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Recovery Trust PLC

(formerly Pavilion Geared Recovery Trust PLC)

Annual Report and Accounts
31 July 2003

INVESTMENT OBJECTIVE AND POLICY

Recovery Trust PLC is an investment trust which has been structured to provide the holders of its Ordinary Income shares with a high and growing income and a geared capital return. The gearing is currently provided by Zero Dividend Preference shares, due to be repaid on 15 August 2007.

The Company's objectives are to provide holders of the Ordinary Income shares with a high and growing income and the potential for capital growth and the holders of the Zero Dividend Preference shares with a predetermined capital return over the period to 15 August 2007.

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COMPANY SUMMARY

Management company	***Montanaro Investment Managers Limited***
Shareholders' funds	£15,273,000 at 31 July 2003
Market capitalisation	£12,707,000 at 31 July 2003
Capital structure	30,000,000 Ordinary Income shares of 1p each 13,835,000 Zero Dividend Preference shares of 1p each
ZDP repayment date	15 August 2007
Shareholder entitlements	***On a winding-up of the Company:*** – Zero Dividend Preference shareholders are entitled to a capital entitlement of 100.00p per share increasing to a final figure of 167.74p on 15 August 2007. This equated to Redemption Yield of 9% at the Placing Price of 100p. – Zero Dividend Preference shares do not carry an entitlement to receive income. – Ordinary Income shareholders are entitled to all the revenue profits of the Company and to all the net assets of the Company, subject to the payment of the Company's liabilities and the prior entitlement of the Zero Dividend Preference shareholders to payment of their fixed capital entitlement on 15 August 2007. Further details are given in note 16 to the Accounts on page 26.
Management fee	For the 5 months to 31 December 2002: 0.066% (exclusive of VAT) of gross assets per month. 0.8% per annum of gross assets calculated monthly. The Manager for this period was Pavilion Asset Management Limited. For the 7 months to 31 July 2003: 0.0417% (exclusive of VAT) of gross assets per month. 0.5% per annum of gross assets calculated monthly. The Manager for this period was Montanaro Investment Managers Limited.
ISA status	The Company is fully eligible for inclusion in ISAs.
AITC	The Company is a member of the Association of Investment Trust Companies (AITC).

FINANCIAL SUMMARY FOR THE PERIOD

	31 July 2003	31 July 2002	% change
Shareholders' funds	**£15,273,000**	£17,736,000	(13.89)%
Net asset value:			
Ordinary Income share	**0.04p**	9.02p	(99.56)%
Zero Dividend Preference share	**110.32p**	108.64p	1.55%
Market price:			
Ordinary Income share	**8.00p**	31.50p	(74.60)%
Zero Dividend Preference share	**74.50p**	77.50p	(3.87)%
Benchmark:			
FTSE All-Share Index	**2,045.82**	2,050.81	(0.24)%
Premium/(discount):			
Ordinary Income share	**19,900%**	249.2%	
Zero Dividend Preference share	**(32.5)%**	(28.7)%	
Dividends:			
First interim dividend of 0.75p per share paid			
Second interim dividend of 0.75p per share paid			
Third interim dividend of 0.75p per share paid			
Fourth interim dividend of 0.6p per share paid			
Cost of running the Company			
Total expense ratio (excluding costs of aborted capital reorganisation)	**2.0%**	3.6%	

	Year ended 31 July 2003		
	Revenue pence	Capital pence	Total return pence
Earnings			
Ordinary Income share	1.85	(12.02)	(10.17)
Zero Dividend Preference share	–	10.14	10.14
Total	**1.85**	**(1.88)**	**(0.03)**

DIRECTORS AND ADVISERS

Directors (all non-executive)

The Hon. Trevor Trefgarne (Chairman)

Mr Trefgarne, aged 59, has extensive and varied experience of the management of UK listed companies and investment funds. He is currently chairman of Garro Securities Limited and Enterprise Insurance Company Limited and a director of Gartmore High Income Trust PLC, Global Menkul Degerler AS and Franklin Templeton Investment Funds SICAV.

Robert Clinton

Mr Clinton, aged 62, was formerly head of corporate finance at Greig Middleton (now part of Old Mutual Securities) where he had been a director since 1986. Between 1981 and 1984 he was managing director of Butler, Laing & Cruickshank. He was managing director of Wimpey Finance Limited between 1977 and 1981, during which time he was also group treasurer of George Wimpey Limited. Previously Mr Clinton held management positions at Charterhouse Japhet (the merchant banking arm of the Charterhouse Group), British Leyland and the Beecham Group (now GlaxoSmithKline). He sits on the boards of Progressive Geared Investment Trust PLC and Broadgate Investment Trust PLC and a number of private companies.

Christopher Jones

Mr Jones, aged 62, is head of investments at Merchant Investors Assurance Co. Limited, a subsidiary of Allianz (UK) Limited, and has held this position since 1985. He has 30 years' investment experience, and was previously the fixed interest and money manager for Property Growth Assurance Company Limited, a subsidiary of Royal & Sun Alliance Insurance Group plc. He is also a member of the Securities Institute and is a non-executive director of Jupiter Financial & Income Trust plc, Thompson Clive Investment plc and a number of other investment companies.

Richard Howell

Mr Howell, aged 59, retired in December 2002 after 40 years in stockbroking during which time he served as a partner of Sheppards and Chase, a director of Greig Middleton & Co. and a director of Seymour Pierce Limited. The last ten years of his career he spent specialising in split capital investment trusts.

Secretary and Registered Office

Sinclair Henderson Limited
23 Cathedral Yard
Exeter EX1 1HB

Investment Manager

Montanaro Investment Managers Limited
135 Cannon Street
London EC4N 5BP

Auditors

PricewaterhouseCoopers LLP
Southwark Towers
32 London Bridge Street
London SE1 9SY

Registrar and Transfer Office

Capita Registrars
Bourne House
34 Beckenham Road
Beckenham
Kent BR3 4TU

Stockbrokers

Seymour Pierce Limited
29-30 Cornhill
London EC3V 3NF

Bankers

Bank of Scotland
New Uberior House
11 Earl Grey Street
Edinburgh EH3 9BN

Custodian

HSBC Bank plc
Global Investor Services
Mariner House
Pepys Street
London EC3N 4DA

CHAIRMAN'S STATEMENT

The financial year under review has been a difficult time for split capital investment trusts and for your Company no less than others.

The Board has taken several steps to put shareholders in the best position in the circumstances including paying off the term borrowings in July 2002 and appointing Montanaro Investment Managers Limited as Manager in January this year.

It is disappointing that shareholders did not approve the Board's proposals to reorganise the Company's share capital into a single class of new ordinary shares and to adopt new investment objectives and policy, which were considered at the shareholders' meeting on 1 August 2003. This highlights the difficulties of managing the conflicting objectives of shareholders in split capital investment trusts such as yours over their remaining life.

The Directors have re-considered how best to continue to manage the Company in a prudent way under the original objectives set out in the Listing Particulars of August 2001. Firstly, the Board intends to agree a new £3m overdraft facility with the Company's Bankers. Unlike the original term borrowings repaid in July 2002, the new facility may be repaid without penalty. The rate of interest is likely to be about LIBOR plus 1.5% and could therefore increase from the current levels if interest rates rise. In prevailing stock market conditions use of this facility should provide opportunities for both increased income and capital growth.

As set out in the Manager's Report it is proposed to generally remain fully invested, although the Board has made it clear to the Manager that borrowings may be repaid and liquid assets held if appropriate.

At flotation the initial proportion of total assets allocated to the Income Portfolio and invested in income shares was 40%, with the remaining 60% allocated to the Recovery Portfolio. By the end of the financial year under review the value of the investments originally made for the Income Portfolio had fallen by almost 85%. Based on the Company's present resources available for investment (including the proposed borrowing facility) it is therefore intended that the portfolios be re-aligned in order to restore and maintain the ratios required by the Company's original Investment Objective. Additionally, in view of the events in the split capital investment trust sector the Board believes it prudent that the Income Portfolio should be diversified to contain high yielding securities other than solely investment trust income shares. The Manager is currently reviewing the existing income holdings with a view to reducing stock specific risk whilst maintaining reasonable income objectives. The ratio of assets held by the Income and Recovery portfolios will be reviewed from time to time in order to ensure that the required proportions are maintained.

As set out in the Directors' Report the Directors declared a fourth interim dividend in respect of the year to 31 July 2003 of 0.6p per Ordinary Income share, which was paid on 30 September. As regards future dividends and in the absence of unforeseen circumstances, the Board anticipates revenue on the portfolio as presently structured will support dividends of 2p in respect of the year to 31 July 2004. It is therefore intended to pay the next interim dividend in March 2004, which it is anticipated will be 1p per Ordinary Income share. A further interim dividend in respect of the year to 31 July 2004 will be paid in September 2004 and this we anticipate will be not less than 1p per Ordinary Income share. These statements should not be taken to be forecasts of net revenue. Revenue available for distribution in the current year may be greater depending on the timing of the portfolio restructuring. The dividend of 0.6p per Ordinary Income share declared on 26 August was lower than might have been anticipated. This is because the costs of the reorganisation, amounting to approximately £134,000 (including VAT) have been charged to revenue, as the Proposals are not being implemented.

In the period since the appointment of Montanaro Investment Managers Limited as Manager, the overall performance of the Company has exceeded our benchmark, the FTSE All-Share, by 2%. The Manager has done well given the necessary restructuring of the portfolio and the levels of cash held.

Trevor Trefgarne
Chairman
15 October 2003

MANAGER'S REPORT AND PORTFOLIO ANALYSIS

Over the 12-month period from 1 August 2002 to 31 July 2003, the total assets of the Company fell from £17.7m to £15.3m. This equates to a decline of 13.9% in absolute terms and underperformance of 13.7% when compared with the Company's benchmark, the FTSE All-Share Index. As previously highlighted in the Interim Report, this underperformance was mainly caused by the Company's continuing exposure to the split capital investment trust sector. The market value of the Income Portfolio declined by 41.7% over this period, falling from £4.8m to £2.8m.

The reasons behind the collapse in the split capital investment trust sector have been well documented and there seems little value in further post-mortems. However, it is worth emphasising that in many cases these losses are irrecoverable due to holdings in companies that have been forced into liquidation as a result of their inability to continue servicing their high levels of borrowing.

The Board had the foresight to entirely repay the Company's bank borrowings of £15m in July 2002. This action, whilst incurring significant breakage costs at the time, almost certainly secured the future of the Company. In a continuing effort to restore value for shareholders, the Board have since initiated other proactive measures. With effect from 2 January 2003, Montanaro Investment Managers Limited was appointed as Manager of the Company. In July 2003 shareholders were offered the opportunity to vote on proposals that involved a reorganisation of the share capital into a single class of share. The Manager was supportive of these proposals, since they appeared to offer shareholders the best possible prospects for sustainable recovery of value. However, in the event, shareholders did not approve the proposals. The Manager will therefore continue working to rebuild value for shareholders within the constraints of the original investment policy and objectives.

The Manager has enabled the Company to outperform its benchmark, the FTSE All-Share, by 2% since appointment. This performance has been achieved despite incurring necessary portfolio restructuring costs and holding relatively high levels of cash during the period.

At the end of the period under review, 86% of the Company's assets were invested in equities, with the balance being held in cash. The Manager's intention is to move gradually to a fully invested position and, when felt appropriate, to reintroduce modest levels of gearing via the new borrowing facility referred to in the Chairman's Statement. Any borrowings drawn down under this facility may be repaid at any time without incurring breakage costs.

Finally, whilst the Manager welcomes a return of confidence in equity markets worldwide, the current strong market rally still seems largely based on sentiment rather than on fundamentals. The return of genuine and sustainable top line growth by companies remains generally elusive. Despite remarkable fiscal and monetary stimulus there seems little tangible evidence of investment-led economic recovery. To date, the corporate world has achieved modest levels of earnings growth by scrambling to reduce overheads rather than by satisfying increasing levels of demand for products and services. The virtually complete absence of pricing power has also acted as a brake on the recovery of corporate earnings.

Forecasts for GDP growth continue to be revised downwards in both the UK and across Europe. Indeed, it has only been the notable propensity of consumers and of the government to borrow and to spend whilst interest rates are at their lowest levels for nearly 50 years that has underpinned what modest GDP growth there has been.

As Mervyn King, the newly appointed Governor of the Bank of England, commented after the Bank's most recent decision to cut the base rate yet again (the base rate is currently 3.5% – its lowest level since 1955):

"High and rising debt burdens increase the vulnerability of households to adverse shocks and raise the risk of a subsequent sharp correction to house prices and consumer spending"

The accumulation of debt by UK households over recent years has now reached record levels and one has to question whether due regard has been paid to the ability to continue servicing that debt in the event of further *"adverse shocks"*. As holders of shares in many split capital investment trusts will testify, the perils of over-gearing can lead to very real and painful wealth destruction.

Chris Hutchinson
Montanaro Investment Managers Limited
15 October 2003

As at 31 July 2003, the portfolios were allocated as follows:

Portfolio summary

	£'000	% of total assets less current liabilities
Recovery portfolio	10,380	67.96
Income portfolio	2,800	18.34
	13,180	86.30
Net current assets	2,093	13.70
	15,273	**100.00**

1. Recovery portfolio

Recovery portfolio holdings

Holdings are in Ordinary shares unless otherwise stated.

		Market value £	% of total assets less liabilities
1	Granada	750,000	4.91
2	Debenhams	649,875	4.26
3	United Utilities	548,000	3.59
4	Associated British Foods	533,000	3.49
5	TBI	531,297	3.48
6	Wyevale Garden Centres	526,500	3.45
7	BP	426,000	2.79
8	Centrica	389,950	2.55
9	Shell Transport & Trading	389,500	2.55
10	Aviva	387,000	2.53
11	Care UK	372,000	2.44
12	Scottish & Newcastle	369,500	2.42
13	Senior	360,000	2.36
14	Pilkington	345,497	2.26
15	Expro International	334,400	2.19
16	Arriva	312,000	2.04
17	Marconi Corporation	292,000	1.91
18	Croda International	276,000	1.81
19	Invensys	270,000	1.77
20	Tesco	269,063	1.76
21	BT	244,687	1.59
22	Shire Pharmaceuticals Group	238,625	1.56
23	Geest	235,500	1.54
24	Lomin	222,203	1.45
25	Ultra Electronics Holdings	208,600	1.37
26	Rexam	206,000	1.35
27	Matalan	201,000	1.32
28	Dana Petroleum	150,998	0.99
29	Celltech Group	144,989	0.95
30	Mitchells & Butlers	101,375	0.66
31	Avon Rubber	94,500	0.62
		10,380,059	**67.96**

2. Income portfolio

Income portfolio holdings

		Share class	Market value £	% of total assets less current liabilities
1	Framlington Income & Capital Trust	Income	1,031,250	6.75
2	JP Morgan Fleming Income & Growth Investment Trust	Ordinary	647,812	4.24
3	Investec High Income Trust	Ordinary	387,500	2.54
4	BFS Managed Properties	Ordinary	336,000	2.20
5	Jupiter Financial & Income Trust	Ordinary	88,125	0.58
6	Investment Trust of Investment Trusts	Preferred	87,412	0.57
7	New Fulcrum Investment Trust	Ordinary	75,000	0.49
8	Exeter Smaller Companies Income Fund	Ordinary	61,875	0.41
9	Jove Investment Trust	Income	42,500	0.28
10	Morley Absolute Growth Investment Company	Units	16,912	0.11
11	Govett European Tec & Inc Trust	Preferred Income	9,375	0.06
12	Britannic UK Income Trust	Ordinary	7,875	0.05
13	Murray Emerging Growth & Income Trust	Ordinary	2,948	0.02
14	Gartmore Distribution Trust	Ordinary	2,641	0.02
15	Framlington Global Finance & Income	Ordinary	2,525	0.02
16	New Star Enhanced Income Trust	Ordinary	98	–
			2,799,848	**18.34**

The Income Portfolio has 21 holdings in total, 5 of which have no current value and are not shown in the listing above.

The Directors present their report and accounts for the year ended 31 July 2003. The Company was incorporated on 7 August 2001 and commenced operations on 15 August 2001.

Status of Company

The Company operates as an investment trust and has been approved by the Inland Revenue as an investment trust under Section 842 of the Income and Corporation Taxes Act 1988 for the period ended 31 July 2002. In the opinion of the Directors the Company has subsequently conducted its affairs so as to enable it to continue such approval. The Company will continue to seek approval under Section 842 of the Income and Corporation Taxes Act 1988 each year.

The Company is an investment company within the meaning of Section 266 of the Companies Act 1985.

Activities

The principal activity of the Company is to carry on business as an investment trust.

A review of the Company's activities is given in the Chairman's Statement on page 4 and in the Manager's Report on pages 5 to 7.

Net asset valuation

The net asset value per Ordinary Income share at 31 July 2003, after deducting the paid fourth interim dividend, was 0.04p. The net asset value attributable to the Zero Dividend Preference shares at 31 July 2003 was 110.32p per share.

Results

The results for the year and the proposed transfer from the revenue reserve are set out in the Statement of Total Return on page 18.

Dividends

The following net dividends have been paid:

	Payment date	Pence (net) per Ordinary Income share
First interim dividend paid	31 December 2002	0.75
Second interim dividend paid	31 March 2003	0.75
Third interim dividend paid	30 June 2003	0.75
Fourth interim paid	30 September 2003	0.60
		2.85

The Directors do not recommend the payment of a final dividend.

Management agreements

Montanaro Investment Managers Limited acts as Investment Manager to the Company under an agreement dated 2 January 2003, which is terminable by six months' written notice. The Company pays to the Investment Manager an annual aggregate fee, paid monthly in arrears, of 0.50% pa (exclusive of VAT) of the value of the Company's gross assets.

On 2 January 2003 the Company and Pavilion Asset Management Limited (PAM) agreed to terminate their investment management agreement at no cost to the Company. The annual aggregate fee payable to PAM under the previous agreement was 0.8% of the value of the Company's gross assets.

Under an agreement dated 13 August 2001, company secretarial services and the general administration of the Company are undertaken by Sinclair Henderson Limited. The agreement may be terminated by six months written notice.

Directors

None of the Directors has a contract of service with the Company nor has there been any other contract or arrangement between the Company and any Director at any time during the year.

Mr T G Trefgarne and Mr R Howell will retire at the Annual General Meeting and, being eligible, will offer themselves for election.

Directors' interests

The interests of the Directors and their families in the Ordinary Income shares and Zero Dividend Preference shares of the Company at 31 July 2003 are set out below.

	2003		2002	
	Ordinary Income shares	Zero Dividend Preference shares	Ordinary Income shares	Zero Dividend Preference shares
T G Trefgarne	**1,750,000**	**25,000**	5,000	-
R Clinton	**5,000**	**5,000**	5,000	5,000
C Jones	**5,000**	**-**	5,000	-
J Rickards (resigned 31 December 2002)	**5,000**	**5,000**	5,000	5,000
R Howell (appointed 10 February 2003)	**180,000**	**-**	-	-

There have been no changes in the above holdings up to the date of this Report.

Substantial share interests

The Directors have been notified of the following substantial interests at the date of this Report (interests in excess of 3% of the issued Ordinary Income share capital):

	Ordinary Income shares	%
Brookdale Group	6,922,000	23.07
Merchant Investors Assurance	5,905,000	19.68
Jupiter Asset Management - general clients	3,333,500	11.11
Family Assurance Friendly Society	3,000,000	10.00
Close Bank Guernsey	2,150,000	7.17
T G Trefgarne	1,750,000	5.83
Dartmoor Investment Trust	1,500,000	5.00
Edinburgh Leveraged Income Trust	1,000,000	3.33
New Fulcrum Investment Trust	950,000	3.17

Annual General Meeting

The Notice of the Annual General Meeting is set out on pages 34 and 35.

It is proposed at the Annual General Meeting that resolutions be passed empowering the Directors to allot relevant securities of the Company up to an aggregate nominal value of £100,000. The Directors have no present intention of using this power.

At last year's Annual General Meeting, held on 8 November 2002, a Special Resolution was passed authorising the Company to purchase its own shares up to a maximum number of 2,073,866 Zero Dividend Preference shares. This authority will expire at the conclusion of the Annual General Meeting and it is proposed that this power be renewed to permit the purchase of up to 100% of the remaining Zero Dividend Preference shares. This power will be exercised only if, in the opinion of the Directors, a purchase would be in the interests of shareholders as a whole.

The Company purchased in the market for cancellation 1,200,000 Zero Dividend Preference shares on 15 October 2003, for a total cost of £967,000.

Corporate governance

The Company is committed to high standards of corporate governance and to the principles of good governance set out in the Combined Code. The Board is accountable to shareholders for the governance of the Company's affairs.

Directors' Statement of Compliance with the Combined Code ('Code')

The Directors have reviewed the principles outlined in the Code and believe that, insofar as they are relevant to the Company's business as an investment trust, they have complied with the provisions of Section 1 of the Code during the year ended 31 July 2003, subject to the exceptions explained below.

Board of Directors
The Board consists entirely of independent, non-executive Directors. Given the size and nature of the Board, it is not considered appropriate to appoint a senior independent Director. The Board is responsible for all matters of direction and control of the Company, including its investment policy, and no one individual has unfettered powers of decision. The Directors review at regular meetings the Company's investments and all other important issues to ensure that control is maintained over the Company's affairs. These procedures have been formalised in a schedule of matters specifically reserved for the decision of the Board, which has been adopted for all meetings.

Under The Articles of Association, one third of the Directors is required to retire by rotation each year. The Company has adopted procedures to ensure that each Director shall submit himself for re-election every three years as required by The Code. In accordance with this procedure, Mr Trefgarne will put himself forward for re-election at the forthcoming Annual General Meeting. In addition, Mr Howell, who was appointed during the year, will put himself forward for election as required by the Articles of Association.

The Company does not have a Chief Executive Officer, but in appointing a management company the roles of Chairman and Chief Executive Officer are effectively separated. Brief biographical details of the Directors can be found on page 3.

Representatives of the Investment Manager attend Board meetings when requested so that any matters concerning the Investment Management Agreement may be discussed with them.

Committees
The Company has appointed a number of committees to monitor specific operations, each of which has formal written terms of reference.

The Audit Committee meets to oversee the production of the Annual Accounts, compliance with Accounting Standards and regulatory requirements, to deal with conflicts of interest and to keep the procedures and controls of the Company constantly under review. The Audit Committee comprises the whole Board and is chaired by Mr R Clinton.

The Management Engagement Committee is responsible for reviewing the terms of the Investment Manager's contract and is comprised of all Directors who are independent of the Investment Manager, currently the full Board and is chaired by T G Trefgarne.

The Nomination Committee comprises the whole Board, chaired by T G Trefgarne, and is convened for the purpose of considering the appointment of additional Directors, as and when considered appropriate.

Independent professional advice
The Board has formalised arrangements under which the Directors, in the furtherance of their duties, may seek independent professional advice.

Directors' remuneration
Under the Financial Services Authority Listing Rule 21.20(i) where an investment trust has only non-executive directors the Code principles relating to directors' remuneration do not apply. Full details of Directors' remuneration are given in the Directors' Remuneration Report on pages 13 and 14 and in note 5 to the accounts. At 31 July 2003 no Director had been granted any options to acquire shares in the Company.

Going concern
After due consideration, the Directors have concluded that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they have adopted the going concern basis in preparing the accounts.

Internal control review
The Directors acknowledge that they are responsible for the Company's systems of internal control and for reviewing their effectiveness.

An ongoing process, in accordance with the guidance of the Turnbull Committee on internal control, has been implemented for identifying, evaluating and managing risks faced by the Company. This process has been in place throughout the period and up to the date the financial statements were approved. Key procedures established with a view to providing effective financial control have been in place for the period and up to the date the financial statements were approved.

The risk management process and systems of internal control are designed to manage rather than eliminate the risk of failure to achieve the Company's objectives. It should be recognised that such systems can only provide reasonable, not absolute, assurance against material misstatement or loss.

Internal control assessment process

Risk assessment and the review of internal controls are undertaken by the Board in the context of the Company's overall investment objective. The review covers the key business, operational, compliance and financial risks facing the Company. In arriving at its judgement of what risks the Company faces, the Board has considered the Company's operations in the light of the following factors:

- the nature and extent of risks which it regards as acceptable for the Company to bear within its overall business objective.
- the threat of such risks becoming a reality.
- the Company's ability to reduce the incidence and impact of risk on its performance.
- the cost to the Company and benefits related to the Company and third parties operating the relevant controls.

Against this background, the Board has split the review of risk and associated controls into four sections reflecting the nature of the risks being addressed. These sections are as follows:

- Corporate strategy.
- Published information, compliance with laws and regulations.
- Relationship with service providers.
- Investment and business activities.

Given the nature of the Company's activities and the fact that most functions are subcontracted, the Directors have obtained information from key third party suppliers regarding the controls operated. To enable the Board to make an appropriate risk and control assessment the information and assurances sought from third party suppliers include the following:

- Details of the control environment operated by the third party suppliers.
- Identification and evaluation of risks and control objectives by third party suppliers.
- Assessment of the communication procedures with third party suppliers.
- Assessment of the control procedures operated by third party suppliers.

The non-executive Directors of the Company clearly define the duties and responsibilities of their agents and advisers. The appointment of agents and advisers is conducted by the Board after the consideration of the quality of the parties involved; the Board monitors their ongoing performance and contractual arrangements. The duties of investment management, accounting and the custody of assets are segregated. The procedures of the individual parties are designed to complement one another. The key third party suppliers are as follows:

- Investment management was previously provided by Pavilion Asset Management Limited and is currently provided by Montanaro Investment Managers Limited. The Board is responsible for setting the overall investment policy and monitors the action of the Investment Manager at regular Board meetings.
- Administration and company secretarial duties for the Company are performed by Sinclair Henderson Limited.
- Custody of assets is undertaken by HSBC Bank plc.

Mandates for authorisation of investment transactions and expense payments are set by the Board. The Board reviews financial information produced by the Investment Manager and the Administrator in detail on a regular basis.

- The non-executive Directors of the Company clearly define the duties and responsibilities of their agents and advisers. The appointment of agents and advisers is conducted by the Board after consideration of the quality of the parties involved; the Board monitors their ongoing performance and contractual arrangements.
- Mandates for authorisation of investment transactions and expense payments are set by the Board.
- The Board reviews financial information produced by the Investment Manager and the Administrator in detail on a regular basis.

The Company does not have an internal audit function. All of the Company's management functions are delegated to independent third parties whose internal controls are reviewed by the Board. It is therefore felt that there is no need for the Company to have an internal audit facility. However this need is reviewed periodically.

In accordance with guidance issued to directors of listed companies, the Directors have carried out a review of the effectiveness of the system of internal controls as they have operated since incorporation.

The Company Secretary
The Board has direct access to the advice and services of the Company Secretary, Sinclair Henderson Limited, which is responsible for ensuring that Board and Committee procedures are followed and that the applicable regulations are complied with. The Secretary is also responsible to the Board for ensuring timely delivery of information and reports and also the statutory obligations of the Company.

Relations with shareholders
Communication with shareholders is given a high priority by both the Board and Investment Manager and the Directors are available to enter into dialogue with shareholders. All shareholders are encouraged to attend and vote at the Annual General Meeting during which the Board and Investment Manager are available to discuss issues affecting the Company.

Payment of suppliers
The Company does not follow any code or standard on payment practice, however it is the Company's payment policy to obtain the best possible terms for all business and, therefore, there is no consistent policy as to terms used. The Company agrees with its suppliers the terms on which business will take place and it is the Company's policy to abide by those terms.

There were no trade creditors at the year end.

Auditors
Following the conversion of our auditors, PricewaterhouseCoopers, to a Limited Liability Partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned on 4 March 2003 and the Directors appointed its successor, PricewaterhouseCoopers LLP as auditors. A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the Annual General Meeting.

By order of the Board
Sinclair Henderson Limited
Secretary
15 October 2003

The Board has prepared this report, in acknowledgement of Schedule 7A to the Companies Act 1985, which applied for the first time for this financial year for companies quoted on the official list. An ordinary resolution will be put to the members to approve the Report at the forthcoming Annual General Meeting.

The law requires your Company's auditors to audit certain disclosures provided. Where disclosures have been audited, they are indicated as such. The auditors' opinion is included in their report on pages 16 and 17.

Remuneration Committee

All Directors act in a non-executive capacity and the fees for their services are approved by the whole Board. It is not considered appropriate for the Company to establish a separate remuneration committee and the Directors therefore believe that the best practice provisions on directors' remuneration are not relevant to this Company.

Policy on Directors' fees

The Board's policy is that the remuneration of non-executive Directors should reflect the experience of the Board as a whole, and is determined with reference to comparable organisations and appointments. It is intended that this policy will continue for the year ended 31 July 2004.

The fees of the non-executive Directors are determined within the limits set out in the Company's Articles of Association, and they are not eligible for bonuses, pension benefits, share options, long-term incentive schemes or other benefits.

Directors' service contracts

None of the Directors has a contract of service with the Company, nor has there been any contract or arrangement between the Company and any Director at any time during the year. The terms of their appointment provide that a Director shall retire and be subject to re-election at the first annual general meeting after his appointment, and at least every three years after that.

Your Company's performance

The graph below compares the total return (assuming all dividends are reinvested) to Ordinary shareholders to the total shareholder return on a notional investment made up of shares of the same kinds and number as those by reference to which the FTSE All-Share Index is calculated. The FTSE All-Share Index has been selected as it is considered to represent a broad equity market index against which the performance of the Company's assets may be adequately assessed.

Directors' emoluments for the year (audited)

The Directors who served in the year received the following emoluments in the form of fees:

	2003	2002
	£'000	£'000
T G Trefgarne (Chairman)	**15**	14
R Clinton	**10**	10
C Jones	**10**	10
J Rickards (resigned 31 December 2002)	**7**	10
R Howell (appointed 10 February 2003)	**5**	-

In addition to the above R Clinton and T G Trefgarne are entitled to receive £6,000 and £4,000 respectively in respect of additional work carried out in connection with the proposals concerning the reorganisation of the Company.

Approval

The Directors' Remuneration Report was approved by the Board on 15 October 2003.

Trevor Trefgarne
Chairman

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ACCOUNTS

Company law requires the Directors to prepare accounts for each financial period which give a true and fair view of the state of affairs of the Company and of its profit or loss for that period.

In preparing those accounts, 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 accounts;
- prepare the accounts on the going concern basis unless it is inappropriate to assume that the Company 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 also have responsibility for safeguarding the assets of the Company and for taking such steps as are reasonably open to them to prevent and detect fraud and other irregularities.

The financial statements are published on www.exeter.co.uk, which is a website maintained by the Company Secretary. The work carried out by the auditors does not involve consideration of the maintenance and integrity of this website and accordingly, the auditors accept no responsibility for any changes that have occurred to the financial statements since they were initially presented on the website. Visitors to the website need to be aware that legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

To the shareholders of Recovery Trust PLC

We have audited the financial statements which comprise the Statement of Total Return, the Balance Sheet, the Cash Flow Statement and the related notes. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the Directors' Remuneration Report ("the auditable part").

Respective responsibilities of Directors and Auditor

The Directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of Directors' responsibilities. The Directors are also responsible for preparing the Directors' Remuneration Report.

Our responsibility is to audit the financial statements and the auditable part of the Directors' Remuneration Report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. 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 whether the financial statements and the auditable part of the Directors' Remuneration Report 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 is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the Directors' Report, the unaudited part of the Directors' Remuneration Report, the Chairman's Statement, the Investment Manager's Report and the corporate governance statement.

We review whether the corporate governance statement reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services Authority, 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 to form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

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 auditable part of the Directors' Remuneration Report. 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 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 and the auditable part of the Directors' Remuneration Report 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 of the state of the Company's affairs at 31 July 2003 and of its total return and cash flows for the year then ended;

- the financial statements have been properly prepared in accordance with the Companies Act 1985; and

- those parts of the Directors' Remuneration Report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
15 October 2003

STATEMENT OF TOTAL RETURN

(incorporating the revenue account*) for the year from 1 August 2002 to 31 July 2003

		2003			2002		
		Revenue*	Capital	Total	Revenue*	Capital	Total
	Note	£'000	£'000	£'000	£'000	£'000	£'000
Losses on investments	11	**–**	**(2,152)**	**(2,152)**	–	(24,378)	(24,378)
Income	2	**946**	**–**	**946**	3,361	–	3,361
Investment management fee	3	**(52)**	**(52)**	**(104)**	(209)	(209)	(418)
Cost of aborted capital reorganisation		**(134)**	**–**	**(134)**	–	–	–
Other expenses	4	**(204)**	**–**	**(204)**	(228)	–	(228)
Net return before finance costs and taxation		**556**	**(2,204)**	**(1,648)**	2,924	(24,587)	(21,663)
Interest payable and similar charges	6	**–**	**–**	**–**	(586)	(586)	(1,172)
Net return on ordinary activities before taxation		**556**	**(2,204)**	**(1,648)**	2,338	(25,173)	(22,835)
Taxation on ordinary activities	7	**–**	**–**	**–**	(4)	–	(4)
Net return on ordinary activities after taxation for the year		**556**	**(2,204)**	**(1,648)**	2,334	(25,173)	(22,839)
Appropriations in respect of non-equity shares:							
– Zero Dividend Preference shares	8	**–**	**(1,403)**	**(1,403)**	–	(1,315)	(1,315)
Return attributable to Ordinary Income shareholders		**556**	**(3,607)**	**(3,051)**	2,334	(26,488)	(24,154)
Dividends in respect of Ordinary Income shares	9	**(855)**	**–**	**(855)**	(2,025)	–	(2,025)
Transfer (from)/to reserves		**(299)**	**(3,607)**	**(3,906)**	309	(26,488)	(26,179)
		pence	pence	pence	pence	pence	pence
Return per share							
– Ordinary Income share	10	**1.85**	**(12.02)**	**(10.17)**	7.78	(88.29)	(80.51)
– Zero Dividend Preference share	10	**–**	**10.14**	**10.14**	–	8.89	8.89

All revenue and capital items in the above statement derive from continuing operations.

*The revenue column of this statement is the Profit and Loss Account of the Company.

The notes on pages 21 to 32 form part of these accounts.

BALANCE SHEET

as at 31 July 2003

	Note	2003 £'000	2002 £'000
Fixed assets:			
Investments	11	**13,180**	17,062
Current assets:			
Debtors	13	**130**	158
Cash at bank		**2,351**	913
		2,481	1,071
Creditors – amounts falling due within one year	14	**388**	397
Net current assets		**2,093**	674
Net assets		**15,273**	17,736
Capital and reserves:			
Called-up share capital	16	**438**	438
Capital Redemption reserve	17	**12**	12
Special Reserve	17	**42,272**	42,232
ZDP Redemption reserve	17	**2,636**	1,233
Capital Reserve – realised	17	**(17,519)**	(5,943)
– unrealised	17	**(12,576)**	(20,545)
Revenue reserve	17	**10**	309
Total shareholders' funds	18	**15,273**	17,736
Total shareholders' funds are attributable to:			
Equity – Ordinary Income shareholders' funds		**(750)**	3,116
Non-equity – Zero Dividend Preference shareholders' funds		**16,023**	14,620
		15,273	17,736
		pence	pence
Net asset values:			
Ordinary Income share	20	**0.04**	9.02
Zero Dividend Preference share	20	**110.32**	108.64

These accounts were approved by the Board of Directors on 15 October 2003.

T G Trefgarne
Chairman

The notes on pages 21 to 32 form part of these accounts.

STATEMENT OF CASH FLOWS

for the year from 1 August 2002 to 31 July 2003

	Note	2003 £'000	2002 £'000
Operating activities:			
Investment income received		**908**	3,035
Bank deposit interest received		**67**	176
Investment management fees paid		**(163)**	(338)
Secretarial fees paid		**(73)**	(52)
Other cash payments		**(131)**	(132)
Net cash inflow from operating activities	21	**608**	2,689
Servicing of finance:			
Interest paid		**-**	(1,142)
Net cash outflow from servicing of finance		**-**	(1,142)
Taxation			
Withholding tax paid		**-**	(4)
		-	(4)
Financial investment:			
Purchases of investments		**(7,112)**	(88,393)
Sales of investments		**8,842**	46,953
Net cash inflow/(outflow) from capital expenditure and financial investment		**1,730**	(41,440)
Equity dividends paid		**(900)**	(1,800)
Net cash inflow/(outflow) before financing		**1,438**	(41,697)
Financing:			
Loan proceeds		**-**	14,970
Proceeds of issue of shares		**-**	45,000
Issue costs		**-**	(1,305)
ZDP repurchase		**-**	(1,055)
Loan repayment		**-**	(15,000)
		-	42,610
Net cash inflow after financing		**1,438**	913
Increase in cash	22	**1,438**	913

The notes on pages 21 to 32 form part of these accounts.

1 Accounting policies

Accounting convention

The accounts are prepared under the historical cost convention as modified by the revaluation of fixed asset investments and are prepared in accordance with applicable Accounting Standards in the United Kingdom and in accordance with the 1995 Statement of Recommended Practice for Financial Statements of Investment Trust Companies.

Income recognition

(i) Dividends receivable on quoted equity shares are brought into account on the ex-dividend date. Dividends are accounted for excluding associated tax credits.

(ii) Dividends receivable on equity shares where no ex-dividend is quoted are brought into account when the Company's right to receive payment is established.

(iii) Returns on fixed interest securities are recognised on a time apportionment basis from the date of purchase, so as to reflect the effective yield on the debt security.

(iv) Underwriting commission is included in income in so far as it relates to shares the Company is not required to take up. Where the Company is required to take up shares underwritten the commission received is treated as a deduction from the cost of the shares.

(v) Other income is accounted for on an accruals basis.

Expenses

All expenses are accounted for on an accruals basis. All expenses are charged through the revenue account in the statement of total return except as follows:

- expenses which are incidental to the acquisition of an investment are included within the cost of the investment.

- expenses which are incidental to the disposal of an investment are deducted from the disposal proceeds of the investment.

- expenses are charged to capital reserve (realised) where a connection with the maintenance or enhancement of the value of the investments can be demonstrated. In respect of the investment management fee and finance costs, 50% has been allocated to capital reserve (realised) and 50% to revenue in the statement of total return, being in line with the Boards expected long-term split of returns, in the form of capital gains and income respectively, from the investment portfolio of the Company.

Investments

Listed investments are included in the accounts at middle-market value at the close of business at the period end. Interest accrued on fixed interest rate securities at the date of the purchase or sale is accounted for separately, as accrued income or as an income receipt so that the value or purchase price or sale price is shown net of such items.

Where the trading in the securities of an investee company is suspended, the investment is valued at the Directors' estimate of its net realisable value.

Taxation

The charge for taxation is based on the revenue before taxation for the period. Deferred tax is provided in accordance with FRS19 on all timing differences that have originated but not reversed by the balance sheet date. Deferred tax assets are only recognised to the extent that they are regarded as recoverable.

The tax effect of different items of income/gain and expenditure/loss is allocated between capital and revenue on the same basis as the particular item to which it relates, using the Company's effective rate of tax for the accounting period.

Capital reserves

Capital reserve (realised)

The following are accounted for in this reserve:

- gains and losses on the realisation of the investments.
- expenses, together with related taxation effect, charged to this account in accordance with the above policies.

Capital reserve (unrealised)

The following are accounted for in this reserve:

- increases and decreases in the valuation of the investments held at the period end.

Finance costs attributable to Zero Dividend Preference shares

The Directors have allocated 100% of the finance costs relating to the Zero Dividend Preference shares to capital. Accordingly, a redemption reserve has been set up to provide for the repayment entitlements attached to the Zero Dividend Preference shares which accrue on a monthly basis to the date of the Company's winding up on 15 August 2007. These shares are entitled to repayment of 100 pence initially on winding up, increasing on a monthly basis compounded annually to 167.74p per share on 15 August 2007.

2 Income

	2003 £'000	2002 £'000
Income from listed investments:		
UK dividend income	**804**	2,705
Unfranked investment income	**74**	476
	878	3,181
Other income:		
Bank interest receivable	**68**	180
Total income	**946**	3,361
Total income comprises:		
Dividends	**878**	3,181
Interest	**68**	180
	946	**3,361**
Income from investments:		
Listed UK	**804**	2,705
Listed overseas	**74**	476
	878	3,181

3 Investment management fee

	2003			2002		
	Revenue	Capital	Total	Revenue	Capital	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Investment management fee	**44**	**44**	**88**	178	178	356
Irrecoverable VAT thereon	**8**	**8**	**16**	31	31	62
	52	**52**	**104**	209	209	418

On 2 January 2003 the Company and Pavilion Asset Management Limited ('PAM') agreed to terminate their Investment Management Agreement at no cost to the Company. The Company appointed Montanaro Investment Managers Limited as Manager with effect from that date.

The investment management fee is paid quarterly in arrears, and is calculated at 0.5% per annum (exclusive of VAT) of the value of the Company's gross assets for the month. At 31 July 2003, £22,100 (2002: £80,294) was due to the Investment Manager.

Previously the fee paid to PAM had been calculated at 0.8% per annum (exclusive of VAT) of the value of the Company's gross assets.

4 Other expenses

	2003	2002
	£'000	£'000
Administrative services	**67**	58
Auditor's remuneration for:		
Audit	**18**	27
Directors' remuneration (see note 5)	**47**	44
Other	**72**	99
	204	228

The Company's auditor was also paid £4,113 (incl. VAT) for non-audit services which has been charged to the revenue reserve.

5 Directors' remuneration

	2003	2002
	£'000	£'000
Total fees	**47**	44
	£	**£**
Remuneration to Directors:		
T G Trefgarne (Chairman)	**15**	14
C Jones	**10**	10
R Clinton	**10**	10
J Rickards (resigned 31 December 2002)	**7**	10
R Howell (appointed 10 February 2003)	**5**	-

6 Interest payable and similar charges

	2003			2002		
	Revenue	Capital	Total	Revenue	Capital	Total
	£'000	£'000	£'000	£'000	£'000	£'000
On loan	–	–	–	420	420	840
Breakage costs on redemption of loan	–	–	–	151	151	302
Amortisation of issue costs of bank loan	–	–	–	15	15	30
	–	–	–	586	586	1,172

7 Taxation

	2003			2002		
	Revenue	Capital	Total	Revenue	Capital	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Based on the profits for the year:						
Withholding tax	–	–	–	4	–	4

Factors affecting current tax charge:
The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 30% (2002: 30%). The differences are explained below:

	2003	2002
	£'000	£'000
Return on Ordinary activities before tax	**556**	2,338
Return on Ordinary activities before tax at the standard rate of UK corporation tax of 30%	**167**	701
Effects of:		
UK dividends not taxable	**(241)**	(811)
Expenses not deductible for tax purposes	**40**	10
Excess expenses of period	**34**	100
Irrecoverable overseas tax	**–**	4
	–	4

The deferred tax asset of £390,000 (2002: £353,000) in respect of unutilised expenses as at 31 July 2003 has not been recognised as it is unlikely that these expenses will be utilised.

8 Appropriations in respect of non equity shares

	2003	2002
	£'000	£'000
Appropriations for premium payable on redemption of Zero Dividend Preference shares	**1,403**	1,315

9 Dividends paid

	2003	2002
	£'000	£'000
Ordinary Income shares:		
First interim dividend paid of 0.75p per share (2002: 2.0p)	**225**	600
Second interim dividend paid of 0.75p per share (2002: 2.0p)	**225**	600
Third interim dividend paid of 0.75p per share (2002: 2.0p)	**225**	600
Fourth interim dividend paid of 0.6p per share (2002: 0.75p)	**180**	225
	855	2,025

10 Return per share

The revenue return per Ordinary Income share is based on the net revenue on ordinary activities after taxation of £556,000 (2002: £2,334,000) and on 30,000,000 Ordinary Income shares in issue throughout the period.

The capital return per Ordinary Income share is based on net capital losses of £3,607,000 (2002: £26,488,000) and on 30,000,000 Ordinary Income shares in issue throughout the period.

Zero Dividend Preference shares

The return per Zero Dividend Preference share is based on an annualised gross redemption yield which takes into account the allocation of issue expenses in accordance with the provisions of Financial Reporting Standard No.4, and on 13,835,000 Zero Dividend Preference shares, being the number of shares in issue during the year.

11 Investments

	2003 £'000	2002 £'000
Investment portfolio summary		
Listed investments at market value	**13,180**	17,062

	Listed £'000	Listed £'000
Analysis of investment portfolio movements		
Opening book cost	**37,607**	-
Opening unrealised depreciation	**(20,545)**	-
Opening valuation	**17,062**	-
Movements in the year:		
Purchases at cost	**7,112**	88,393
Sales – proceeds	**(8,842)**	(46,953)
– realised losses on sales	**(6,143)**	(3,833)
Provision for permanent diminution in value	**(3,978)**	-
Decrease/(increase) in unrealised depreciation	**7,969**	(20,545)
Closing valuation	**13,180**	17,062
Closing book cost	**25,756**	37,607
Closing unrealised depreciation	**(12,576)**	(20,545)
	13,180	17,062

	2003 £'000	2002 £'000
Analysis of capital gains and losses		
Realised losses on sales	**(6,143)**	(3,833)
Decrease/(increase) in unrealised depreciation	**7,969**	(20,545)
Provision for permanent diminution in value	**(3,978)**	-
Losses on investments	**(2,152)**	(24,378)

12 Significant holdings

The Company had one holding of 3% or more that is material in the context of the accounts. The Company held 6.39% of the share capital of Framlington Income & Capital Trust Income shares.

13 Debtors

	2003	2002
	£'000	£'000
Dividends receivable	**115**	145
Prepayments and accrued income	**15**	13
	130	158

14 Creditors: amounts falling due within one year

	2003	2002
	£'000	£'000
Other creditors and accruals	**78**	172
Dividend declared	**180**	225
Cost of aborted reorganisation	**130**	-
	388	397

15 Provisions for liabilities and charges

No provisions for liabilities and charges are considered necessary at the Company's year end. There were no amounts unprovided in respect of deferred taxation.

16 Share capital

	2003	2002
	£'000	£'000
Authorised:		
45,000,000 Ordinary Income shares of 1p each	**450**	450
25,000,000 Zero Dividend Preference shares of 1p each	**250**	250
	700	700
Allotted, called up and fully paid:		
30,000,000 Ordinary Income shares of 1p each	**300**	300
13,835,000 (2002: 15,000,000) Zero Dividend Preference shares of 1p each	**138**	150
Nil (2002: 1,165,000) Zero Dividend Preference shares of 1p each repurchased	**-**	(12)
13,835,000 Zero Dividend Preference shares of 1p each	**138**	138
Total called-up share capital	**438**	438

Zero Dividend Preference shares

The Zero Dividend Preference shares have no right to any income available for distribution but have a preferential entitlement, on a predetermined growth basis, to the available assets excluding revenue reserve at the Company's winding-up date. The Zero Dividend Preference shares were issued at 100p each on 15 August 2001 and will have a final entitlement of 167.74p each on 15 August 2007.

16 Share capital – continued

The Zero Dividend Preference shares do not carry any rights to vote at an annual general meeting conducting normal business as laid down by the Company's Articles of Association. However where resolutions are proposed which affect their interests in any way, at either an Annual or an Extraordinary General Meeting, they will be entitled to participate either in that meeting or at a separate class meeting, depending on the circumstances.

The Company purchased in the market for cancellation 1,200,000 Zero Dividend Preference shares on 15 October 2003, for a total cost of £967,000.

Following this purchase the number of Zero Dividend Preference shares in issue is reduced to 12,635,000.

Ordinary Income shares

In addition to receiving the income distributed, the Ordinary Income shareholders will be entitled to any balances on the revenue reserve at the winding-up date, together with the assets of the Company remaining after payment of the Zero Dividend Preference shareholders' entitlement. The Ordinary Income shareholders participate in all general meetings of the Company on the basis of one vote for each share held.

The total return and residue of assets available for distribution will be dependant on dividends and growth of portfolio value between now and 15 August 2007.

17 Reserves

	Special reserve £'000	Capital reserve (realised) £'000	Capital reserve (unrealised) £'000	ZDP redemption reserve £'000	Capital Redemption reserve £'000	Revenue reserve £'000
Balance at 31 July 2002	42,232	(5,943)	(20,545)	1,233	12	309
Write back of unused costs of issue	40	–	–	–	–	–
Net losses on realisation of investments	–	(1,008)	–	–	–	–
Transfer on disposal of investments	–	(5,135)	5,135	–	–	–
Movement on unrealised depreciation	–	–	(1,144)	–	–	–
Provision for permanent diminution in value		(3,978)	3,978	–	–	–
Cost charged to capital	–	(52)	–	–	–	–
Appropriations for premium payable on redemption of Zero Dividend Preference shares	–	(1,403)	–	1,403	–	–
Retained net revenue for the period	–	–	–	–	–	(299)
Balance at 31 July 2003	42,272	(17,519)	(12,576)	2,636	12	10

The Zero Dividend Preference shares are entitled to receive a capital payment of 167.74p per share on 15 August 2007. In accordance with Financial Reporting Standard No. 4, the premium on repayment is being accrued at a constant rate of growth which is charged to the capital reserve.

18 Reconciliation of movements in shareholders' funds

	2003 £'000	2002 £'000
Revenue reserve		
Net revenue for the year	**556**	2,334
Dividends paid and declared	**(855)**	(2,025)
(Accumulated loss)/retained net revenue for the year	**(299)**	309
Capital Return for the year	**(2,204)**	(25,173)
Net depletion of shareholders funds	**(2,503)**	(24,864)
Share issue and repurchase		
Proceeds	**–**	45,000
Expenses of issue	**40**	(1,345)
Share repurchase	**–**	(1,055)
	(2,463)	17,736
Opening shareholders' funds	**17,736**	-
Closing shareholders' funds	**15,273**	17,736
Analysis between equity and non-equity interests:		
Equity	**(750)**	3,116
Non-equity	**16,023**	14,620
	15,273	17,736

19 Capital commitments and contingent liabilities

At 31 July 2003 there were no outstanding commitments in respect of investments carrying an obligation for future subscriptions. There were no contingent liabilities at 31 July 2003.

20 Net asset value per share

The net asset values per share, calculated in accordance with the Articles of Association, are as follows:

	31 July 2003 pence	31 July 2002 pence
Ordinary Income share	**0.04**	9.02
Zero Dividend Preference share	**110.32**	108.64

The net asset value per Ordinary Income share is based on the revenue reserve of £10,000 (2002: net assets of £2,706,000) and on 30,000,000 shares, being the number of Ordinary Income shares in issue at the year end.

The net asset value per Zero Dividend Preference share is based on net assets of £15,263,000 (2002: £15,030,000) and on 13,835,000 shares, being the number of Zero Dividend Preference shares in issue at the year end.

The funds attributable to equity and non-equity shareholders shown on the balance sheet have been calculated under the provisions of Financial Reporting Standard No. 4, which take into account the allocation of share issue expenses to the Zero Dividend Preference shareholders. The provisions of Financial Reporting Standard No. 4 do not reflect the rights under the Articles of Association of the respective classes of share on a return of assets.

A reconciliation of the two figures for each class of share is as follows:

	Ordinary Income shares £'000	Zero Dividend Preference shares £'000	Total £'000
Shareholders' funds attributable (see note 18)	**(750)**	**16,023**	**15,273**
Expenses of share issue	**(448)**	**448**	**–**
Differential in growth rates	**89**	**(89)**	**–**
Transfer to cover shortfall on Ordinary Income shares	**1,119**	**(1,119)**	**–**
Net assets attributable at 31 July 2003 in accordance with the Articles of Association	**10**	**15,263**	**15,273**

21 Reconciliation of net revenue before finance costs and taxation to net cash inflow from operating activities

	2003 £'000	2002 £'000
Net revenue before finance costs and taxation	**556**	2,924
Decrease/(increase) in debtors and accrued income	**28**	(158)
Increase in creditors	**76**	132
Investment management fees charged to capital	**(52)**	(209)
Net cashflow from operating activities	**608**	2,689

22 Reconciliation of net cash flow to movement in net cash

	2003 £'000	2002 £'000
Increase in cash for the year	**1,438**	913
Drawndown of long term loan	–	(15,000)
Loan arrangement fee	–	30
Repayment of long term loan	–	15,000
Amortisation of expenses associated with loan issue	–	(30)
Net cash at beginning of year	**913**	–
Net cash at 31 July 2003	**2,351**	913

	At beginning of year £'000	Cash flow £'000	31 July 2003 £'000
Analysis of net cash			
Cash at bank	**913**	**1,438**	**2,351**

23 Analysis of financial assets and liabilities

The investment objective of the Company is to provide both income and capital appreciation from investment in larger UK companies, fixed interest securities both in the UK and overseas, and split capital investment trusts. The Company's financial instruments comprise securities, cash balances, debtors and creditors that arise from its operations, for example, in respect of sales and purchases of securities awaiting settlement and debtors accrued for income.

The principal risks the Company faces through the holding of financial instruments are:

- Market price risk, i.e. the movements in value of investment holdings caused by factors other than currency movements;
- Liquidity risk.

The Investment Manager monitors the financial risks affecting the Company on an ongoing basis. The Directors receive financial information, which is used to identify and monitor risk, monthly. It is not the Company's policy to enter into derivative contracts, other than forward foreign currency contracts, to manage risk.

Market price risk

Market price risk arises mainly from uncertainty about future prices of financial instruments used in the Company's business. It represents the potential loss the Company might suffer through holding market positions in the face of price movements. The Manager constantly monitors the prices of financial instruments held by the Company on a real-time basis.

No interest is received on UK equity shares.

Liquidity risk

The Company's assets comprise mainly readily realisable securities, which can be sold to meet funding commitments if necessary.

Financial assets

The Company holds investments which are traded on the London Stock Exchange. These assets are discussed fully in the Investment Manager's report. All the Company's assets are in sterling and accordingly the Company has no direct currency exposure.

23 Analysis of financial assets and liabilities – continued

The interest rate profile of the Company's financial assets at 31 July 2003 was:

	Total £'000	Financial assets on which no interest is paid £'000	Floating rate financial assets £'000
Equity Shares	**13,083**	**13,083**	**–**
Preference Shares	**97**	**97**	**–**
	13,180	**13,180**	**–**
Cash	**2,351**	**–**	**2,351**
Debtors	**130**	**130**	**–**
	15,661	**13,310**	**2,351**

The interest rate profile of the Company's financial assets at 31 July 2002 was:

	Total £'000	Financial assets on which no interest is paid £'000	Floating rate financial assets £'000
Equity Shares	16,538	16,538	-
Preference Shares	524	524	-
	17,062	17,062	-
Cash	913	–	913
Debtors	158	158	-
	18,133	17,220	913

Financial liabilities

The Company finances its operations through its issued capital and retained reserves. The financial liabilities of the Company at the year-end are creditors which are due within one year, as disclosed in note 14 and its Zero Dividend Preference shares. No interest is paid to the creditors and they are all in sterling. Details of the Zero Dividend Preference shares are set out below:

	2003			2002		
	Fixed rate financial liabilities £'000	Annual compound rate growth %	Weighted average period to maturity (years)	Fixed rate financial liabilities £'000	Annual compound rate growth %	Weighted average period to maturity (years)
Zero Dividend Preference shares	**16,023**	**9.00**	**4**	14,620	9.00	5

23 Analysis of financial assets and liabilities - continued

Fair value of financial assets and liabilities

All financial assets and liabilities of the Company apart from non-equity shares disclosed are held at fair value.

		2003		2002
	Book value	Fair value	Book value	Fair value
	£'000	£'000	£'000	£'000
Zero Dividend Preference shares	**16,023**	**10,307**	14,620	10,722

24 Related Party Transactions

Under the terms of an agreement dated 2 January 2003, the Company has appointed Montanaro Investment Managers Limited to be the Investment Manager. The fee arrangements for these services and fees payable are set out in note 3.

Discount

If the share price of an investment trust is lower than the NAV per share, the shares are said to be trading at a discount. The size of the discount is calculated by subtracting the share price from the NAV per share and is usually expressed as a percentage of the NAV per share. If the share price is higher than the NAV per share, the shares are said to be trading at a premium.

Gearing

Gearing is the process whereby changes in the total assets of a company have an exaggerated effect on the net assets of that company's ordinary shares due to the presence of borrowings or share classes with a prior ranking entitlement to capital.

Total assets

Total assets less current liabilities before deducting prior charges. Prior charges include all loans used for investment purposes.

Net asset value ('NAV')

The NAV is shareholders' funds expressed as an amount per individual share. Shareholders' funds is the total value of all the company's assets, at current market value, having deducted all prior charges at their par value (or at their asset value).

Split capital investment trust

An investment trust with two or more classes of share in issue, each class having specified entitlements to income or capital. Typical classes of share include income shares, capital shares, zero dividend preference shares and income and residual capital (or geared ordinary) shares.

Total expense ratio

The total expenses incurred by the company, including those charged to capital (excluding interest costs) as a percentage of average total shareholders' funds.

Total return

The combined effect of any dividends paid, together with the rise or fall in the share price or NAV. Total return statistics enable the investor to make performance comparisons between investment trusts with different dividend policies. Any dividends (after tax) received by a shareholder are assumed to have been reinvested in either additional shares of the trust at the time the shares go ex-dividend (the share price total return) or in the assets of the investment trust at its NAV per share (the NAV total return).

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that the ANNUAL GENERAL MEETING of the Company will be held at the offices of Lawrence Graham, 190 Strand, London WC2R 1JN on 26 November 2003, at 12 noon for the following purposes:

Ordinary resolutions

1 To receive and, if thought fit, to accept the reports of the Directors and Auditor and the audited accounts for the year ended 31 July 2003

2 To receive and approve the Directors' Remuneration Report

3 To elect The Hon T Trefgarne as a Director of the Company

4 To elect Mr R Howell a Director of the Company

5 To consider the following resolution, special notice having been received of the intention to propose the resolution as an ordinary resolution:

That PricewaterhouseCoopers LLP be reappointed Auditors of the Company (having previously been appointed by the Board to full the casual vacancy arising by reason of the resignation of PricewaterhouseCoopers), to hold office until the conclusion of the next General Meeting at which accounts are laid before the Company and that their remuneration be fixed by the Directors.

Special business

To consider and if thought fit, to pass the following resolutions of which Resolution 6 will be proposed as an Ordinary resolution and Resolutions 7 and 8 will be proposed as Special resolutions.

6 THAT the Directors of the Company be and they are hereby generally and unconditionally authorised, (in substitution for any authorities previously granted to the Directors), pursuant to Section 80 of the Companies Act 1985 (the Act), to exercise all the powers of the Company to allot relevant securities (within the meaning of Section 80(2) of the Act) up to an aggregate nominal amount of £100,000 (one third of the total issued Ordinary share capital on 31 July 2002) provided that this authority shall expire on the earlier of the date of the next Annual General Meeting of the Company and 31 December 2004 save that the Company may before such expiry make offers, agreements or arrangements which would or might require relevant securities to be allotted after such expiry and so that the Directors of the Company may allot relevant securities in pursuance of such offers, agreements or arrangements as if the authority conferred hereby had not expired.

7 THAT, subject to the passing of Resolution 6 set out above, the Directors of the Company be and they are hereby empowered pursuant to Section 95(1) of the Act to allot equity securities (within the meaning of Section 94 of the Act) pursuant to the authority conferred by Resolution 6 as if Section 89(1) of the Act did not apply to any such allotment, provided that this power shall be limited to the allotment of equity securities: for cash up to an aggregate nominal amount of £30,000, being 10 per cent of the current ordinary issued share capital, at a price of not less than the net asset value per share and shall expire on the earlier of the date of the next Annual General Meeting of the Company and 31 December 2004 save that the Company may before such expiry make offers, agreements or arrangements which would or might require equity securities to be allotted after such expiry and so that the Directors of the Company may allot equity securities in pursuance of such offers, agreements or arrangements as if the power conferred hereby had not expired.

8 THAT, the Company be and it is hereby authorised in accordance with Section 166 of the Companies Act 1985 to make market purchases (within the meaning of Section 163 of the said Act) of up to 100% of the issued Zero Dividend Preference share capital of the Company (being 12,635,000 Zero Dividend Preference shares) in accordance with the rules of the UK Listing Authority in force as at the date of the purchase and at a minimum price of 0.1p and a maximum price of the net asset value of the Zero Dividend Preference shares at the date of the repurchase, such authority to expire at the conclusion of the Annual General Meeting of the Company to be held in 2004 or eighteen months from the passing of this resolution whichever is earlier, save that the Company may, prior to such expiry, enter into a contract to purchase Zero Dividend Preference shares which will or may be completed or executed wholly or partly after such expiry and may make a purchase of Zero Dividend Preference shares pursuant to any such contract.

By order of the Board:
Sinclair Henderson Limited, Secretary
Registered Office: 23 Cathedral Yard, Exeter EX1 1HB
15 October 2003

Notes

A holder of Ordinary Income shares is entitled to attend and vote at this Meeting may appoint one or more proxies to attend and vote instead of him or her. A proxy need not also be a member of the Company. To be effective, forms of proxy must be lodged with the Company's Registrar, Capita IRG Plc, PO Box 25, Beckenham, Kent BR3 4BR, not less than 48 hours before the time appointed for holding the Meeting. Lodgement of the form of proxy will not preclude a shareholder from attending the Meeting and voting in person.

The holders of Zero Preference Dividend shares do not have the right to attend or vote at the Annual General Meeting.

The Company, pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, specifies that only those shareholders registered in the register of members of the Company as at 12 noon on 24 November 2003 shall be entitled to attend or vote at the aforesaid Annual General Meeting in respect of the number of shares registered in their name at that time. Changes to entries on the relevant registrar of securities after 12 noon on 24 November 2003 shall be disregarded in determining the rights of any person to attend or vote at the Meeting.

Shareholders (and any proxies or representatives they appoint) agree, by attending this meeting, that they are expressly requesting and that they are willing to receive any communications (including communications relating to the Company's securites) made at the meeting.

The following documents will be available for inspection at the registered office of the Company during usual business hours on any weekday (except Saturdays, Sundays and Public Holidays) until the date of the Meeting and at the place of the Meeting for a period of 15 minutes prior to and during the Meeting:

a) A statement of all transactions of each Director and of their family interests in the share capital of the Company.

b) The Articles of Association.

None of the Directors has a contract of service with the Company.

SHAREHOLDER INFORMATION

Contact details

Company Secretary:	Sinclair Henderson Limited Tel: 01392 412 122 Fax: 01392 253 282
Registrar:	Capita Registrars Tel: 020 8639 2000 Fax: 020 8658 3430
Investment Manager:	Montanaro Investment Managers Limited Tel: 0207 929 1995 Fax: 0207 283 6200

Sources of further information
The Company's Ordinary Income shares and the Zero Dividend Preference shares are listed on the London Stock Exchange. The mid-market prices are quoted daily in the *Financial Times* under "Investment Companies".

Information on the Company is also available on the AITC Website: www.itsonline.co.uk

Share dealing
Shares can be traded and sold through your usual stockbroker.

Share register enquiries
The register for the Ordinary Income and the Zero Dividend Preference shares is maintained by Capita Registrars. In the event of queries regarding your holding, please contact the Registrar on 020 8639 2000. Changes of name and/or address must be notified in writing to the Registrar at the address shown on page 3.

Key dates

Company's year end	31 July
Interim dividends paid	March and September
Annual results announced	October
Annual General Meeting	November
Company's half-year	31 January
Interim results announced	March

Frequency of NAV publication
The Company's Ordinary Income share and Zero Dividend Preference share net asset values are published monthly via the AITC and the London Stock Exchange.

Registered in England and Wales No. 4266460