total property return by location %*

*As at 31st March 2003

Operating Review: Property

Below
Map showing core holdings in key London areas.

Like for like change in value by use %*

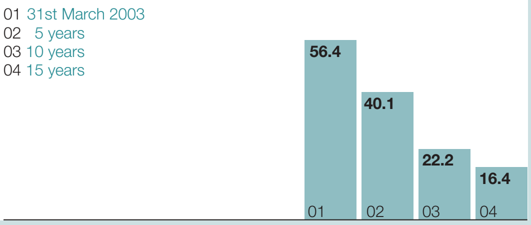


*As at 31st March 2003

Like for like change in value by location %*

*As at 31st March 2003

Security of rental income £m



Left to right
Nicholas Groves
David Brogan
Badar Butt

Performance

Capital value The independent valuation of our property investment portfolio at the year end was £823.1 million, a like for like increase of 1.6%. In addition to this the value of the trading stock at the year end was £26.5 million.

Income Net rental income for the year was £56.6 million, an increase of 10.5%. Included in this figure is the pre-paid rental element of the $9 million lease termination payment received in the US in April 2002.

The aggregate gross annual rate of rent reserved under all the leases was £56.4 million per annum, a fall of 1.6%, reflecting predominantly the effect of the significant volume of property sales which occurred during the year.

Including properties held for redevelopment, the voids in the entire portfolio now stand at 6.8%, a significant improvement on the 9.9% level reported in the interim figures. Voids in the Central London holdings excluding properties held for redevelopment are currently 2.2%.

Assuming all lease breaks are exercised and all properties are vacated upon the expiry of their existing leases, 71.1% of the current commercial rent roll is secured for five years, 39.4% for 10 years and 29.1% for 15 years. The average unexpired lease term (weighted by rent) is 14.8 years (13.8 years including breaks).

Total return The total return for the year from the investment property portfolio was 9.5%.

Business review

The property holdings have maintained the good annual performance levels achieved over the past decade, producing capital value growth and good total returns despite difficult market conditions.

Rent reviews have continued to illustrate the benefits of the Group's middle market locations which suffer less from the volatility experienced in the areas perceived to be prime. The rental uplift generated by reviews in the 12 months to 31st March 2003 was £1.1 million, an increase of 10.8% over the rents previously passing.

Dorset Square Within easy and quick access of Heathrow, this 2,183 sq m refurbishment, recladding and partial reconstruction of a Listed Dorset Square building is well placed to benefit from its proximity both to the West End and Paddington markets.

LMS won a Civic Trust Award when converting and extending the building in the 1960's and has now applied for planning permission to upgrade and reclad the property to bring it up to a 21st century specification.

Pending a planning decision, the accommodation has been let for a two year period to Woolworths plc, subject to prior rights to determine should the planning decision and economic climate dictate. Part of the LMS policy to keep the income flowing and limit the speculation of the development process.

Operating Review: Property

As to the letting market, despite the low level of demand which is currently affecting the Central London market, we have been successful in concluding the letting of 60 Whitfield Street, London W1 to which reference was made at the half year. The full rent reserved of £1.2 million per annum for the entire 3,363 sq m becomes payable at the end of June 2004 but payment at approximately half that rate commences in February 2004. The term is 15 years although the tenant has the right to determine the lease of approximately half the accommodation – upon payment of compensation – in March 2008.

We have also taken the opportunity to maintain short-term income at 26/28 Dorset Square, NW1, by letting the 1,983 sq m office building for two years to Woolworths plc. This Grade II Listed Building fell vacant last December and a planning application has been submitted to upgrade it to a modern specification and re-clad the rear extension for which we won a Civic Trust Award in the 1960's. It is the intention that the new development should come on stream in phase with termination of Woolworths' short-term occupation.

In the US, the entire 5,617 sq m of offices at 275 Sacramento Street, San Francisco vacated last year has been relet to OpenTV Inc., an interactive television company controlled by Liberty Media Corporation, for a term of seven years at an initial net rent of $1.4 million per annum, payable from August 2004, rising to $2.0 million per annum in the final year.

It has been our policy to reduce the number of joint venture operations and where possible eliminate long leasehold interests by acquisition of their freeholds. In March of this year we acquired the minority interest in Urbanfirst Limited as reported below and we purchased CGNU's stake in our joint companies, together with the freeholds, thus achieving 100% ownership of properties such as 63 St. James's Street, 170 Tottenham Court Road and 26/28 Dorset Square. The cash cost to the Group for CGNU's 40% stake plus the freehold interests in all its property assets was £28.6 million.

The Rotunda, Kingston A disused bus station and a former Grade II Listed furniture depository has been reborn to create a vibrant new entertainment complex in the heart of Kingston-upon-Thames.

Some 15,056 sq m, including a 14 screen multiplex Odeon cinema; a 3,251 sq m David Lloyd Leisure operation; a 16 lane Megabowl and themed pubs and restaurants let to operators including Scottish & Newcastle; Pizza Express and Frankie & Benny's.

The Rotunda opened last October to much local acclaim and is now a well established and popular attraction.

Left to right
John Clark
Julian Diamond
Steven Dykes
David Fuhr
Jason Garrod
Colin Hartford

Development programme

Fitzrovia Project, London W1 The construction of the 8,454 sq m first phase of the redevelopment of Arup's headquarters is now expected to be completed at the end of August this year.

105 Tottenham Court Road, London W1 The local planning authority has resolved to approve the Company's application for permission to construct 8,826 sq m of office accommodation, 1,300 sq m of retail space and a separate block of six residential flats at this location, subject to the conclusion of a Section 106 Agreement. Negotiations with the local authority in relation to that Agreement are currently in hand.

26/28 Dorset Square, London NW1 A planning application has been submitted for permission to undertake a major refurbishment and re-cladding of this 1,983 sq m office building. The new proposals, if approved, will provide approximately 2,183 sq m of high quality offices with easy access to Heathrow via Paddington.

The Rotunda, Kingston, Surrey Following its opening to the public last October, this leisure complex has become a very popular attraction. Since the interim report, a lease of a 372 sq m unit on the first floor has been concluded with City Centre Restaurants trading as Frankie & Benny's. This letting takes the percentage of income secured to 91% of the estimated rental value of the centre. 930 sq m out of the total of 15,056 sq m remains to be let.

Strathkelvin Retail Park, Glasgow Following conclusion of the Section 75 Agreement, we expect to start work shortly on the 9,569 sq m retail unit, pre-let to B&Q, and to complete by June 2004. The extended retail park will then comprise some 26,941 sq m and, as an adjunct to the construction of the new unit, the entire park will be upgraded and re-clad.

Arup, Fitzrovia Another example of hedging the speculation of development – a phased reconstruction of the Arup headquarters over a three to four year period. Income is maintained throughout the development process and increases by agreed amounts once each phase is completed when new full repairing and insuring leases are granted.

A partnership between Landlord and Tenant to secure a further 20 year extension to a relationship with Arup both as advisor and tenant which started over 30 years ago.

Phase 1, some 8,454 sq m net, is due to be completed in August this year. The total area for which planning permission has been granted is 18,952 sq m.

Operating Review: Property

Greenwich Reach We continue to examine the various options for this land, and in the meantime we are considering carrying out certain site works to reduce the lead time necessary before construction work can commence once the planning issues are resolved.

Acquisitions and disposals

Acquisitions Two significant office acquisitions were made during the year, both in the vicinity of our core London holdings:

The City Road Estate, London EC1 This £24.8 million acquisition was referred to in the interim report last November. The property comprises 8,918 sq m predominantly of office accommodation in four buildings on a site of approximately one acre bounded by City Road, Featherstone Street and Mallow Street, London EC1. The current rent roll is approximately £2 million, derived from 28 occupational leases. The acquisition puts in place seedcorn for future development in the latter part of this decade, while generating attractive revenue in the meantime.

76/78 Charlotte Street and 1 Chitty Street, London W1 This freehold property comprising 1,035 sq m of offices together with a separate residential block containing two maisonettes and a studio flat was acquired in March for £4.2 million. The property is adjacent to the Group's core buildings in Fitzrovia and its acquisition forms part of our policy to extend our ownership where appropriate, to benefit from the general improvement in that part of London resulting from our current and proposed investment in the upgrading and recreation of our existing stock.

In total, the Group purchased some £57.7 million of property assets during the year, including properties in Cardiff, Ealing, Peterborough and Southampton bought by Urbanfirst Limited, together with the freehold of the KCP joint companies.

Disposals £73.6 million of property assets were sold during the year, the majority of which formed part of the Urbanfirst portfolio.

B&Q, Strathkelvin Only four miles north of Glasgow city centre, this 17,372 sq m retail park was completed by LMS just over ten years ago and has been a highly successful operation since its inception. As with all such centres, it is necessary to update and upgrade them to ensure that they provide an exciting competitive edge for those that trade from them.

The catalyst for this at Strathkelvin has been our agreement with B&Q to take a surrender of their lease of a 3,716 sq m unit at one end of the park and construct a new 9,569 sq m unit at the other end.

The local authority resolved to grant planning permission for this last September and the Section 75 Agreement has just been concluded.

It is hoped that work will start shortly and be finished by June 2004. Serious interest is already being expressed in the space to be released by B&Q.

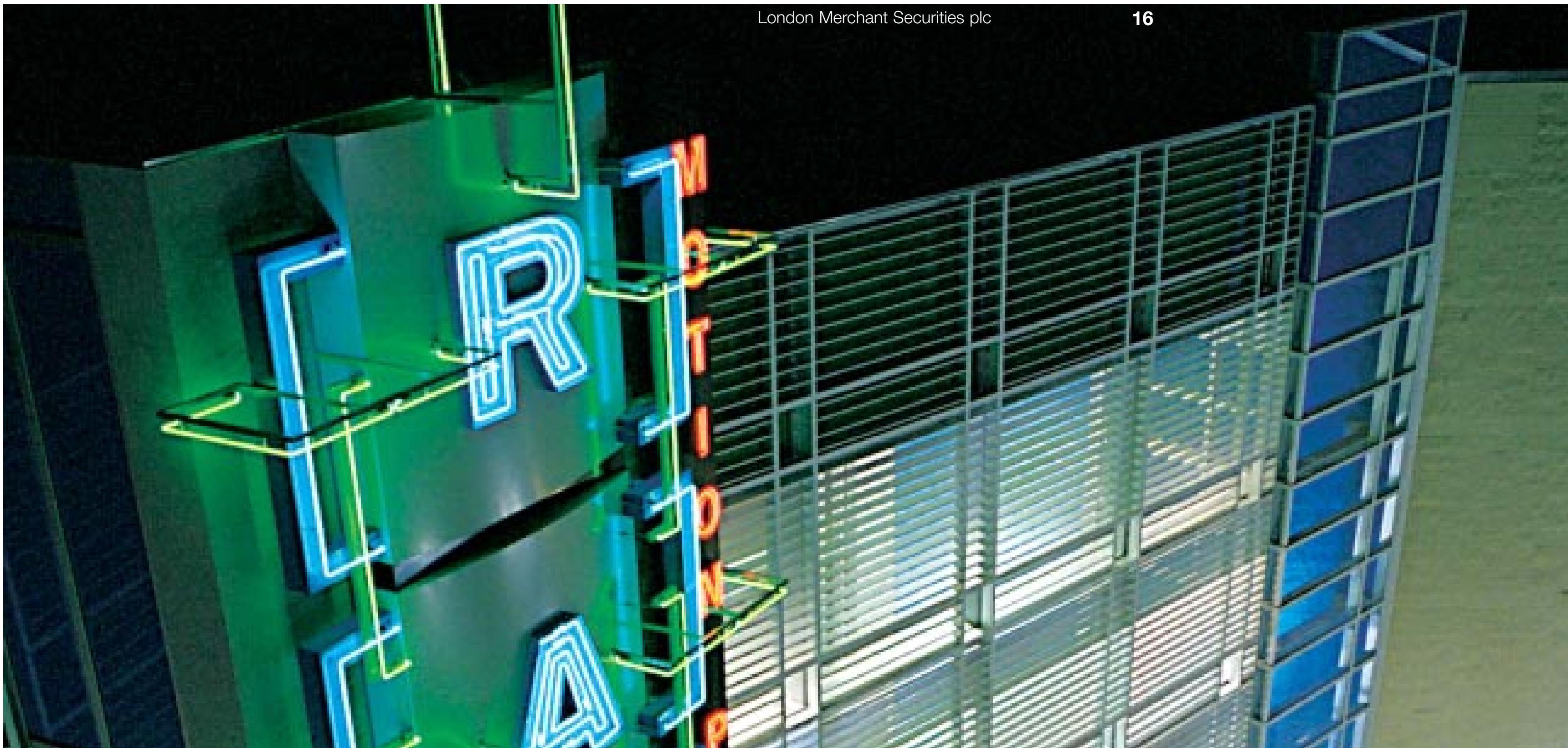
Left to right
Ian Mayhew
John Turner
Michael Ward
Richard Wood

Urbanfirst During the year we responded to the strong market for retail investments of the type owned by Urbanfirst by capitalising on those assets for which we felt market prices fully reflected future growth prospects. As a result investments were sold in Altrincham, Bournemouth, Chelmsford, Ealing, Leeds, Leicester, Northampton, Nottingham, Staines and Walsall generating total proceeds of £69.2 million, a profit on cost of 25% and an increase on 2002 value of 11%. Subsequent to the year end further properties were sold in Cardiff, Maidstone and Stirling.

We retained as part of LMS's retail and leisure portfolio Urbanfirst's investments in Bournemouth, Brighton, Peterborough and Romford, since they fit our strategy for maintaining and building a strong base complementary to our office holdings for the creation of long-term revenue growth.

We have acquired 100% ownership of the Urbanfirst companies but will continue to collaborate with the founding directors in the selective expansion of our retail and leisure property portfolio. Our investment in Urbanfirst and our association with Rod Pearson and Peter Smith has been highly successful and has produced an IRR over the period since its inception of over 16%.

Nicholas Driver Managing Director
10th June 2003



Venture Capital

Left Rave Motion Pictures a developer and operator of mega-plex theatres in the US.

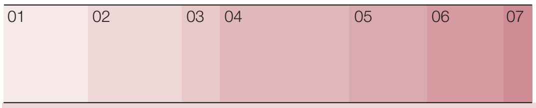
Right Offshore Tool & Energy's Titan Crane on an offshore oil rig in the Gulf of Mexico.

LMS continues to be an active investor in high growth venture capital opportunities predominantly in oil field service, communications, e-commerce, software and health sectors.

Operating Review: Venture Capital

Analysis by sector (book value) %*

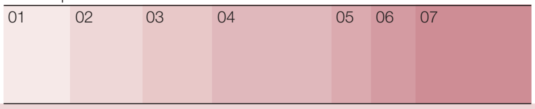
01 Communication 15.9
02 e-commerce 17.8
03 Health 7.1
04 Energy/Industrial 24.5
05 Media/Leisure/Retail 14.8
06 Software 14.4
07 Other technology 5.5



Analysis by sector (average age of investments) years*

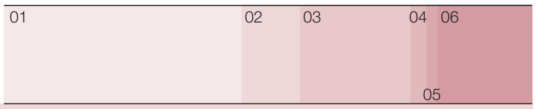
01 Communication 4.0
02 e-commerce 4.4
03 Health 4.2
04 Energy/Industrial 7.2
05 Media/Leisure/Retail 2.4
06 Software 2.7
07 Other technology 7.0

Total average age is 4.7 years. Age relates to the date of first investment of the top 50 investments



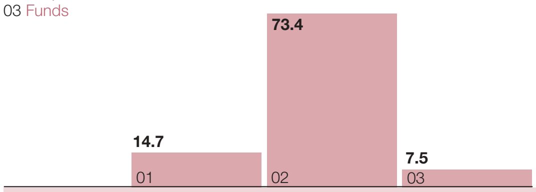
Analysis by sector (principal new investments in 2003) %

01 Energy/Industrial 45
02 Media/Leisure/Retail 11
03 Software 21
04 e-commerce 3
05 Other technology 2
06 Funds 18



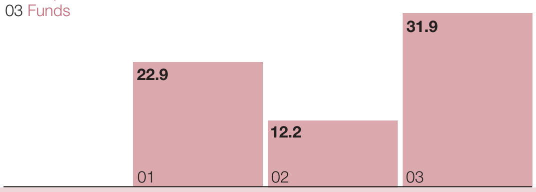
UK portfolio analysis by class (book value) £m*

01 Quoted
02 Unquoted
03 Funds



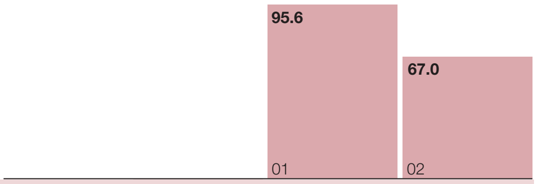
US portfolio analysis by class (book value) £m*

01 Quoted
02 Unquoted
03 Funds



Analysis by location (book value) £m*

01 UK
02 US



*As at 31st March 2003

7 Global Limited was founded in 1999 by its current management team. LMS Capital invested in 2000 and has supported the company in further rounds of funding. 7 Global provides a range of software-hosting services for software developers to deliver their products as a service. This provides a range of benefits, including lower cost of sales, lower customer cost of ownership and a range of financial purchase options.

7's Software Hosting Services are enabling software developers to deliver Software-as-a-Service today to thousands of users in both the private and public sector.

UK Team
Left to right
Michael Bennett
Nick Habgood
Shawn Pittman

Venture capital division

The venture capital division comprises both venture and development capital. In the current year the Group focused on refinancing its existing venture capital companies and growing further its development capital holdings. Generally it was a year of low investment levels both in the UK and the US with investee companies experiencing difficulties raising finance.

The Group realised £26.5 million from the sale of investments and £11.0 million of profit. In contrast to those satisfactory results it was deemed prudent to write-down £50.0 million primarily against the unquoted technology investments. During the year several companies ceased trading and included within the £50.0 million is £5.4 million of write-offs.

The Group is carrying investments with a book value at the year end of £162.6 million (2002 – £170.4 million). The book value is the lower of either cost or written-down value. The market value of the quoted investments (23.1% of book) at the year end was £40.3 million, some £2.8 million higher than book cost of £37.6 million, and at 1st June 2003 was £46.3 million, an increase of a further £5.9 million. No upward revaluation has been made to the value of the unquoted investments as such gains are only recognised on realisations.

The current average age of our portfolio is 4.7 years, compared to the Group historical norm of 7 to 9 years. The slowdown in the economies in the UK and Europe has extended the development period of many young companies. This presents both an opportunity and challenge to the Group. The opportunity arises from participating in lower value follow-up rounds of financing for companies. The challenge is in ensuring that the objectives of funding partners remain in line with those of the Group and the investee companies. This year two of our UK portfolio companies successfully introduced new shareholders. In the forthcoming year we expect this trend to continue.

Vio Worldwide Limited was established by British Telecom and Israeli technology company Scitex in 1997. It was bought by the current management team, with LMS Capital backing, in June 2001.

Vio provides ‘digital workflow’ software and advanced networking services that manage the electronic transmission of large, mission-critical, digital files in the production of media. Customers include advertising and creative agencies, publishers, prepress houses, printers and others collaborating online in the graphics arts industry. Active in creating and implementing XML-based industry standards, Vio is developing new products and services, including recently announced products based on the ‘JDF’ standard.

Operating Review: Venture Capital

Some of the platform technologies of the late 1990s have proven to be unsound business models and many of these companies have had to reinvent themselves. This will undoubtedly result in a consolidation of smaller technology companies and we are active in this arena. The technology drive will, in our opinion, continue and growth in the western world will be driven by technology improvements resulting in higher productivity and better value to consumers. At the same time it is our belief that to ensure sound long-term results for the LMS Group diversification of risk is paramount. We provide this through the mix and geography of our investments. The portfolio comprises some 45% of early stage investments, 32% of development capital investments and 23% of quoted investments.

Significant events in the year include the acquisition of Sparrows Offshore for £25.6 million financed with equity of £10.2 million provided by the Group and Sparrows management, and debt provided by the Royal Bank of Scotland. LMS has a 93% interest in the company. The operations of Sparrows are complementary to those of American Aero and Titan, part of Offshore Tool & Energy, which was 85% owned by the Group at the year end. The latter company operates in the Gulf of Mexico and manufactures cranes for the offshore market internationally. Sparrows is the dominant crane service and engineering company for the UK continental shelf and is rapidly expanding in the international arena.

In the US additional capital was provided to Rave Motion Pictures which is expanding its multiplex development programme and is currently the most active theatre builder in the US with 118 screens built and 67 screens planned for 2003.

Dmatek is a leading provider of electronic monitoring technologies, specialising in human-related applications. Dmatek's technological platform is based on a unique system architecture and operating methodology, which can be implemented in many different commercial sectors.

Current applications of the company's core technology are marketed by Dmatek's subsidiaries – Elmo-Tech, which addresses the global law enforcement field, and HomeFree Systems, which operates in the emerging telehomecare market. Dmatek's systems are used by private operators and government agencies worldwide. Dmatek is traded on the London Stock Exchange (LSE: DTK.L). LMS Capital first invested in 1996.

US Team
Left to right
Scott Potter
Brian Bank
Josh Lamstein

In an illiquid venture market we were pleased with the sale of our investment in Quiver to Inktomi and the subsequent sale of Inktomi to Yahoo. This transaction resulted in a net gain of $2.4 million and a cash inflow of $3.1 million. The IRR on the investment was over 32.0%. We also received the final proceeds from the sale of Jazz[fm] and Intertrust.

I would like to thank our team who have provided great support to our investee companies and who have stood up to the pressure of the current market with fortitude.

Robert Rayne Chief Executive
10th June 2003

Financial Review

Operating performance

The financial performance for the year reflects a good performance by the property business offset by the impact of additional write-downs in the venture capital business.

Equity shareholders' funds at 31st March 2003 amounted to £678.9 million compared with £720.6 million at 31st March 2002.

The reported loss for the year has resulted in a negative return on shareholders' equity of 3.7% (2002 – negative 2.4%). The average annual rate of return achieved over the last five years is 10.6%.

Equity shareholders' funds, on an adjusted basis to reflect the variation between the market value of assets and liabilities and the values at which they are included in the balance sheet, were £630.4 million (2002 – £714.6 million, restated as explained below).

The table below shows how the adjusted equity shareholders' funds have been arrived at. The calculation of adjusted shareholders' equity funds includes, for the first time this year, the tax losses that would be realised and available for relief within the Group against tax liabilities on its property and venture capital activities, if the venture capital investments were disposed of at balance sheet values.

	2003 £m	2002 £m
Shareholders' funds	**678.9**	720.6
Excess of market value over book value		
– Trading properties net of tax	**10.5**	10.3
– Venture capital investments net of tax	**2.8**	19.8
Contingent tax liability on disposal of investment property at balance sheet value	**(23.3)**	(25.5)
Contingent tax asset on disposal of venture capital investments at balance sheet value	**8.0**	9.7
Mark to market value of fixed rate borrowing	**(46.5)**	(20.3)
Adjusted equity shareholders' funds	**630.4**	714.6

Profit and loss account

Rental income Gross rental income was £62.6 million compared with £55.6 million in 2002. £2.8 million of the increase reflects the net impact of the £5.3 million exceptional lease termination payment on a property in San Francisco, referred to in last year's annual report, less £2.5 million loss of rent in the year on that property. The remaining net increase of £4.2 million is explained by rent reviews and lettings of £3.2 million and acquisitions of £2.3 million, offset by £1.3 million from vacancies and sales of properties in the current and prior year.

Property outgoings were £6.0 million compared to £4.5 million in 2002. The increase relates principally to letting costs incurred in the US and vacant property costs.

Left to right
John Townley
Dawn Brand
Victoria Buxton

The increase in gross rental income offset by the increase in property outgoings produced an increase in net rental income of £5.4 million to £56.6 million.

Property disposals Disposals of investment properties during the year realised gains of £6.5 million (2002 – £0.1 million) over book values. The historical cost profit was £17.1 million. The disposals were principally in the Urbanfirst portfolio.

Venture capital Realisations of venture capital investments produced a net profit of £11.0 million (2002 – £1.2 million) over book values.

Provisions for estimated permanent diminution in value in the venture capital portfolio, together with write offs, amount to £50.0 million (2002 – £57.7 million). These provisions and write offs have been made after a detailed review of the venture capital investment portfolio by the directors; £16.5 million are in respect of the quoted portfolio, £15.6 million in respect of the unquoted investment portfolio and £17.9 million in respect of the investments in funds managed by external managers. Included in these amounts are £5.4 million write offs that have been made in respect of investments with no further economic value.

Finance costs Net finance costs were £25.0 million (2002 – £16.0 million).

Interest payable (excluding amortisation of issue costs) net of interest receivable, was £21.1 million (2002 – £15.7 million) reflecting the increased average level of debt during the year. This net cost was covered 2.7 times by net rental income compared to 3.2 times in 2002. At 31st March 2003 the average cost of debt was 7.8% compared to 8.2% at the previous year end.

Exchange losses on dollar deposits, principally in the first half of the year, amounted to £1.7 million (2002 – £0.2 million). Breakage costs of £1.8 million were incurred in relation to fixed interest borrowings in Urbanfirst following the property sales in that portfolio.

Taxation The taxation charge for the year is £7.4 million (2002 – £8.4 million). This represents an effective tax rate of 25% on results excluding investment write-downs and profits on property and venture capital realisations, and a negative rate after their inclusion.

The overall tax rate has benefited from the utilisation of capital losses which have fully offset the tax liability arising on the investment property profits.

The provisions for diminution in value charged to the profit and loss account in respect of the venture capital investments are not deductible for tax until those investments are realised. This is the most significant factor in raising the Group's overall effective tax rate. Venture capital disposals in the year gave rise to a £2.5 million US tax charge. In addition Weatherford, one of the Group's quoted US investments, changed its domicile from the US to Bermuda during the year resulting in the levying of a one-off US tax charge on investors, which for the Group

Financial Review

amounted to £1.7 million and is reflected in the profit and loss account. This charge will offset any future taxation on the disposal of these shares.

Balance sheet

Investment properties Investment properties were valued at £823.1 million by external valuers at 31st March 2003. The surplus on revaluation amounted to £7.4 million of which £3.6 million is attributable to the Group and £3.8 million to minority interests. Trading properties, included in the balance sheet at cost of £11.5 million, were valued at £26.5 million by the directors at 31st March 2003.

Venture capital investments Venture capital investments are included in the balance sheet at cost less write offs and provisions for estimated permanent diminution in value.

As referred to above, the market conditions in the sectors in which many of our venture capital investments operate continue to be difficult, and further provisions and write offs totalling £50.0 million have been considered prudent in the current financial year.

The Group has had, and continues to have equity interests of between 20% and 50% in a number of its venture capital investments. It has always been the directors' view that these investments are held for the realisation of a capital gain over a relatively short period. The Group has taken advantage of the provisions of FRS 9 'Associates and Joint Ventures' and has not adopted the equity accounting approach in respect of such investments. At 31st March 2003 the Group has six investments which represent more than 50% of the equity of the companies concerned. It is the directors' view that these investments, like all others, are held for realisation of a capital gain, as part of the Group's established pattern of venture capital activity, and should not be consolidated. Accordingly, as explained in the accounting policies, these are accounted for as investments. The Group's exposure to its investee companies is fully reflected in its balance sheet and is limited to its investment at the balance sheet date.

Debt The Group had net debt of £262.5 million at 31st March 2003 (2002 – £181.8 million). The net debt to capital employed ratio increased from 23.3% at 31st March 2002 to 36.9% at 31st March 2003.

The increased net indebtedness reflects a net expenditure of some £65.2 million on property investments, venture capital investments and the buy-in of minorities, offset by property and venture capital disposals. £14.0 million of the increase arises from the payment of interest, dividends and taxation of £56.5 million offset by operational cash inflows of £42.5 million. The remaining £1.5 million of net movements arises from non-cash items, principally exchange differences.

Left to right
Brian Steggall
Paul Dickson

Total borrowings increased from £289.3 million to £340.3 million, principally from the successful issue of a further £73.9 million of 6.5% Secured Bond 2026 in November 2002, offset by the repayment of mortgages in Urbanfirst following property sales.

At the time of the bond issue the Group's corporate credit rating was BBB+ and the secured debt was rated A. The security of the Group's income and financing continues to be recognised and positions it well to fund existing and future activities.

We continue to manage our cash deposits and borrowings so as to minimise financial risk; to ensure that sufficient liquidity is available to meet budgeted development and investment plans and commitments, both in sterling and in US dollars, and to ensure that the equity shareholders' funds are invested at beneficial rates with a range of banks and institutions.

FRS 13 'Derivatives and Other Financial Instruments' requires companies to disclose the fair value of their financial instruments as at the balance sheet date. The venture capital investments of £162.6 million (2002 – £170.4 million) were valued at the year end at £166.8 million (2002 – £190.2 million), giving rise to an excess of £4.2 million, £2.8 million on a post-tax basis (2002 – £19.8 million).

With the exception of £3.3 million (2002 – £2.4 million), the Group's long-term borrowings are at fixed rates of interest.

The upward adjustment to fair value required of the Group's long-term liabilities amounts to £50 million (2002 – £22.2 million) on a post-tax basis. Of this total amount, the Group's share is £46.5 million (2002 – £20.3 million).

Capital commitments The Group's capital commitments are £101.8 million, of which £52.8 million relates to property development expenditure. The contracted commitments of the venture capital division amounting to £48.9 million relate to continuing participation 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 these partnerships and direct investments, although not necessarily in the same accounting period.

Accounting policies and financial reporting

The Group's accounting policies are set out on page 40. As referred to above, the policy in relation to non-consolidation of venture capital investments has been adopted in the current financial year. There have been no other changes to accounting policies.

Nicholas Friedlos Finance Director
10th June 2003

Report of the Directors

The directors submit their report and the financial statements of the Group for the year ended 31st March 2003.

Results and dividends
The Consolidated Profit and Loss Account for the year is set out on page 36. An interim dividend of 2p per share was paid on the Ordinary shares on 3rd January 2003. The directors recommend a final dividend of 4.3p per share making 6.3p (2002 – 6.2p) per share for the year. If the final dividend is approved, it will be paid on 28th July 2003 to the holders of the issued Ordinary shares on the register at the close of business on 20th June 2003.

Principal activities and business review
The principal subsidiary undertakings of the Group and their activities are shown in note 11 on page 49. 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 22 to 25.

Property
The Group's investment properties were valued at 31st March 2003 on the basis explained in note 9 on page 48. The resultant surplus is shown in the note.

Corporate governance
A report on the Company's policy on corporate governance is shown on pages 28 and 29.

Environmental policy
A statement of the Group's environmental policy is shown on page 57.

Health and safety policy
A statement of the Company's Health and Safety policy is shown on page 57.

Directors
The directors of the Company, are those listed on page 64. Mr M Waldron who held office during the year, resigned as a director of the Company on 16th May 2002. Lord Remnant and Mr Millsom also held office during the year and both resigned as directors of the Company on 25th July 2002.

Mr M A Pexton and Mr N R Friedlos were appointed directors on 17th October 2002 and 22nd January 2003 respectively. In accordance with the Company's Articles of Association Mr M A Pexton and Mr N R Friedlos retire from the Board and offer themselves for reappointment.

Mr N G E Driver, Mr P J Grant, Mr G C Greene and Mr D Newell 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.

Directors' interests and service contracts
These are disclosed in the Remuneration Report of the Board of Directors shown on pages 30 to 34.

Share scheme
Resolution 11 set out in the Notice of the Annual General Meeting proposes to amend the LMS Executive Share Option Scheme (the 'Executive Scheme'). The Executive Scheme was established some time ago and has since then been an important part of the Company's executive remuneration strategy. The Executive Scheme has been amended several times in the light of developing practice and it is proposed to make further changes, principally to simplify the administration of the Executive Scheme and to introduce more flexibility in operating it while continuing to provide appropriate protection for shareholders. Further details of the proposals are given in the appendix to the Notice of the Annual General Meeting circulated to shareholders on 24th June 2003.

Share capital
Details of changes in the issued share capital during the year ended 31st March 2003 are given in note 20 on page 54.

Directors' authority to allot shares
The purpose of special resolution 12 set out in the Notice of the Annual General Meeting is to renew the power of the directors to allot unissued shares of a nominal value up to £10,118,692 or 36,877,011 Ordinary/Deferred Ordinary shares (which represents the whole of the unissued capital of the Company or approximately 11.26% of the issued share capital of the Company at 31st May 2003) for a period expiring five years after the passing of this resolution.

The purpose of special resolution 13 set out in the Notice of the Annual General Meeting is to renew the power of the directors to allot up to 12,181,847 Ordinary shares of $27\frac{18}{41}$p each and/or 4,196,521 Deferred Ordinary shares of $27\frac{18}{41}$p each (in aggregate representing approximately 5% of the issued share capital of the Company at 31st May 2003) 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 2003 represented some 27 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. During the year the Group made charitable donations of £18,005.

Substantial shareholdings
The Company has been notified of the following material interests of 3% or more of its share capital at 31st May 2003.

	Ordinary shares	%	Deferred Ordinary shares	%	Total of issued share capital %
The Lord Rayne	37,750,597	15.50	30,164,655	35.94	20.73
Landsdowne Partners LP	–	–	2,857,000	3.40	0.87
Trustees of The Rayne Foundation*	14,817,277	6.08	–	–	4.52

*Non-beneficial.

The Company has not been notified of any non-material interests of 10% or more of its share capital at 31st May 2003.

By order of the Board

Simon Mitchley Company Secretary
10th June 2003

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 to 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.

Corporate Governance

The Company has complied with the Principles and Provisions of the Combined Code throughout the year ended 31st March 2003.

The Board
The Board has nine directors, four executive and five non-executive, their details and experience are set out on page 64. All the non-executive directors are considered by the Board to be independent as they neither represent a major shareholder group nor have any significant involvement in the day-to-day management of the Group.

The Board holds regular meetings and has a number of matters reserved for its approval, including major investment expenditure, financing matters and dividend policy. The Board and its committees are provided with full and timely information to enable them to discharge their responsibilities. 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.

The committees of the Board, each of which has clear terms of reference, are:

- Remuneration Committee – membership comprising, Mr P J Grant (Chairman), Mr G C Greene, Mrs J de Moller and Mr D Newell;
- Audit Committee – membership comprising, Mr D Newell (Chairman), Mr P J Grant, Mr G C Greene and Mrs J de Moller;
- Nomination Committee – membership comprising all directors and chaired by Mr G C Greene.

The Board ensures that all new directors are sufficiently apprised of the Company's business and their duties as directors.

Mr P J Grant is the senior independent director on the Board.

Remuneration policy
Details of the Group's remuneration policy is given in the Directors' Remuneration report on page 30.

Relations with shareholders
The Company has regular meetings with its institutional shareholders and the Annual General Meeting gives all shareholders the opportunity to put questions to the entire Board.

The balance of proxy votes cast for or against each resolution is indicated after the resolution has been dealt with under a show of hands. All substantial issues including adopting the report and accounts are proposed at the Annual General Meeting as separate resolutions.

The Chairmen of the Board Committees are available to answer questions at the Annual General Meeting.

The Company complies with the Combined Code to give at least 20 working days' notice of the Annual General Meeting.

Directors' responsibility statement
The Statement of the directors' responsibility to prepare financial statements required by provision D.1.1 of the Combined Code is given on page 27.

Going concern
After making enquires, 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 accounts.

Internal control
The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. Such a 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 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. This process is regularly reviewed by the Board and the Audit Committee and accords with the Turnbull guidance *Internal Control: Guidance for Directors on the Combined Code*. Where areas for improvement in the system are identified, the Board considers the recommendations made by management and the Audit Committee.

In discharging its duties in respect of the Directors' Responsibility Statement and Internal Controls, the Board has received reports from the Audit Committee. The activities of the Audit Committee are explained opposite.

Audit Committee

Responsibility The Audit Committee's responsibility is:

- To monitor the integrity of the financial statements of the Group, reviewing significant financial reporting judgements;
- To review the Group's internal financial control system and risk management systems;
- To make recommendations to the Board in relation to the appointment of the auditors and to approve the remuneration and terms of engagement of the auditor;
- To monitor and review the auditor's independence, objectivity and effectiveness, taking into consideration relevant UK professional and regulatory requirements; and
- To develop and implement policy on the engagement of the auditors to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the audit firm.

Membership The membership of the Audit Committee is noted on page 28.

Lord Remnant was Chairman of the Audit Committee until his retirement from the Board. Mr D Newell was appointed Chairman with effect from the meeting on 19th November 2002.

Members of the Audit Committee are appointed by the Board and details of their experience is given on page 64.

The Audit Committee is satisfied that it has sufficient resources both internal and external available to discharge its responsibilities.

The Audit Committee met three times during the year.

The remuneration of the members of the Audit Committee is a matter for the Board and the remuneration policy on directors' fees is stated on page 30.

Financial statements 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 significant accounting policies, any changes to them and any significant estimates and judgements.

Internal financial control and risk management systems 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.

The Audit Committee has a responsibility to review the Group's internal financial control system and risk management system and make appropriate recommendations to the Board.

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;
- 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.

The Audit Committee present their findings of the reviews to the Board as appropriate.

External audit The Board, on the recommendation of the Audit Committee, has adopted a policy in relation to the provision of non-audit services by the auditors.

The Audit Committee is satisfied that the Group's auditors, KPMG Audit Plc, are objective and independent of the Group and that the procedures adopted on the provision of non-audit services by the auditors provide adequate protection of the auditors' independence. The auditors do perform non-audit services for the Group as described below but the Audit Committee is satisfied that their objective is not impaired by such work.

Internal audit The Company does not have an internal audit function and the Committee reviews annually the requirement for such a function.

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

Lord Remnant was a member of the Committee until his retirement from the Board on 25th July 2002.

The Secretary of the Committee is Mr S C Mitchley. The Committee appointed Towers Perrin to provide market information on directors' remuneration and considered advice from Clifford Chance, who also provided other legal services to the Company during the year. 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 reference to market rates.

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

– base salary

– annual performance-related bonus

– long-term incentives

Basic salary
In recommending basic salaries for executive directors the Remuneration Committee takes into account information from an independent source on market rates in comparable companies.

Annual bonus
Each executive director is eligible for an annual bonus based on the performance of the individual and of the aspects of the business for which they are responsible. The Chief Executive may receive a bonus of up to 100% of basic salary for the year in question, while other directors may receive a bonus of up to 50% of basic salary. The annual bonus is the primary element of remuneration related to financial performance.

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 the options granted from September 2002 onwards is that in the first three year period after grant of the options shareholders' funds must have increased by a percentage greater than the increase in the Retail Price Index plus 9%. This performance condition, which was approved by shareholders in 2001, is designed to support and encourage focus on the Company's commitment to good long-term shareholder returns.

Approval is being sought from shareholders for several changes to the Executive Share Option Scheme, which are designed to update the Rules to bring them into line with current practice. Among the changes included in the Notice of the Annual General Meeting is a proposal to allow on recruitment the grant of options worth up to three times salary, in order to facilitate the recruitment of directors and staff of the appropriate calibre. If approved, it is intended to apply this to Mr N R Friedlos, who was recruited to the Company in January 2003.

A *Long-Term Incentive Plan* was established for Mr M A Pexton as part of the terms of his recruitment to the Company in April 2002, prior to his appointment as an executive director in October 2002. Under the Plan he has cash-settled options with the same performance conditions as those governing the Executive Share Option Scheme. It is not intended to make further grants to him under this Plan.

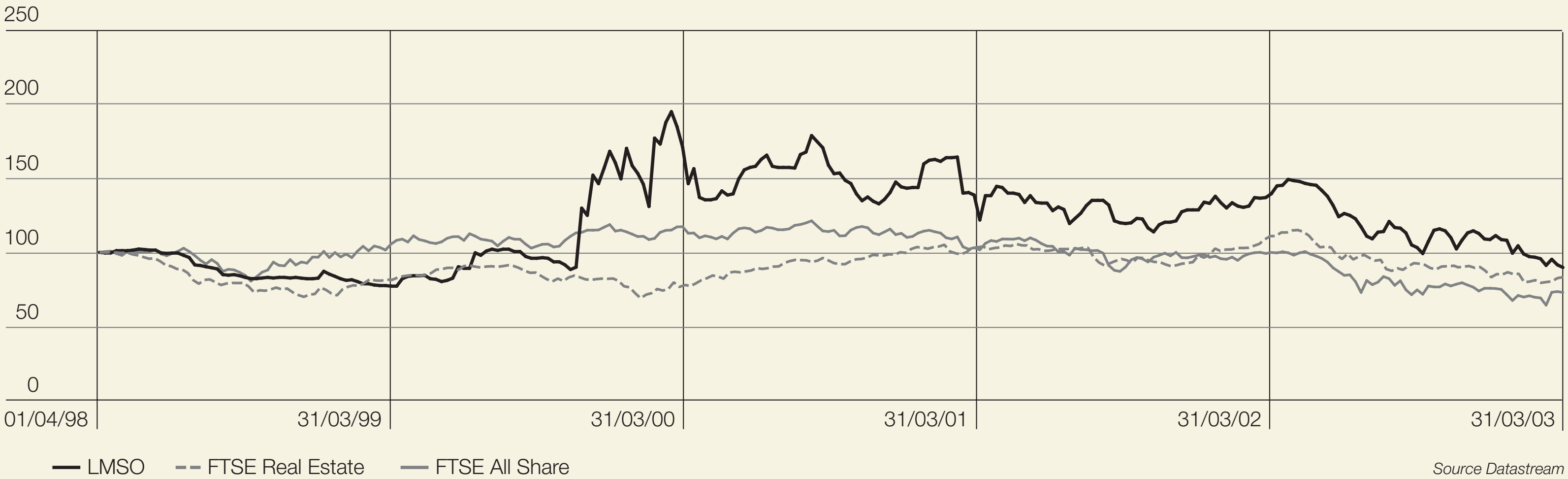
The Chief Executive, Mr R A Rayne, participates in the *Carried Interest Plan,* which applies to certain executives who have responsibility for investments made by the venture capital division, and was approved by shareholders in 2001. The Plan is intended to correspond to the incentive arrangements 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 2003.

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. Non-executive directors' appointments are not for specific periods as it is considered that the process whereby they are re-elected by shareholders at least every three years provides a satisfactory means for the Board to keep appointments under review.

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 graph
The graph below shows the total return for holders of LMS Ordinary shares for the five year period beginning 1st April 1998. 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.



Source Datastream

Executive directors' service contracts
The contracts of service for Mr R A Rayne, Mr N G E Driver, 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 on 1st May 2003. There is no specific term for non-executive directors' appointments and none of their appointment letters contains compensation provisions in the event of early termination.

Lord Remnant and Mr W Millsom, who retired as directors in July 2002, and Mr M Waldron, who retired as a director in May 2002, did not have formal letters of appointment to the Board.

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	Compensation for loss of office £000	Total excluding pensions 2003 £000	Total excluding pensions 2002 £000	Share option gains 2003 £000	Share option gains 2002 £000
Executive									
N G E Driver	398	–	119	18	–	535	573	490	–
N R Friedlos[2]	43	–	–	2	–	45	–	–	–
W Millsom[3]	–	54	–	1	–	55	173	–	–
M A Pexton[2]	89	–	60	5	–	154	–	–	–
Hon R A Rayne	471	–	283	22	–	776	851	–	579
M Waldron[4]	25	–	–	2	1,490	1,517	257	435	–
Non-executive									
P J Grant	–	60	–	–	–	60	60	–	–
G C Greene	–	125	–	–	–	125	125	–	–
Mrs J de Moller[2]	–	26	–	–	–	26	–	–	–
D Newell	–	30	–	–	–	30	30	–	–
Lord Remnant[5]	–	10	–	–	–	10	30	–	–
Hon J M Wilson	–	30	–	–	–	30	30	–	–
Total	1,026	335	462	50	1,490	3,363	2,129	925	579

Notes
(1) Benefits comprise car allowance and private medical insurance.
(2) Appointed as a director during the year.
(3) Mr W Millsom retired as a director on 25th July 2002 but continued as a consultant to the Company. During the remainder of the year to 31st March 2003 he received a fee of £121,000 and benefits of £1,000, bringing total emoluments for the year to £177,000.
(4) Mr M Waldron retired as a director on 16th May 2002 but remained an employee of the Company until 31st March 2003. The total of £1.49 million shown as compensation for loss of office includes salary of £190,000 and benefits of £15,000 received after his retirement as a director and £1.285 million which represents the capital value of enhancements made to his pension entitlement.
(5) Retired as a director during the year.
(6) The basic salaries payable with effect from 1st April 2003 are as follows: Mr R A Rayne £485,500; Mr N G E Driver £410,000; Mr N R Friedlos £230,000; Mr M A Pexton £225,000.

Directors' share options and long-term incentive awards

The number of shares subject to options/awards as at 31st March 2003 is set out below.

Name and scheme	Exercise price (p)	Deferred Ordinary balance at 31st March 2003[1]	Deferred Ordinary balance at 1st April 2002[1]	First exercise date	Expiry/actual exercise date
N G E Driver					
Executive[2]	32.25	–	575,000	29th Sep 1995	24th Sep 2002
Executive[3]	149.00	961,656	961,656	5th Jan 2004	5th Jan 2011
Executive[4]	114.50	347,601	–	4th Sep 2005	4th Sep 2012
SAYE	40.50	19,259	19,259	1st Apr 2003	30th Sep 2003
SAYE	65.25	17,931	17,931	1st Apr 2005	30th Sep 2005
SAYE	104.50	3,708	3,708	1st Sep 2004	28th Feb 2005
N R Friedlos					
Executive	–	–	–	–	–
M A Pexton					
Executive[4]	114.50	131,003	131,003	4th Sep 2005	4th Sep 2012
Long-term incentive	114.50	393,013	393,013	25th Sep 2005	25th Sep 2012
Hon R A Rayne					
Executive[3]	149.00	1,235,420	1,235,420	5th Jan 2004	5th Jan 2011
Executive[4]	114.50	411,563	–	4th Sep 2005	4th Sep 2012
M Waldron					
Executive[2]	32.25	–	510,000	29th Sep 1995	24th Sep 2002
Executive[3]	149.00	266,171	266,171	5th Jan 2004	5th Jan 2011
SAYE	40.50	19,259	19,259	1st Apr 2003	30th Sep 2003
SAYE	65.25	17,931	17,931	1st Apr 2005	30th Sep 2005

Notes
(1) Holdings of options are shown as at the beginning and end of the year except where directors were appointed or ceased appointment, in which cases they are shown as at the date of taking up or ceasing appointment. All options are over Deferred Ordinary shares – no options were held over Ordinary shares.
(2) Mr N G E Driver exercised options over 575,000 Deferred Ordinary shares, and Mr M Waldron exercised options over 510,000 shares, both on 24th September 2002. The exercise price of the options was 32.25p and the middle market price on the day of exercise was 117.5p.
(3) The exercise price of the options granted on 5th January 2001 was increased during the year from 131.5p to 149.0p after it was found that an error had been made in applying the scheme rules determining the relevant date for pricing of the options.
(4) Options over Deferred Ordinary shares were granted to Mr N G E Driver, Mr M A Pexton and Mr R A Rayne on 4th September 2002 at an exercise price of 114.5p. The performance condition for exercise of these options 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 exercise of the options granted in January 2001 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%.
(5) Each option was granted for a consideration of £1.
(6) The market price of a Deferred Ordinary share at 31st March 2003 was 89p and the range during the year was 86p to 151.5p.

Pensions

Mr N G E Driver, Mr R A Rayne and Mr M Waldron are all members 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 2003 £000	Accrued pension entitlement at age 60 at 31st March 2002 £000	Transfer value at 31st March 2003 £000	Transfer value at 31st March 2002 £000	Employee contributions £000	Change in transfer value during the year less employee contributions £000
Executive								
N G E Driver	59	33	238	220	4,927	4,137	23	767
Hon R A Rayne	54	28	255	234	3,452	3,390	28	34
M Waldron	56	33	108	99	1,763	1,656	11	96

Mr M Waldron retired early from the Company on 31st March 2003. His pension was enhanced to provide an immediate annual pension of £110,000 per annum, the cost of the enhancement being £1.285 million.

Mr N R Friedlos and Mr M A Pexton received the following pension contributions in respect of their services as directors during the year:

Mr N R Friedlos	£8,434
Mr M A Pexton	£18,411

Directors' share interests

At 31st March 2003 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 2003 Ordinary	At 31st March 2003 Deferred Ordinary	At 31st March 2002 or on appointment Ordinary	At 31st March 2002 or on appointment Deferred Ordinary
Beneficial				
N G E Driver	**213,102**	**575,000**	209,443	477,930
N R Friedlos[1]	**–**	**–**	–	–
P J Grant	**944**	**303**	944	303
G C Greene	**–**	**16,400**	–	16,400
Mrs J de Moller[1]	**–**	**20,000**	–	–
D Newell	**10,000**	**–**	10,000	–
M A Pexton[1]	**23,659**	**–**	14,555	–
Hon R A Rayne	**2,190,326**	**1,439,467**	2,190,326	1,439,467
Hon J M Wilson	**–**	**360,000**	–	360,000
Non-beneficial				
P J Grant	**6,382,584**	**1,386,259**	6,537,078	2,197,730
G C Greene	**13,726,231**	**1,386,259**	13,880,725	2,197,730
D Newell	**6,382,584**	**1,386,259**	6,537,078	2,197,730
Hon R A Rayne	**15,511,544**	**–**	15,511,544	–

(1) Appointed during the year.

Because of common interests some shares are included against the names of more than one director. After eliminating such duplications, the total number of shares in which the directors are interested as Trustees is shown below:

	At 31st March 2003 Ordinary	At 31st March 2003 Deferred Ordinary	At 31st March 2002 Ordinary	At 31st March 2002 Deferred Ordinary
Directors	**29,237,775**	**1,386,259**	29,392,269	2,197,730

Changes in directors' shareholdings between 31st March 2003 and 31st May 2003 were as follows:

	Ordinary	Deferred Ordinary
Beneficial		
N G E Driver	466	19,259
N R Friedlos	–	10,000
M A Pexton	30,466	–
Non-beneficial		
P J Grant	(8,171)	(351,775)
G C Greene	(8,171)	(351,775)
D Newell	(8,171)	(351,775)

Approved by the Board on 10th June 2003 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 36 to 56. 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 27, 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 statement on page 28 reflects the Company's compliance with the seven provisions of the Combined 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 2003 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
10th June 2003
London

Consolidated Profit and Loss Account

year ended 31st March 2003

	Notes	2003 £000	2002 £000
Gross rental income – Group	2	**62,621**	55,635
Operating profit – Group	2-4	**41,539**	36,233
Venture capital investment income		**191**	155
Profit on disposal of investment properties		**6,449**	63
Profit on disposal of venture capital investments		**11,016**	1,206
Amounts written off venture capital investments		**(50,015)**	(57,715)
Profit/(loss) on ordinary activities before finance costs		**9,180**	(20,058)
Net finance costs	6	**(24,972)**	(16,010)
Loss on ordinary activities before taxation		**(15,792)**	(36,068)
Tax on loss on ordinary activities	7	**(7,427)**	(8,387)
Loss on ordinary activities after taxation		**(23,219)**	(44,455)
Equity minority interests		**(2,301)**	(2,463)
Loss for the year		**(25,520)**	(46,918)
Appropriations			
Transfer to capital reserve	21	**–**	(550)
Equity dividends			
– Final proposed 4.3p (2002 – 4.2p), Interim paid 2.0p (2002 – 2.0p)		**(15,349)**	(15,104)
Retained loss for the year	21	**(40,869)**	(62,572)
Earnings/(loss) per Ordinary share	8		
– Before investment profit/(losses)		**4.81p**	4.80p
– Investment profit/(losses)		**(15.28p)**	(24.06p)
– Total		**(10.47p)**	(19.26p)
– Diluted		**(7.81p)**	(14.34p)

All operations are continuing in both current and previous year.

Consolidated Balance Sheet

at 31st March 2003

	Notes	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Fixed assets					
Investment properties	9	**821,944**	809,153	**22,650**	19,755
Other tangible assets	10	**547**	542	**–**	–
Investments – consolidated subsidiary undertakings	11	**–**	–	**348,812**	377,219
Investments – venture capital	12	**162,640**	170,450	**–**	–
		985,131	980,145	**371,462**	396,974
Current assets					
Trading properties	13	**11,489**	10,885	**–**	–
Debtors	14	**20,354**	16,991	**611,284**	572,606
Cash and short-term deposits	15	**77,833**	107,532	**–**	–
		109,676	135,408	**611,284**	572,606
Creditors: amounts falling due within one year	16	**(41,935)**	(48,250)	**(42,229)**	(53,459)
Net current assets		**67,741**	87,158	**569,055**	519,147
Total assets less current liabilities		**1,052,872**	1,067,303	**940,517**	916,121
Creditors: amounts falling due after more than one year	17	**(334,187)**	(281,479)	**(269,905)**	(195,871)
Provisions for liabilities and charges	18	**(6,622)**	(6,893)	**(54)**	(53)
Net assets		**712,063**	778,931	**670,558**	720,197
Capital and reserves					
Called up share capital	20	**89,881**	89,516	**89,881**	89,516
Share premium account	21	**19,034**	18,970	**19,034**	18,970
Capital reduction account	21	**2,868**	2,868	**2,868**	2,868
Revaluation reserve	21	**306,440**	315,246	**205,911**	212,383
Capital reserve	21	**–**	215,806	**–**	308,429
Profit and loss account	21	**260,708**	78,220	**352,864**	88,031
Equity shareholders' funds		**678,931**	720,626	**670,558**	720,197
Equity minority interests		**33,132**	58,305	**–**	–
Capital employed		**712,063**	778,931	**670,558**	720,197
Shareholders' funds per share	8	**207p**	221p		

The accounts on pages 36 to 56 were approved by the Board of directors on 10th June 2003 and were signed on its behalf by

Robert Rayne Director
Nicholas Friedlos Director

Consolidated Cash Flow Statement

year ended 31st March 2003

	2003 £000	2003 £000	2002 £000	2002 £000
Net cash inflow from operating activities (see note 22(1))		42,544		34,973
Returns on investments and servicing of finance				
Interest received	1,561		7,903	
Interest paid	(31,467)		(23,078)	
Dividends received	191		155	
Dividends paid – minority shareholders	(2,422)		(2,489)	
Dividends paid – in connection with purchase of minority interest	(22,841)		–	
Net cash outflow from returns on investments and servicing of finance		(54,978)		(17,509)
Taxation paid		(9,310)		(18,054)
Capital expenditure and financial investment				
Property developments and acquisitions	(75,859)		(48,052)	
Sales of investment property	67,870		2,653	
Acquisition of other fixed assets	(278)		(242)	
Disposal of other fixed assets	63		37	
Purchase of venture capital investments	(57,750)		(52,948)	
Sale and redemption of venture capital investments	24,550		18,619	
Net cash outflow from capital expenditure and financial investment		(41,404)		(79,933)
Acquisitions and disposals				
Purchase of minority interests		(1,052)		–
Equity dividends paid		(15,105)		(14,857)
Cash outflow before use of liquid resources and financing		(79,305)		(95,380)
Management of liquid resources				
– Decrease in short-term deposits (see note 22(2))		44,361		82,300
Financing				
Issue of share capital	429		252	
Debt due after more than one year: (see note 22(2))				
– Repayment of mortgages	(21,305)		–	
– 6.5% Bond issue	73,896		–	
– New mortgages	–		6,560	
Debt due within one year:				
– (Repayment)/issue of bank loans	(128)		5,184	
Net cash inflow from financing		52,892		11,996
Increase/(decrease) in cash in the year (see note 22(2))		17,948		(1,084)

Other Primary Statements

Consolidated Statement of Total Recognised Gains and Losses
year ended 31st March 2003

	2003 £000	2002 £000
Loss for the year	(25,520)	(46,918)
Unrealised surplus on revaluation of investment properties	3,644	28,253
Foreign exchange and other	(4,899)	450
Total recognised gains and losses relating to the financial year	(26,775)	(18,215)

Note of Consolidated Historical Cost Profits and Losses
year ended 31st March 2003

	2003 £000	2002 £000
Loss on ordinary activities before taxation	(15,792)	(36,068)
Realisation of property revaluation surpluses/(deficits) of previous years	9,067	(56)
Historical cost loss on ordinary activities before taxation	(6,725)	(36,124)
Historical cost loss retained after taxation, minority interests, transfer to capital reserve and dividends	(31,802)	(62,572)

Reconciliation of Movements in Shareholders' Funds
year ended 31st March 2003

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
(Loss)/profit for the year	(25,520)	(46,918)	(11,990)	10,036
Ordinary dividends	(15,349)	(15,104)	(15,349)	(15,104)
Retained loss for the year	(40,869)	(62,022)	(27,339)	(5,068)
Other recognised gains and losses	(1,255)	28,703	(22,729)	(43,573)
Issue of shares	429	252	429	252
Net reduction from shareholders' funds	(41,695)	(33,067)	(49,639)	(48,389)
Shareholders' funds at beginning of year	720,626	753,693	720,197	768,586
Shareholders' funds at end of year	678,931	720,626	670,558	720,197

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 following 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.

Venture capital investments that are subsidiary undertakings are carried at cost 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 financial statements. 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 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.

Venture capital investments

Venture capital investments are stated at cost less amounts written off to reflect permanent diminution in value.

Those venture capital 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 financial statements.

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 three and five years.

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 property developments are treated as revenue expenditure and written off as incurred.

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.

The results and balance sheets of overseas operations are translated at the closing rates ruling at the balance sheet dates. Exchange differences arising on translation of the opening net assets are dealt with through reserves. All other exchange differences are included in the profit and loss account.

Venture capital 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. There are no foreign currency borrowings against these assets.

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.

This has been applied to all lease incentives for leases commencing on or after 1st April 2000.

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 of short-term cash deposits.

Cost of raising finance
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.

Pensions
Contributions to the Group's pension and life assurance schemes are charged to 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 scheme' from recognising a charge in the profit and loss account for the discount on the option.

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 financial statements 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 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 financial statements.

Deferred tax is measured on a non-discounted basis.

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 2003 which will include, where applicable, the professional valuation of properties and the carrying value of venture capital investments. Surpluses and 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 2003 £000	Venture capital 2003 £000	Total 2003 £000	Property 2002 £000	Venture capital 2002 £000	Total 2002 £000
Gross rental income – UK	54,608	–	54,608	50,328	–	50,328
– US	8,013	–	8,013	5,307	–	5,307
	62,621	–	62,621	55,635	–	55,635
Property outgoings – UK	(3,969)	–	(3,969)	(2,634)	–	(2,634)
– US	(2,038)	–	(2,038)	(1,817)	–	(1,817)
Net rental income from properties	56,614	–	56,614	51,184	–	51,184
Profit on property trading (see below)	602	–	602	705	–	705
Net limited partnership administrative costs	–	(1,372)	(1,372)	–	(2,043)	(2,043)
Administrative expenses	(8,937)	(5,368)	(14,305)	(8,184)	(5,429)	(13,613)
Operating profit/(loss)	48,279	(6,740)	41,539	43,705	(7,472)	36,233
Investment income	–	191	191	–	155	155
Profit on disposal of properties and other investments	6,449	11,016	17,465	63	1,206	1,269
Amounts written off other investments	–	(50,015)	(50,015)	–	(57,715)	(57,715)
Profit/(loss) before finance costs	54,728	(45,548)	9,180	43,768	(63,826)	(20,058)

Property trading turnover and cost of sales were £2,284,000 and £1,682,000 respectively in 2003 and £2,895,000 and £2,190,000 respectively in 2002.

	2003 £000	2002 £000
Operating profit is stated after charging:		
Amortisation and depreciation of fixed assets	210	261
Auditors' remuneration (Company – £126,000 (2002 – £99,000))	140	112
Remuneration for other services to KPMG Audit plc and its associates		
– Due diligence on venture capital acquisitions	255	–
– Taxation advice	145	215

3 Segmental net assets

	Property 2003 £000	Venture capital 2003 £000	Group Total 2003 £000	Property 2002 £000	Venture capital 2002 £000	Group Total 2002 £000
Investment properties	821,944	–	821,944	809,153	–	809,153
Other tangible assets	438	109	547	434	108	542
Venture capital investments	–	162,640	162,640	–	170,450	170,450
Fixed assets	822,382	162,749	985,131	809,587	170,558	980,145
Trading properties	11,489	–	11,489	10,885	–	10,885
Debtors	18,326	2,028	20,354	16,464	527	16,991
Creditors: amounts falling due within one year	(39,618)	(2,317)	(41,935)	(48,072)	(178)	(48,250)
Provisions for liabilities and charges	(6,622)	–	(6,622)	(6,893)	–	(6,893)
	805,957	162,460	968,417	781,971	170,907	952,878
Cash and short-term deposits			77,833			107,532
Creditors: amounts falling due after more than one year			(334,187)			(281,479)
Net assets			712,063			778,931

£36.1 million (2002 – £49.9 million) of the investment properties and £2.8 million (2002 – £3.1 million) of the creditors falling due after more than one year are in the US. Of the venture capital investments, £72.2 million (2002 – £89.7 million) are located in the US.

4 Employees, including executive directors

	2003 £000	2002 £000
Staff costs		
– Wages and salaries	**5,814**	6,155
– Social security costs	**671**	633
– Pension contributions	**3,359**	2,645
	9,844	9,433

The average number of employees of the Group was 105 (2002 – 109). The areas of the Group's operations in which they are employed were: property management 51 (2002 – 53), venture capital 14 (2002 – 14) and 40 staff (2002 – 42) who were employed directly at the Group's properties and their cost recharged to tenants.

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.

The pension charge for the Group was £3.4 million (2002 – £2.6 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 5.4% per annum and that salaries will be increased at 3.9% per annum. The market value of assets of the scheme at 31st March 2003 was £9.3 million and the actuarial value of those assets on an ongoing basis represented 54.7% of the benefit of £17.0 million that had accrued to members allowing for expected future increases in earnings. Net of the related deferred tax asset the pension deficit is £5.4 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 2002 and use the following financial assumptions as at 31st March 2003.

	2003 per annum	2002 per annum
Future salary growth	**3.9%**	4.5%
Discount rate	**5.4%**	5.9%
Rate of increase in pension payments	**5.0%**	5.0%
Inflation rate	**2.7%**	3.0%

The assumptions used by the actuary 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.

5 Pension costs continued

The fair value of the scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the scheme's liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain, were:

	2003 Long-term rate of return expected % per annum	2003 Value £m	2002 Long-term rate of return expected % per annum	2002 Value £m
Assets				
– Unitised with profit policy	6.8	9.3	6.8	15.4
Total market value of assets		9.3		15.4
Present value of scheme liabilities		(17.0)		(18.7)
Deficit in scheme		(7.7)		(3.3)
Related deferred tax asset		2.3		1.0
Net pension liability		(5.4)		(2.3)
Equity shareholders' funds		678.9		720.6
Net pension liability		(5.4)		(2.3)
Equity shareholders' funds including net pension liability		673.5		718.3
Reserves				
Profit and loss account excluding net pension liability		260.7		78.2
Net pension liability		(5.4)		(2.3)
Profit and loss account including net pension liability		255.3		75.9

	2003 £m
Analysis of the amount that would have been charged to operating profit	
Current service cost	0.7
Past service cost	1.6
Total operating charge	2.3
Analysis of the amount that would have been credited/(charged) to other finance income/(expense)	
Interest on pension liabilities	(1.0)
Expected return on scheme's assets	0.9
Net return	(0.1)

Analysis of the amount that would have been recognised in the Group statement of recognised gains and losses (STRGL).

	2003 £m
Actual return less expected return on assets	(1.6)
Experienced gains and losses on liabilities	(1.9)
Changes in financial assumptions underlying the present value of the scheme's liabilities	(1.7)
Actuarial loss recognised in STRGL	(5.2)

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 accounting period.

Experienced gains and losses on the scheme liabilities are the difference between actuarial assumptions underlying the scheme's liabilities and actual experience during the period.

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

5 Pension costs continued

	2003 £m
Movement in deficit during the year	
Deficit in scheme at 31st March 2002	**(3.3)**
Current service cost	**(0.7)**
Contributions	**3.2**
Past service costs	**(1.6)**
Other finance income	**(0.1)**
Actuarial loss	**(5.2)**
Deficit in scheme at 31st March 2003	**(7.7)**

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

History of experience gains and losses

	2003 £m
Difference between the expected and the actual return on the scheme's assets	
– Amount	**(1.6)**
– Percentage of scheme's assets	**17.2%**
Experience gains and losses on the scheme's liabilities	
– Amount	**(1.9)**
– Percentage of the present value of the scheme's liabilities	**11.0%**
Effect of changes in assumptions underlying the present value of the scheme's liabilities	
– Amount	**(1.7)**
– Percentage of the present value of the scheme's liabilities	**10.1%**
Total amount recognised in the statement of Group total recognised gains and losses	
– Amount	**(5.2)**
– Percentage of the present value of the scheme's liabilities	**30.5%**

6 Net finance costs

	2003 £000	2002 £000
Interest payable		
– 10% First Mortgage Debenture Stock 2018	**10,000**	10,000
– 6.5% Secured Bond 2026	**8,222**	6,464
– Other mortgages	**6,493**	6,352
– Amortisation of issue costs and discounts on issue of mortgages and bonds	**299**	141
– Bank loans and bank overdrafts	**29**	148
	25,043	23,105
Interest receivable	**(3,621)**	(7,309)
Exchange losses on dollar deposits	**1,706**	214
Mortgage breakage costs	**1,844**	–
	24,972	16,010

7 Tax on loss on ordinary activities

	2003 £000	2002 £000
Analysis of charge for year		
UK corporation tax on loss for the year	2,832	5,844
UK taxation on disposal of investment properties	–	17
Adjustments relating to prior years	(250)	(168)
	2,582	5,693
US taxation arising on Weatherford's change of domicile to Bermuda	1,698	–
US taxation on disposal of venture capital investments	2,510	–
Other US taxation	433	465
Total current tax	7,223	6,158
Deferred tax		
Origination and reversal of capital allowances and other timing differences	(271)	438
Deferred tax movement on investment provisions	–	2,266
Deferred tax asset on US lease surrender payment	475	(475)
Total deferred tax	204	2,229
Tax on loss on ordinary activities	7,427	8,387

Factors affecting the tax charge for the year
The tax assessed for the year is higher than that at the standard rate of corporation tax for the year. The differences are explained below:

	2003 £000	2002 £000
Loss on ordinary activities before taxation	(15,792)	(36,068)
Loss on ordinary activities multiplied by the standard UK rate of corporation tax at 30%	(4,738)	(10,820)
Investment provisions, not available for tax relief	12,065	17,315
Investment property historical profits in excess of accounting profits	1,744	–
Investment property and venture capital taxable profits sheltered by venture capital realised loss	(3,678)	(19)
US taxation arising on Weatherford's change of domicile to Bermuda	1,698	–
Bermuda losses not available for current tax deduction	446	–
Adjustments to tax charge in respect of prior years	(250)	(168)
Tax charge arising on transfer of a trading property to investment properties	–	143
Other items	(64)	(293)
Current tax charge for the year	7,223	6,158

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

	2003 '000	2002 '000
Calculations are based on the following		
Basic – weighted average Ordinary shares in issue	**243,637**	243,556

	2003 £000	2002 £000
Investments profit and losses		
– Profits, losses and write-downs on fixed asset investments and investment properties	**(32,550)**	(56,446)
– Debt breakage costs	**(1,844)**	–
– Taxation attributable to above	**(2,765)**	(2,250)
– Taxation adjustment in respect of prior years	**–**	87
– Minority interests	**(84)**	(10)
Total investments profit and losses	**(37,243)**	(58,619)
Total other profit and losses	**11,723**	11,701
Loss for the year	**(25,520)**	(46,918)

	2003 '000	2002 '000
Diluted		
– Weighted average Ordinary shares in issue	**243,637**	243,556
– Weighted average Deferred Ordinary shares in issue	**83,285**	82,315
– Adjustment in respect of shares issuable under share option schemes	**287**	1,920
– Adjustment in respect of shares held as trustees by LMS QUEST Trustee Limited on which no dividends are payable	**(287)**	(607)
– Weighted average number of shares in issue – diluted	**326,922**	327,184

	2003 £000	2002 £000
Loss for the year	**(25,520)**	(46,918)

Shareholders' funds per share
This is calculated on the total of 327.6 million (2002 – 326.2 million) Ordinary and Deferred Ordinary shares, based on the equity shareholders' funds of £678.9 million (2002 – £720.6 million). The resulting shareholders' funds per share is 207.3p (2002 – 220.8p).

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
Net book amount at 31st March 2002	673,762	135,276	115	809,153	19,755
Amount included in prepayments under UITF 28	34	–	–	34	–
Open market value at 31st March 2002	673,796	135,276	115	809,187	19,755
Exchange difference	**(4,943)**	**–**	**–**	**(4,943)**	**–**
Additions at cost	**74,172**	**2,808**	**–**	**76,980**	**6**
Disposals	**(60,766)**	**(4,750)**	**–**	**(65,516)**	**–**
Transfers	**51,820**	**(53,770)**	**1,950**	**–**	**–**
Surplus/(deficit) on revaluation	**4,616**	**2,933**	**(180)**	**7,369**	**2,889**
At 31st March 2003 – valuation	**738,695**	**82,497**	**1,885**	**823,077**	**22,650**
Amount included in prepayments under UITF 28	**(1,133)**	**–**	**–**	**(1,133)**	**–**
Net book amount at 31st March 2003	**737,562**	**82,497**	**1,885**	**821,944**	**22,650**

The transfer from leasehold to freehold followed the purchase of the freehold interest in these properties.

The historical cost of Group investment properties at 31st March 2003 was £356.0 million (2002 – £341.6 million). The historical cost of the Company's investment properties at 31st March 2003 was £3.7 million (2002 – £3.7 million).

Included in Group freehold above are properties with a value of £36.1 million located in the US (2002 – £49.9 million).

All investment properties have been valued at 31st March 2003 on the basis of 'Open Market Value' in accordance with the Approved Valuation Manual of the Royal Institution of Chartered Surveyors. As disclosed in last year's Annual Report, the valuation of the US freehold properties at 31st March 2002 included a special assumption relating to a $9 million lease termination payment received in April 2002. Following receipt of that amount this special assumption is no longer part of the valuation.

86.9% by value of the properties have been valued by Cluttons, Chartered Surveyors and 8.7% valued by Colliers Conrad Ritblat Erdman, Chartered Surveyors. Properties in the US (4.4%) have been valued by Jones Lang LaSalle Americas, Inc., San Francisco.

The 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 £29.9 million (2002 – £32.4 million). The deferred taxation relating to capital allowances which would be released in such circumstances, assuming that no balancing charge would be incurred, is £6.6 million (2002 – £6.9 million).

10 Other tangible assets

	Group £000
At 31st March 2002	
Cost	1,674
Depreciation	(1,132)
Net book value at 31st March 2002	542
Additions at cost	**278**
Disposals at net book value	**(63)**
Depreciation charge for the year	**(210)**
Total movements in the year	**5**
At 31st March 2003	
At cost	**1,718**
Depreciation	**(1,171)**
Net book value	**547**

Other tangible assets comprise of computers, office equipment and motor vehicles.

11 Investments – consolidated subsidiary undertakings

	Company £000
At 31st March 2002 at valuation	377,219
Additions	**9,818**
Disposals	**–**
Deficit on revaluation	**(38,225)**
At 31st March 2003 at valuation	**348,812**

Principal consolidated subsidiary undertakings

	% held by Group
Property investment companies	
340 Pine Street, Inc – USA*	**100**
Urbanfirst Limited	**100**
British Commercial Property Investment Trust Limited	**100**
Caledonian Property Investments Limited*	**100**
Central London Commercial Estates Limited*	**100**
Greenwich Reach 2000 Limited	**100**
Kensington Commercial Property Investments Limited*	**100**
LMS Leisure Investments Limited	**100**
LMS Properties Limited	**100**
LMS Shops Limited*	**100**
Palaville Limited*	**100**
Portman Investments (Baker Street) Limited*	**55**
Portman Investments (Farnham) Limited*	**55**
St. James' Real Estate Company Limited*	**100**
The New River Company Limited*	**100**
West London & Suburban Property Investments Limited	**100**
Property trading companies	
Caledonian Properties Limited*	**100**
Corinium Estates Limited*	**100**
City Shops Limited*	**100**
Venture capital companies	
LMS Capital Limited	**100**
LMS Capital (Bermuda) Limited – Bermuda*	**100**
LMS Investments Limited*	**100**
LMS Tiger Investments Limited*	**100**
Lion Investments Limited*	**100**
Westpool Investment Trust plc	**100**
Other subsidiary companies	
LMS Industrial Finance Limited *Group Financing*	**100**
LMS Services Limited *Group Services*	**100**
London Merchant Securities, Inc. – USA*	**100**

*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 Investment – venture capital

	Fund investments £000	Listed investments £000	Unlisted investments £000	Total £000
Group				
At 31st March 2002 at cost less amounts written off	53,594	48,908	67,948	170,450
Additions at cost	9,861	11,988	35,534	57,383
Amounts written off	(17,946)	(16,474)	(15,277)	(49,697)
Disposals	(6,133)	(6,841)	(2,522)	(15,496)
At 31st March 2003	39,376	37,581	85,683	162,640

As is common practice in the venture 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 both 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 venture capital investments is included on pages 62 and 63.

FRS 13 requires disclosure of the fair value of the Group's venture capital 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	Total £000
Fair values per FRS 13				
At 31st March 2003	40,780	40,343	85,682	166,805
At 31st March 2002	53,502	68,652	68,040	190,194

Of the above, £47.5 million are investments which are subsidiary undertakings which the Group does not consolidate. 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 2003. It is not practicable to state the impact of the non-consolidation of the subsidiaries on the Group's account 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. All of the investments are UK companies except where indicated.

Investment	Activity	Percentage holding %	Most recent audited accounts	Most recent audited net assets £000	Most recent audited net profit/(loss) £000
Offshore Tool and Energy Corporation	Crane manufacture and crane services to the offshore energy industry	85	31.12.01	1,727	(7,094)
Sparrows Offshore International Group Limited	Provider of crane and crane-related services to the offshore energy industry	93	31.12.02	3,300	3,600
7 Global Limited	Software hosting services	83	31.03.02	(2,689)	(4,430)
Ridgeway Systems and Software Inc	Secure solutions for IP multimedia communication	85	31.12.01	2,832	(4,850)
Citizen Limited (Vio Worldwide Limited)	Digital content distribution services	80	30.06.01	2,057	(14,847)
Cityspace Limited	Urban information networks	60	30.06.02	1,432	(2,028)

13 Trading properties

	Group 2003 £000	Group 2002 £000
Trading properties	**11,489**	10,885

As at 31st March 2003 the trading properties have been valued at £26.5 million (2002 – £25.6 million).

These properties have been valued by the directors. 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 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Rents and service charges receivable	**4,151**	5,502	**44**	315
Amounts owed by subsidiary undertakings	**–**	–	**610,459**	569,971
Other debtors	**13,204**	7,344	**578**	4
Pension prepayment	**661**	987	**–**	–
Other prepayments and accrued income	**2,338**	2,683	**203**	191
Corporation tax	**–**	–	**–**	2,125
Deferred tax asset	**–**	475	**–**	–
	20,354	16,991	**611,284**	572,606

All Group debtors fall due within one year.

All Company debtors fall due within one year. In 2002 an amount of £10.0 million was due after more than one year from a subsidiary undertaking.

15 Cash and short-term deposits

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Short-term deposits	**60,059**	106,042	**–**	–
Bank and cash balances	**17,774**	1,490	**–**	–
	77,833	107,532	**–**	–

16 Creditors: amounts falling due within one year

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Bank overdrafts	**535**	2,116	**–**	19
Bank loans	**5,606**	5,734	**–**	–
Rents received in advance	**11,921**	11,435	**304**	296
Amounts owed to subsidiary undertakings	**–**	–	**26,995**	37,389
Corporation tax	**730**	2,816	**–**	–
Other taxes and social security	**1,294**	994	**79**	92
Proposed final dividend	**10,476**	10,233	**10,476**	10,233
Other creditors	**9,909**	7,794	**3,939**	181
Accruals	**1,464**	7,128	**436**	5,249
	41,935	48,250	**42,229**	53,459

Bank loans are secured on investment properties.

17 Creditors: amounts falling due after more than one year

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
6.5% Secured Bond 2026	172,914	98,926	172,914	98,926
10% First Mortgage Debenture Stock 2018	96,991	96,945	96,991	96,945
7.21% Mortgage 2010-2015	9,405	31,500	–	–
9.695% Mortgage 2018	20,000	20,000	–	–
7.295% Mortgage 2010-2015	–	10,500	–	–
7.22% Mortgage 2010-2015	5,202	5,068	–	–
7.135% Mortgage 2010-2015	10,440	–	–	–
6.675% Mortgage 2010-2015	5,160	5,110	–	–
6.68% Mortgage 2010-2015	3,748	3,682	–	–
8.25% Mortgage 2020	2,766	3,076	–	–
Floating rate Mortgage 2003	–	2,400	–	–
6.7% Mortgage 2014	2,384	2,384	–	–
6.57% Mortgage 2010-2015	1,874	1,888	–	–
Floating rate Mortgage 2017	2,000	–	–	–
Unsecured loans	1,303	–	–	–
	334,187	281,479	269,905	195,871

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Borrowings				
– Repayable after more than five years	334,187	279,079	269,905	195,871
– Repayable between one and two years	–	2,400	–	–
	334,187	281,479	269,905	195,871
– Repayable within one year (note 16)	6,141	7,850	–	19
	340,328	289,329	269,905	195,890

The discount on issue in January 1992 at a price of 91.284% on £40 million of the £100 million First Mortgage Debenture Stock 2018 is being amortised over the period to April 2018. The effective finance cost, taking into account redemption at par in 2018, is 11.0% per annum. The unamortised amount of discount at 31st March 2003 was £3.0 million (2002 – £3.1 million).

The discount and issue costs in March 2002 at a price of 99.792% of £100 million of the £175 million Secured Bond 2026 and the discount and issue costs in November 2002 at a price of 99.394% of a further £75 million are being amortised over the period to March 2026. The effective finance cost, taking into account redemption at par in 2026, is 6.6% per annum. The unamortised amount of discount at 31st March 2003 was £2.1 million (2002 – £1.1 million).

The Secured Bond and the Mortgage Debenture Stock, of nominal value £175 million and £100 million respectively, together with the Mortgages are secured on investment properties.

The Floating rate Mortgage 2017 has an interest rate of LIBOR plus a margin of 1.0%.

18 Provisions for liabilities and charges

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Provision for deferred taxation on accelerated capital allowances				
At 31st March 2002	6,893	6,455	53	51
Net (reversal)/provision during the year	(271)	438	1	2
At 31st March 2003	6,622	6,893	54	53

19 Financial instruments

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

	£ sterling 2003 £m	US dollars 2003 £m	Total 2003 £m	£ sterling 2002 £m	US dollars 2002 £m	Total 2002 £m
Venture capital investments (note 12)						
At FRS 13 fair value	**90.5**	**76.3**	**166.8**	81.2	109.0	190.2
At cost less amounts written off	**90.4**	**72.2**	**162.6**	80.7	89.7	170.4
Surplus/(deficit)	**0.1**	**4.1**	**4.2**	0.5	19.3	19.8
Less: taxation	**–**	**–**	**–**	–	–	–
	0.1	**4.1**	**4.2**	0.5	19.3	19.8
Long-term borrowings						
Denomination of long-term borrowings	**331.4**	**2.8**	**334.2**	278.4	3.1	281.5
Weighted average interest rate of fixed rate financial liabilities	**7.8%**	**8.3%**	**7.8%**	8.2%	8.2%	8.2%
Weighted average period for which interest rates on the fixed rate financial liabilities are fixed	**18.3 years**	**17.3 years**	**18.3 years**	17.2 years	18.3 years	17.4 years

The Group has not included short-term debtors and creditors on the disclosures relating to FRS 13. Cash deposits held by the Group are denominated £74.5 million sterling, £3.3 million US dollars and are predominantly held on short-term floating rate deposit accounts with a range of banks.

Note 12 explains the basis of the fair value of the venture capital investments.

Mark to market of long-term borrowing adjustment

	Accounts value 2003 £m	Fair value 2003 £m	Excess over accounts value 2003 £m	Accounts value 2002 £m	Fair value 2002 £m	Excess over accounts value 2002 £m
6.5% Secured Bond 2026	**172.9**	**193.6**	**20.7**	98.9	92.8	(6.1)
10% First Mortgage Debenture Stock 2018	**97.0**	**130.1**	**33.1**	96.9	125.0	28.1
7.21% Mortgage 2010-2015	**9.4**	**10.5**	**1.1**	31.5	32.6	1.1
9.695% Mortgage 2018	**20.0**	**31.2**	**11.2**	20.0	25.1	5.1
7.295% Mortgage 2010-2015	**–**	**–**	**–**	10.5	10.9	0.4
7.22% Mortgage 2010-2015	**5.2**	**5.8**	**0.6**	5.1	5.4	0.3
7.135% Mortgage 2010-2015	**10.4**	**11.5**	**1.1**	–	–	–
6.675% Mortgage 2010-2015	**5.2**	**5.6**	**0.4**	5.1	5.1	–
6.68% Mortgage 2010-2015	**3.7**	**4.0**	**0.3**	3.7	3.8	0.1
8.25% Mortgage 2020	**2.8**	**3.7**	**0.9**	3.1	4.0	0.9
Floating rate Mortgage 2003	**–**	**–**	**–**	2.4	2.4	–
6.7% Mortgage 2014	**2.4**	**2.3**	**(0.1)**	2.4	2.4	–
6.57% Mortgage 2010-2015	**1.9**	**2.0**	**0.1**	1.9	1.9	–
Floating rate Mortgage 2017	**2.0**	**2.0**	**–**	–	–	–
Unsecured loans	**1.3**	**1.3**	**–**	–	–	–
	334.2	**403.6**	**69.4**	281.5	311.4	29.9
Less: taxation			**(19.4)**			(7.7)
Less: minority share			**(3.5)**			(1.9)
Group share of fair value adjustment (net of taxation)			**46.5**			20.3

Fair values of the liabilities have been calculated at the year end by taking market value, where available, or using discounted cash flows. However, the Group is under no obligation to redeem borrowings until maturity at which time they will be repaid 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
At 31st March 2002	272,850,398	82,654,203	8,939,843	243,636,971	82,600,460
Issued during the year	–	1,330,000	(1,330,000)	–	1,330,000
At 31st March 2003	**272,850,398**	**83,984,203**	**7,609,843**	**243,636,971**	**83,930,460**
Nominal value at 31st March 2003	**£74,867,487**	**£23,044,446**	**£2,088,067**	**£66,851,608**	**£23,029,699**
			£100,000,000		**£89,881,307**

The Ordinary shares and the Deferred Ordinary shares constitute a single class of share ranking pari passu in all respect, except that the Deferred Ordinary shares do not entitle their holders to receive any dividend before the conclusion of the Annual General Meeting in 2004, at which time the Deferred Ordinary shares will be automatically converted into the same number of Ordinary shares. The first dividend that the converted Deferred Ordinary shares will rank for a dividend will be the interim dividend in respect of the year ended 31st March 2005.

Options to subscribe for shares under the Company's share option scheme are listed below.

Executive Share Option Scheme

Number	Class	Exercise price	Date from which exercisable	Expiry date
257,260	Deferred Ordinary	180½p	27th July 2003	27th July 2010
451,008	Deferred Ordinary	178½p	27th July 2003	27th July 2010
5,630	Deferred Ordinary	134p	5th January 2004	5th January 2011
2,491,389	Deferred Ordinary	149p	5th January 2004	5th January 2011
91,670	Ordinary	120p	4th September 2005	4th September 2012
2,189,950	Deferred Ordinary	114½p	4th September 2005	4th September 2012

The Rules of the LMS Executive Share Option Scheme have a performance criterion for options granted on or after 4th September 2002, based on the growth in shareholders' funds of RPI plus 9% over the first three years from the grant of options.

On 4th September 2002, 271,377 options granted over Deferred Ordinary shares on 28th July 2000 were re-priced from 178½p to 180½p, 2,491,389 options granted over Deferred Ordinary shares on 5th January 2001 were re-priced from 131½p to 149p and 5,630 options granted over Deferred Ordinary shares on 5th January 2001 were re-priced from 131½p to 134p.

Savings-Related Share Options Scheme

Number	Class	Exercise price	Date from which exercisable	Expiry date
187,770	Deferred Ordinary	40½p	1st April 2003	30th September 2003
58,686	Deferred Ordinary	65¼p	1st April 2003	30th September 2003
242,065	Deferred Ordinary	65¼p	1st April 2005	30th September 2005
632	Ordinary	122½p	1st September 2004	31st March 2005
8,265	Ordinary	122½p	1st September 2006	31st March 2007
20,394	Deferred Ordinary	104½p	1st September 2004	31st March 2005
76,859	Deferred Ordinary	104½p	1st September 2006	31st March 2007
93,890	Deferred Ordinary	104½p	1st September 2008	31st March 2009

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. Shares acquired by the QUEST are included in other investments in note 12 on page 50 of these accounts. 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 2003, the QUEST held 606,716 Deferred Ordinary shares at a cost and valuation of £0.3 million which are included in Investments – venture capital in note 12.

21 Reserves

	Share premium account £000	Capital reduction account £000	Revaluation reserve £000	Capital reserve £000	Profit and loss account £000	Total £000
Group						
At 31st March 2002	18,970	2,868	315,246	215,806	78,220	631,110
Reclassification (see note below)	–	–	–	(215,806)	215,806	–
Premium on issue of shares during the year	64	–	–	–	–	64
Surplus on revaluation						
Investment properties – Group share	–	–	3,644	–	–	3,644
Realisation of revaluation surpluses of previous years	–	–	(9,067)	–	9,067	–
Exchange difference	–	–	(4,943)	–	(1,516)	(6,459)
Increase in share of revaluation reserve on acquisition of minority interests	–	–	1,560	–	–	1,560
Retained loss for the year	–	–	–	–	(40,869)	(40,869)
At 31st March 2003	19,034	2,868	306,440	–	260,708	589,050
Company						
At 31st March 2002	18,970	2,868	212,383	308,429	88,031	630,681
Reclassification (see note below)	–	–	16,257	(308,429)	292,172	–
Premium on issue of shares during the year	64	–	–	–	–	64
Surplus on revaluation						
Investment properties	–	–	2,889	–	–	2,889
Subsidiary undertakings	–	–	(25,618)	–	–	(25,618)
Retained loss for the year	–	–	–	–	(27,339)	(27,339)
At 31st March 2003	19,034	2,868	205,911	–	352,864	580,677

The capital reserves have historically arisen from the sale of properties and other investments. Following a change to the Company's Articles approved at the Annual General Meeting in July 2002, the capital reserves are now fully distributable. Accordingly, the capital reserve has been reclassified. The reclassification is considered appropriate and is consistent with the Company's Articles of Association. The transfer to the revaluation reserve of £16.3 million is in respect of prior year revaluation deficits on the valuations of subsidiary undertakings that are now considered permanent.

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 £12.0 million (2002 – profit £10.0 million).

22 Notes to consolidated cash flow statement

	2003 £000	2002 £000
(1) Reconciliation of operating profit to net cash inflow from operating activities		
Operating profit	41,539	36,233
Depreciation and amortisation charges	213	402
Other non-cash movements	(3)	(30)
Increase in stocks	(603)	(2,620)
Decrease/(increase) in debtors	1,824	(3,351)
(Decrease)/increase in creditors	(426)	4,339
Net cash inflow from operating activities	42,544	34,973

22 Notes to consolidated cash flow statement continued

	At 31st March 2002 £000	Cash flow £000	Other non-cash changes £000	Exchange movements £000	At 31st March 2003 £000
(2) Analysis of movement in net debt					
Bank and cash balances*	1,490	16,367	–	(82)	17,775
Bank overdrafts	(2,116)	1,581	–	–	(535)
		17,948			
Debt due within one year	(5,734)	128	–	–	(5,606)
Debt due after more than one year	(281,479)	(52,719)	(299)	310	(334,187)
		(52,591)			
Short-term deposits*	106,042	(44,361)	–	(1,622)	60,059
	(181,797)	(79,004)	(299)	(1,394)	(262,494)

*Totalled on balance sheet as cash at bank and in hand.

	2003 £000	2002 £000
(3) Reconciliation of net cash flow to movement in net debt		
Increase/(decrease) in cash in the year	17,948	(1,084)
Cash inflow from increase in debt financing	(52,591)	(11,744)
Cash inflow from decrease in liquid resources	(44,361)	(82,300)
Change in net debt resulting from cash flows	(79,004)	(95,128)
Translation differences	(1,394)	(209)
Other non-cash changes	(299)	(141)
Movement in net debt in the year	(80,697)	(95,478)
Net debt at 31st March 2002	(181,797)	(86,319)
Net debt at 31st March 2003	(262,494)	(181,797)

23 Capital commitments

	Group 2003 £000	Group 2002 £000
Property division	52,843	51,987
Venture capital division	48,937	64,494
Total	101,780	116,481

The Company had no capital commitments (2002 – nil).

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 (2002 – nil) relating to the borrowings of subsidiaries.

25 Acquisitions

In March 2003 the Group purchased the 40% minority interest in the Kensington Commercial group of companies for a nominal consideration of £2,000 after distributing to the minority their share of net assets by way of dividend. The total cash cost to the Group was £22.8 million.

The Group also in March 2003 purchased the 20% minority share in the Urbanfirst group of companies for a consideration payable in instalments, estimated in accordance with an agreed pricing formula, at £4.5 million.

Both transactions were priced on a formula linked to adjusted net asset values and resulted in a price below the value at which the underlying assets were shown in the consolidated accounts. As a result of these two transactions the Group has increased its share of accumulated revaluation gains by £1.6 million and this amount is credited to the revaluation reserve.

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 and 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. A Health and Safety team has been formed which meets quarterly and reports to 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

	2003 £000	2002 £000	2001 £000	2000 £000	1999 £000
Group balance sheet					
Investment properties	**821,944**	809,153	736,884	632,690	567,815
Other tangible assets	**547**	542	655	722	845
Venture capital investments	**162,640**	170,450	192,719	148,316	113,356
Cash at bank and in hand	**77,833**	107,532	190,015	173,543	67,684
Other net liabilities	**(10,092)**	(20,374)	(26,512)	(52,322)	(17,688)
Long-term loans	**(334,187)**	(281,479)	(274,783)	(190,638)	(150,261)
Provision for liabilities and charges	**(6,622)**	(6,893)	(6,455)	(5,862)	(5,708)
Net assets	**712,063**	778,931	812,523	706,449	576,043
Equity minority interests	**(33,132)**	(58,305)	(58,830)	(52,966)	(47,077)
Equity shareholders' funds	**678,931**	720,626	753,693	653,483	528,966
Represented by					
Called up share capital	**89,881**	89,516	89,334	82,331	81,713
Reserves	**589,050**	631,110	664,359	571,152	447,253
	678,931	720,626	753,693	653,483	528,966
Group profit and loss account					
Net rental income	**56,614**	51,184	46,028	44,800	41,606
(Loss)/profit before taxation	**(15,792)**	(36,068)	60,338	122,366	45,636
(Loss)/profit for the year	**(25,520)**	(46,918)	36,096	81,392	30,956
(Loss)/earnings per Ordinary share	**(10.47p)**	(19.26p)	15.45p	36.28p	13.84p
Dividends per Ordinary share	**6.3p**	6.2p	6.1p	5.9p	5.5p
Shareholders' funds per share	**207p**	221p	231p	218p	178p
Diluted shareholders' funds per share	**207p**	220p	231p	206p	170p

Note: The figures for the years ended 1999-2001 have been restated to incorporate the implementation of FRS 19, which requires the Group to provide in full for deferred taxation.

	2003	2002	2001	2000	1999
Return on equity					
LMS overall	**(3.7%)**	(2.4%)	14.2%	25.5%	19.5%
Property	**3.9%**	6.7%	16.0%	18.6%	22.6%
Venture capital	**(28.1%)**	(34.4%)	7.9%	51.2%	9.3%
Market price at 31st March					
Ordinary shares	**99.5p**	157p	158.5p	196.5p	100p
Deferred Ordinary shares	**89p**	140p	129.5p	166.5p	72p

Portfolio Breakdown*

	Values (£m)	% of portfolio	% like for like change	Rate of rent (£m)
London, West End	**353.8**	**43.0%**	**2.1%**	**21.0**
Office	284.8	34.6%	0.1%	16.4
Retail	46.4	5.7%	15.5%	2.9
Leisure	12.4	1.5%	2.9%	0.9
Other	10.2	1.2%	3.7%	0.8
Islington and Clerkenwell	**149.3**	**18.1%**	**–4.8%**	**12.2**
Office	133.8	16.2%	–5.8%	11.4
Retail	2.3	0.3%	5.7%	0.2
Leisure	1.4	0.2%	18.0%	0.1
Other	11.8	1.4%	5.8%	0.5
Other Central London	**50.3**	**6.1%**	**–5.1%**	**3.2**
Office	35.6	4.3%	–7.9%	2.0
Retail	5.1	0.6%	13.3%	0.5
Leisure	8.1	1.0%	–1.6%	0.6
Other	1.5	0.2%	–8.0%	0.1
Scotland	**60.1**	**7.3%**	**4.7%**	**5.0**
Office	2.6	0.3%	–4.8%	0.2
Retail	54.5	6.6%	5.5%	3.7
Leisure	2.4	0.3%	3.2%	0.4
Other	0.6	0.1%	–14.6%	0.7
Other UK	**173.5**	**21.1%**	**10.6%**	**12.6**
Office	13.2	1.6%	3.9%	2.1
Retail	90.8	11.0%	12.1%	6.5
Leisure	65.1	7.9%	10.1%	3.7
Other	4.4	0.6%	7.8%	0.3
US	**36.1**	**4.4%**	**–8.2%**	**2.4**
Office	16.7	2.0%	–17.6%	0.8
Retail	19.4	2.4%	1.9%	1.6
Subtotal	**823.1**	**100%**	**1.6%**	**56.4**

*As at 31st March 2003.

Principal Properties
as at 31st March 2003

Value in excess of £30 million

36 Howland Street and 13-17 Fitzroy Street London W1
8,454 sq m (91,000 sq ft) **Redevelopment** W O

The Rotunda Kingston
15,056 sq m (162,000 sq ft) UK L

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

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

Strathkelvin Retail Park Bishopbriggs, Glasgow
17,372 sq m (187,300 sq ft) S R

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

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

Value in excess of £20 million

105 Tottenham Court Road London W1
8,539 sq m (91,920 sq ft) **Held for Redevelopment** W O R

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

Greenwich Reach Greenwich, London
7.75 acre site with consent for 600,000 sq ft **Held for development** UK R L RD

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

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

Value in excess of £15 million

163/170 Tottenham Court Road London WC1
3,344 sq m (36,000 sq ft) W O R RD

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

Lion & Lamb Yard Farnham
6,605 sq m (71,104 sq ft) UK O R P

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

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

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

Value in excess of £10 million

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

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

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

17-39 George Street London W1
1,973 sq m (21,235 sq ft) W O R RD LH P

W London, West End
I Islington and Clerkenwell
CL Other Central London
S Scotland
UK Other UK
US US

O Office
R Retail
L Leisure
RD Residential
LH Leasehold
P Portman Investments, 55% owned

Value in excess of £7.5 million

Rivergate Centre Peterborough
6,085 sq m (65,500 sq ft) UK R

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

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

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

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

88-110 George Street London W1
2,345 sq m (25,235 sq ft) W O R RD LH P

The Bargate Centre Southampton
5,624 sq m (60,455 sq ft) UK R L

The Quadrant Arcade Bournemouth
2,153 sq m (23,180 sq ft) UK R L

Value in excess of £5 million

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

The Royal Arcade Maidstone*
3,641 sq m (39,190 sq ft) UK R

24-40 Gloucester Place London W1
2,202 sq m (23,705 sq ft) W O RD LH P

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

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

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

The Quadrant Arcade Romford
6,413 sq m (69,035 sq ft) UK R

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

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

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

22-66 Myddelton Square London EC1 I RD

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

High Street/Duke Street Arcades Cardiff*
3,534 sq m (38,051 sq ft) UK R

*Sold after 31st March 2003

Principal Venture Capital Investments

Largest investments: UK (quoted)

Company	Activity	Number of shares 000	Book value £000
Offshore Tool and Energy Corporation*	Oilfield services	767,802	5,251
Crown Sports plc	Health and fitness club owner/operator	57,754	3,540
DMATEK Limited	Security tagging technology	4,076	1,936
Bloomsbury Publishing plc	Book and information publisher	199	1,366
Whittard of Chelsea plc	Tea and coffee retailer	962	904
NMT Group plc	Medical safety devices	54,346	500
Dunedin Enterprise Investment Trust plc	Investment trust	214	426
Bond International Software plc	Recruitment/HR software	1,683	227
Medal Entertainment & Media plc	TV studios and video distribution	214	150
Civilian Content plc	Television and film production	2,143	54
Other			365
Total			14,719

Largest investments: US (quoted)

Company	Activity	Number of shares 000	Book value £000
Weatherford International Inc	Oilfield services	421	8,068
Grant Prideco Inc	Oil and gas exploration products	1,100	7,223
Digital Generation Systems Inc	Media delivery network	1,909	2,956
Aclara Biosciences Inc	Drug discovery technology	848	1,073
Chyron Corporation	Broadcast media technology	3,715	470
Chordiant Software Inc	Multi-channel CRM Software	538	378
AXS-One Inc	Enterprise Software	1,385	370
Ultimate Software Group Inc	HRM and payroll software solutions	109	272
Psychiatric Solutions Inc	Hospital and psychiatric unit owner/operator	50	253
Pegasus Communications Corporation	Digital broadcast satellite service	36	252
Other			1,547
Total			22,862

Largest investments: UK (unquoted)

Company	Activity	Book value £000
7 Global Limited*	Software Hosting Services	9,746
Sparrows Offshore International Group Limited*	Provider of crane and crane-related services	9,559
Strakan Group Limited	Speciality pharmaceuticals	9,260
Ridgeway Systems and Software Inc*	Secure solutions for IP multimedia communication	8,426
Offshore Tool & Energy Corporation (Debt)*	Oilfield services	5,737
Entuity Limited	Network management software	4,643
Citizen Limited (Vio Worldwide Limited)*	Digital content distribution services	4,500
Cityspace Limited*	Urban information networks	4,258
Wesupply Limited	Supply chain management software	4,000
First Index Group Limited	Manufacturing sourcing service	3,690
netdecisions Holdings Limited	IT services	2,993
AssetHouse Technology Limited	Content services infrastructure software	1,833
Genient Limited	Application integration software	1,795
CopperEye Limited	Database indexing technology	1,520
Elateral Holdings Limited	Marketing automation technology	1,474
Other		4
Total		73,438

Largest investments: US (unquoted)

Company	Activity	Book value £000
Rave Motion Pictures	Movie theatre operators	5,804
TradePower Inc	Construction application software	2,110
GoBeam Inc	Business communication services	1,042
Chyron Corporation (Debt)	Broadcast media technology	958
Oberon Financial Technology Inc	Investment management software services	780
Telespree Communications	Wireless telecommunications infrastructure	688
LifeMasters Supported SelfCare Inc	Comprehensive disease management services provider	422
Other		441
Total		12,245

*Economic Interest above 50%.

Directors and Management

Life President
The Lord Rayne was founder of the Company in its present form. He was Chairman and Chief Executive from 1960 to 2000, until he retired and was appointed Life President.

Directors
Chairman G C Greene CBE*
Mr Greene is aged 67 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 also a director of Greene King plc and former Chairman of the Trustees of The British Museum.

Deputy Chairman P J Grant CBE*
Mr Grant is aged 73 and has been a director since 1984 and 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 was formerly Chairman of Sun Life Corporation plc and Deputy Chairman of Lazard Brothers & Co., Limited.

Chief Executive The Hon R A Rayne
The Hon R A Rayne is aged 54 and joined the Company in 1975. He was appointed Investment Director in 1983, Joint Managing Director in 1998 and Chief Executive on 17th May 2001. He is a member of the Nomination Committee.

Managing Director N G E Driver
Mr Driver is aged 59 and joined the Company in 1970. He was appointed Property Director in 1989, Joint Managing Director in 1998 and sole Managing Director on 17th May 2001. He is a member of the Nomination Committee.

Finance Director N R Friedlos
Mr Friedlos is aged 45 and was appointed Finance Director on 22nd January 2003. He is a member of the Nomination Committee.
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.

Director of Corporate Development M A Pexton
Mr Pexton is aged 46, joined the Company in April 2002 and was appointed a director on 17th October 2002. He is a member of the Nomination Committee. 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 (now PricewaterhouseCoopers) 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.

Mrs J F de Moller*
Mrs de Moller is aged 55 and was appointed a director on 16th May 2002. She is a member of the Nomination, Remuneration and Audit Committees. She is a non-executive director of J Sainsbury plc, Cookson Group plc and Archant Limited. Mrs de Moller is a former Managing Director of Carlton Communications Plc.

D Newell*
Mr Newell is aged 60 and was appointed a director in 1998. He is Chairman of the Audit Committee and a member of the Remuneration and Audit 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.

The Hon J M Wilson*
The Hon J M Wilson is aged 50 and was appointed a director on 1st April 2001. A founding partner and Managing Director of Boston Ventures, a leading US media and communications private equity firm, he is also director of Jobson Publishing LLC, PartMiner Inc., CAMP Systems Corp, TradePower Inc., Marshall & Swift, Northstar Travel Media and World Publications.

*Non-executive director.

Company Secretary S C Mitchley ACIS

Group Accountant J M Townley BA ACA

Group Property Manager N T J Groves BA MRICS

Shareholder Information

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www.capitaregistrars.com

Shareholder enquiries
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Email ssd@capitaregistrars.com

Trustee for
10% First Mortgage
Debenture Stock 2018 and 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 18th June 2003

Record date 20th June 2003

AGM 25th July 2003

Dividend payment date 28th July 2003

Interim results November 2003

Glossary of Terms

CRM: Customer Relations Management.

FRS: Financial Reporting Standard.

Gross annual rate of rent: Contracted rent roll.

HR: Human Resources.

HRM: Human Resource Management.

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

IT: Information Technology.

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 investment 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.

Advisors

Auditors
KPMG Audit Plc, London

Bankers
Barclays Bank plc

Brokers
Cazenove

Solicitors
Clifford Chance

Michael Conn Goldsobel

Valuers
Cluttons

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