

Registered No. 3462675

Morgans Hotel Group London Limited
(formerly Ian Schrager London Limited)

Annual report

For the year ended 31 December 2005



Morgans Hotel Group London Limited
(formerly Ian Schrager London Limited)

Annual report
for the year ended 31 December 2005

	Pages
Directors and advisers	1
Directors' report	2 - 3
Independent auditors' report	4 - 5
Profit and loss account	6
Balance sheet	7
Notes to the financial statements	8 - 16

Morgans Hotel Group London Limited (formerly Ian Schrager London Limited)

Directors and advisers

Directors

B Porter
E Scheetz
J MacCarty
D Hamamoto

Secretary and registered office

Paul Hastings Administrative Services Limited
20 Thayer Street
London
W1U 2DD

Solicitors

MacFarlanes
10 Norwich Street
London EC4A 1BD

Registered auditors

PricewaterhouseCoopers LLP
1 Embankment Place
London WC2N 6RH

Bankers

National Westminster Bank PLC
135 Bishopsgate
London EC2M 3UR

Morgans Hotel Group London Limited (formerly Ian Schrager London Limited)

Directors' report for the year ended 31 December 2005

The directors present their report and the audited financial statements of the company for the year ended 31 December 2005. The company changed its name from Ian Schrager London Limited to Morgans Hotel Group London Limited on 24 November 2005.

Principal activity

The principal activity of the company is the operation of two hotels in London - the St Martin's Lane Hotel and the Sanderson Hotel.

Results and dividends

The results for the year are set out in the profit and loss account on page 6.

The directors do not recommend the payment of a dividend for the year (2004: nil). The company's loss for the year of £5,678,000 (2004: £2,006,000) has been charged against reserves.

2006 trading has continued to be buoyant.

Directors

The directors of the company during and after the year are as follows:

J Gleek	(resigned 24 April 2006)
I Schrager	(resigned 10 October 2005)
B Porter	(appointed 24 April 2006)
J Anderson	(resigned 24 April 2006)
J MacCarty	(appointed 24 April 2006)
D Hamamoto	
E Scheetz	(appointed 10 October 2005)

Directors interests

According to the register of directors' interests, none of the directors who held office at the end of the year had any interest in the shares of the company, nor were any rights to subscribe for shares in company granted to, or exercised by, any of these directors.

Statement of directors' responsibilities

The directors are required by UK company law to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company as at the end of the financial year and of the profit or loss of the company for that period. The directors are also responsible for preparing financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

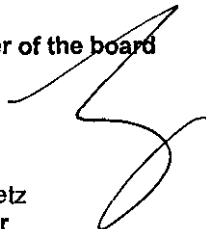
The directors confirm that suitable accounting policies have been used and applied consistently with the exception of the changes arising on the adoption of new accounting standards in the year as explained in the note to the financial statements. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2005 and that applicable accounting standards have been followed.

Morgans Hotel Group London Limited **(formerly Ian Schrager London Limited)**

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By order of the board

E Scheetz
Director

A handwritten signature in black ink, appearing to be 'E Scheetz', written over the printed name.

30.10.06

Independent auditors' report to the members of Morgans Hotel Group London Limited

We have audited the financial statements of Morgans Hotel Group London Limited for the year ended 31 December 2005 which comprise the Profit and Loss Account, the Balance Sheet and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are 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 other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company'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 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.

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2005 and of its loss and cash flows for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

31.12.06

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London

Morgans Hotel Group London Limited
(formerly Ian Schrager London Limited)
Profit and loss account
for the year ended 31 December 2005

	Notes	2005 £000	2004 £000
Turnover	1	26,206	25,906
Cost of sales		<u>(7,084)</u>	<u>(7,033)</u>
Gross profit		19,122	18,873
Administrative expenses		<u>(14,441)</u>	<u>(13,463)</u>
Operating profit		4,681	5,410
Interest receivable		218	196
Interest payable and similar charges	4	<u>(7,220)</u>	<u>(7,612)</u>
Exceptional interest charge	5	<u>(3,357)</u>	<u>-</u>
Net interest payable		(10,359)	(7,416)
Loss on ordinary activities before taxation	3	<u>(5,678)</u>	<u>(2,006)</u>
Tax on profit on ordinary activities	6	-	-
Loss for the financial year		<u>(5,678)</u>	<u>(2,006)</u>

All income and expenditure arises from continuing operations.

The company has no recognised gains or losses other than the loss for the year.

The historical cost loss and reported loss are the same.

Morgans Hotel Group London Limited
(formerly Ian Schrager London Limited)

Balance sheet
At 31 December 2005

	Notes	2005 £000	2005 £000	2004 £000	2004 £000
Fixed assets					
Tangible assets	7		104,209		105,940
Current assets					
Stock	8	147		209	
Debtors	9	14,572		9,088	
Cash at bank and in hand (restricted cash £0, 2004: £4,230,000)	10	8,438		4,623	
		23,157		13,920	
Creditors: amounts falling due within one year	11	(3,954)		(8,708)	
Net current assets			19,203		5,212
Total assets less current liabilities			123,412		111,152
Creditors: amounts falling due after more than one year	12		(104,533)		(86,595)
Net assets			18,879		24,557
Capital and reserves					
Called up share capital	14		-		-
Share premium account	15		35,000		35,000
Profit and loss account - deficit	15		(16,121)		(10,443)
Equity shareholders' funds	16		18,879		24,557

The financial statements on pages 6 to 16 were approved by the board of directors on
and were signed on its behalf by:

E Scheetz
Director



B Porter
Director

30.12.06

Morgans Hotel Group London Limited
(formerly Ian Schrager London Limited)

**Notes to the financial statements for the year ended
31 December 2005**

1 Principal accounting policies

The financial statements have been prepared under the historical cost convention and in accordance with applicable Accounting Standards in the United Kingdom. A summary of the more important accounting policies, which have been applied consistently subject to the changes in accounting policy laid out below, is set out below.

Changes in accounting policies

The company has adopted FRS 21 'Events after the balance sheet date', and FRS 25, 'Financial instruments: disclosure and presentation', in these financial statements. The adoption of these standards represents a change in accounting policy. There was nil effect (2004: £nil) by changing accounting policy to adopt these standards.

Cash flow statement

The company is exempt under FRS1 (revised) from the requirement to prepare a separate cash flow statement on the grounds that its immediate parent, Morgans Hotel Group Europe Limited, incorporates the company's cash flows in its own published consolidated cash flow statements.

Fixed assets and depreciation

Tangible fixed assets are stated at cost less depreciation and any provision for impairment. Assets are depreciated to their residual values on a straight line basis over their estimated residual lives as follows:

Freehold buildings	50 years
Building surface finishes	25 years
Plant and machinery	15 years
Fixtures, fittings and equipment	5 – 10 years

No depreciation is provided on freehold land. No residual values are ascribed to building surface finishes.

Interest paid on fixed assets purchases is capitalised up until the time the asset is available for use.

Foreign currency transactions

Translations into sterling are made at the average of rates ruling throughout the period for profit and loss items and at the rate ruling at 31 December 2005 for assets and liabilities. Exchange differences arising in the ordinary course of trading are reflected in the profit and loss account.

Deferred taxation

Deferred taxation is provided in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events have occurred which result in an obligation to pay more or less tax in the future.

Deferred tax is measured at the average tax rates which apply in the period in which the timing differences are expected to reverse. Deferred tax is measured on a non-discounted basis.

Morgans Hotel Group London Limited **(formerly Ian Schrager London Limited)**

Deferred tax assets are regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it is more likely than not that there will be adequate future taxable profits against which to recover carried forward tax losses.

Finance costs

Finance costs are included within the carrying value of the loan and are amortised over the term of the loan.

Stocks

Stocks are stated at the lower of cost and net realisable value. In determining the cost of raw materials and consumables the weighted average purchase price is used.

Turnover

Turnover represents the amounts (excluding value added tax) derived from the provision of goods and services to customers. Turnover is wholly generated in the United Kingdom.

Pension scheme

The company operates a defined contribution pension scheme. Contributions are charged to the profit and loss account in the period in which they are incurred.

2 Staff numbers and costs

The average number of employees in the year was:

	2005	2004
	Number	Number
Hotel operating staff	150	152
Management/administration	30	29
Sales and marketing	12	10
Repair and maintenance	21	17
Total	<u>213</u>	<u>208</u>

Morgans Hotel Group London Limited
(formerly Ian Schrager London Limited)

The aggregate payroll costs for these persons were as follows:

	2005	2004
	£'000	£'000
Employee costs	5,476	5,455
Social security costs	407	396
Pension costs	47	62
	<u>5,930</u>	<u>5,913</u>

None of the directors received any remuneration during the year or previous year.

Funded defined contribution scheme for employees (group scheme)

Pension costs of £47,000 (2004: £62,000) were charged to the profit and loss account of which £nil (2004: £nil) was outstanding at the balance sheet date.

The pension scheme is held with Standard Life and is administered by Inter Alliance.

3 Loss on ordinary activities before taxation

	2005	2004
	£'000	£'000
Loss on ordinary activities before taxation is stated after charging:		
Auditors' remuneration:		
Audit	66	59
Non audit – (Tax compliance)	182	102
Depreciation and other amounts written off tangible fixed assets:		
Owned assets	<u>3,267</u>	<u>3,222</u>

4 Interest payable and similar charges

	2005	2004
	£'000	£'000
On bank loans and overdrafts	<u>7,220</u>	<u>7,612</u>

Morgans Hotel Group London Limited (formerly Ian Schrager London Limited)

5 Exceptional Interest charge

During 2005 Morgans Hotel Group London undertook a review of their debt structure. In November 2005 Management took advantage of the improvement in the Company's business performance and a favourable capital market and secured new financing at more competitive rates providing a strong, stable financial base from which to operate in the future. Costs of £3,357,000 were incurred in cancelling the previous loan financing.

6 Tax on profit on ordinary activities

No corporation tax has been provided due to losses incurred in the year (2004: nil).

(a) Factors affecting tax charge for the year

	2005	2004
	£'000	£'000
Loss on ordinary activities before tax	(5,678)	(2,006)
Loss on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2004: 30%)	(1,703)	(602)
<i>Effects of:</i>		
Expenses not deductible for tax purposes	194	195
Capital allowances in excess of / (less than) depreciation	739	(1,752)
Tax losses	770	2,159
Tax charge for the period	-	-

(b) Factors affecting future tax charges

In respect of the company's tax losses, no deferred tax asset has been recognised due to uncertainty regarding the company's future trading results.

Morgans Hotel Group London Limited
(formerly Ian Schrager London Limited)

7 Fixed assets

	Land and Buildings £000	Plant and Machinery £000	Fixtures, fittings and equipment £000	Total £000
Cost				
At 1 January 2005	99,492	7,999	12,548	120,039
Additions	1,092	-	444	1,536
At 31 December 2005	100,584	7,999	12,992	121,575
Depreciation				
At January 2005	4,737	2,639	6,723	14,099
Charge for the year	1,133	535	1,599	3,267
At 31 December 2005	5,870	3,174	8,322	17,366
Net book value				
At 31 December 2005	94,714	4,825	4,670	104,209
At 31 December 2004	94,755	5,360	5,825	105,940

Included in total net book value of land and buildings is £42,839,000 (2004: £43,723,000) of long leasehold property and £4,245,000 (2004: £4,271,000) of capitalised interest (net of accumulated depreciation).

8 Stocks

	2005 £'000	2004 £'000
Raw materials and consumables	147	209

9 Debtors: amounts due within one year

	2005 £'000	2004 £'000
Trade debtors	1,193	1,448
Amounts due from immediate parent undertaking	12,634	7,045
Amounts due from related parties (see note 18)	341	128
Prepayments and accrued income	404	465
	14,572	9,088

Morgans Hotel Group London Limited
(formerly Ian Schrager London Limited)

10 Cash at bank and in hand

	2005	2004
	£'000	£'000
Cash at bank and in hand	8,438	393
Restricted cash	-	4,230
	<u>8,438</u>	<u>4,623</u>

Under the terms of the previous loan agreement (see note 12), the company was required to set aside cash as a general reserve. At 31 December 2005 this amount totalled £nil (2004: £4,230,000) as no reserve is required under the terms of the new loan agreement.

11 Creditors: amounts falling within one year

	2005	2004
	£'000	£'000
Bank loans and overdrafts	1,250	5,000
Trade creditors	338	551
Amounts due to related parties (see note 18)	469	308
Other creditors including taxation and social security	399	710
Accruals and deferred income	1,498	2,139
	<u>3,954</u>	<u>8,708</u>

12 Creditors: amount falling due after more than one year

	2005	2004
	£	£'000
Bank loans and overdrafts	<u>104,533</u>	<u>86,595</u>

Morgans Hotel Group London Limited (formerly Ian Schrager London Limited)

Bank loans are repayable as follows:

	2005	2004
	£'000	£'000
In one year or less, or on demand	1,250	5,000
In more than one year, but not more than two years	1,500	30,000
In more than two years, but not more than five years	103,033	56,595
	<u>105,783</u>	<u>91,595</u>

Bank loans are as follows:

	2005	2004
	£'000	£'000
Sterling bank loan Note: 6.3110%	105,783	-
2004: Sterling bank loans repayable in monthly instalments	-	91,595
	<u>105,783</u>	<u>91,595</u>

Bank loans are repayable in monthly instalments, are denominated in sterling and bear interest on a fixed rate as noted above.

In November 2005, the Group undertook a refinancing which led to the cancelling of swap agreements. The bank loans are secured by fixed and floating charges against the group's assets.

13 Deferred taxation

	2005	2004
	£'000	£'000
The unrecognised deferred tax asset comprises:		
Short term timing differences	(726)	(1,465)
Losses	5,003	4,212
Total deferred tax asset	<u>4,277</u>	<u>2,747</u>

No deferred taxation asset has been recognised in the financial statements due to uncertainty of its future economic value.

Morgans Hotel Group London Limited
(formerly Ian Schrager London Limited)

14 Called up share capital

	2005 £'000	2004 £'000
Authorised		
100 ordinary shares of £1 each	-	-
Allotted, called up and fully paid		
50 ordinary shares of £1 each	-	-

15 Reserves

	Share premium account £000	Profit and loss account £000	Total £000
At 1 January 2005	35,000	(10,443)	24,557
Loss for the year	-	(5,678)	(5,678)
At 31 December 2005	<u>35,000</u>	<u>(16,121)</u>	<u>18,879</u>

16 Reconciliation of movements in shareholders' funds

	2005 £'000	2004 £'000
Loss for the financial year	(5,678)	(2,006)
Opening shareholders' funds	<u>24,557</u>	<u>26,563</u>
Closing shareholders' funds	<u>18,879</u>	<u>24,557</u>

17 Immediate and ultimate controlling parties

The company's immediate and ultimate parent is Morgan Hotel Group Europe Limited (formerly IS Europe Limited) a company registered in England and Wales.

Morgan Hotel Group Europe Limited is owned 50% by Burford Hotels Limited, whose ultimate holding company is Lehman Brothers Holdings Inc., a company incorporated in the state of Delaware in the USA.

The consolidated accounts of Lehman Brothers Holdings Inc are available to the public from 399, Park Avenue, New York, USA and from One Broadgate, London.

Morgans Hotel Group London Limited (formerly Ian Schrager London Limited)

The other 50% is owned by Royalton Europe Holdings LLC (formerly IS Europe Holdings LLC), a wholly owned subsidiary of Morgans Hotel Group Co, a company incorporated in the USA, whose principal place of business is 475 10th Avenue New York, NY 10018 USA.

18 Related party transactions

Morgans Hotel Group UK Management Limited (formerly Royalton UK Management Limited)

Morgans Hotel Group UK Management Limited is 100% owned by Morgans Hotel Group LLC.

Morgans Hotel Group UK Management Limited charged Morgan Hotel Group London Limited a management fee and staff costs relating to hotel management, which totalled £2,520,000 (2004: £2,573,000).

SC London Limited

SC London is indirectly owned 50% by Morgans Hotel Group LLC and 50% by Chodorow Ventures LLC.

SC London pays rent and recharged expenditure to Morgans Hotel Group London Limited, which totalled £3,396,000 (2004: £3,200,000).

Related party balances and transactions	2005	2004
	£'000	£'000
Debtors: amounts falling within one year		
SC London Limited	246	-
Morgans Hotel Group Co	-	58
Other Morgans Hotel Group companies	95	70
	<u>341</u>	<u>128</u>
	2005	2004
	£'000	£'000
Creditors: amounts falling within one year		
Morgans Hotel Group UK Management Limited	270	215
SC London Limited	197	89
Other Morgans Hotel Group companies	2	4
	<u>469</u>	<u>308</u>

The directors confirm that there were no related party transactions other than those disclosed in these financial statements and that all transactions were undertaken on an arms length basis.