LONDON MERCHANT SECURITIES PLC

Annual Report & Accounts 2006

Highlights

18.5%

Like-for-like annual growth
in property portfolio value

326,500 sq ft

Construction underway at four sites

£1,113.9 million

Total value of property portfolio

1.25 million sq ft

Consents obtained for three schemes

420,000 sq ft

New opportunities either in planning
or undergoing detailed feasibility

LMS is an active property investment and development company dedicated to creating shareholder value.

This is achieved by:

Upgrading and expanding our core holdings through a deep knowledge base, active asset management and a long-term perspective.

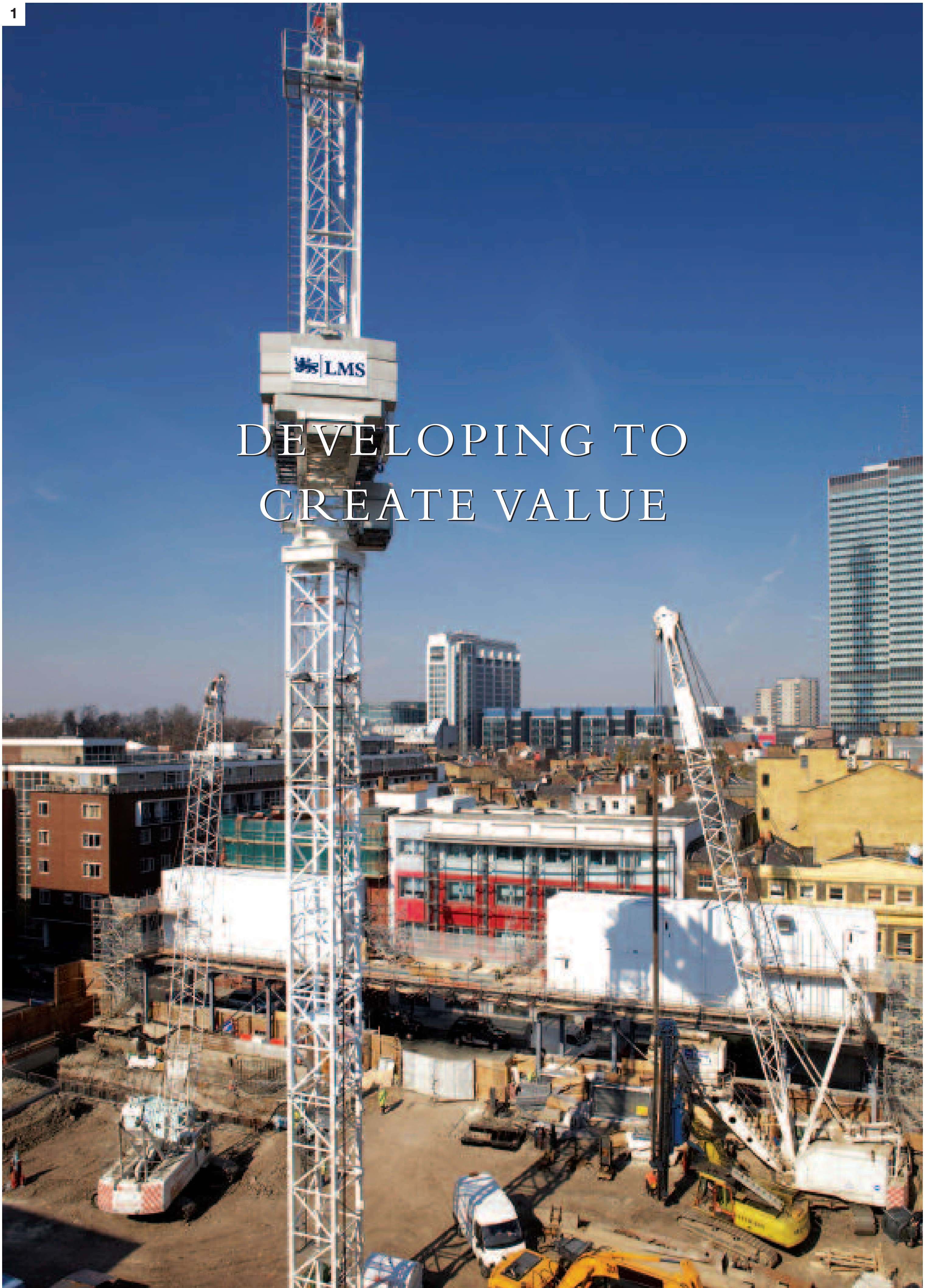
Pursuing an active development programme, both in core areas and in other locations where there is scope for renewal and reconfiguration.

Acquiring, developing and selling properties where value can be added on an opportunistic basis.

Building long-term partnerships with tenants, the communities in which the Group operates, key suppliers and other property owners.

1

DEVELOPING TO CREATE VALUE



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3

Developing to create value by:

- Constantly seeking to improve and enhance our assets
- Improving the built environment
- Reinvigorating and improving Fitzrovia – 250,000 sq ft of redevelopment under way

1 Onsite at Qube, 90 Whitfield Street, Fitzrovia, London W1

2 CGI of the entrance at Qube (on the corner of Whitfield Street and Maple Street)

3 Michael Wood, Asset Manager for Islington and City, London

4 CGI of Arup's HQ Phases 2 and 3, Fitzroy Street and Howland Street, Fitzrovia, London W1

4

1

2

1 28 Dorset Square, London NW1

2 John Robson, Asset Manager for the West End, London

3 Onsite at Phase 2, Strathkelvin Retail Park, Glasgow

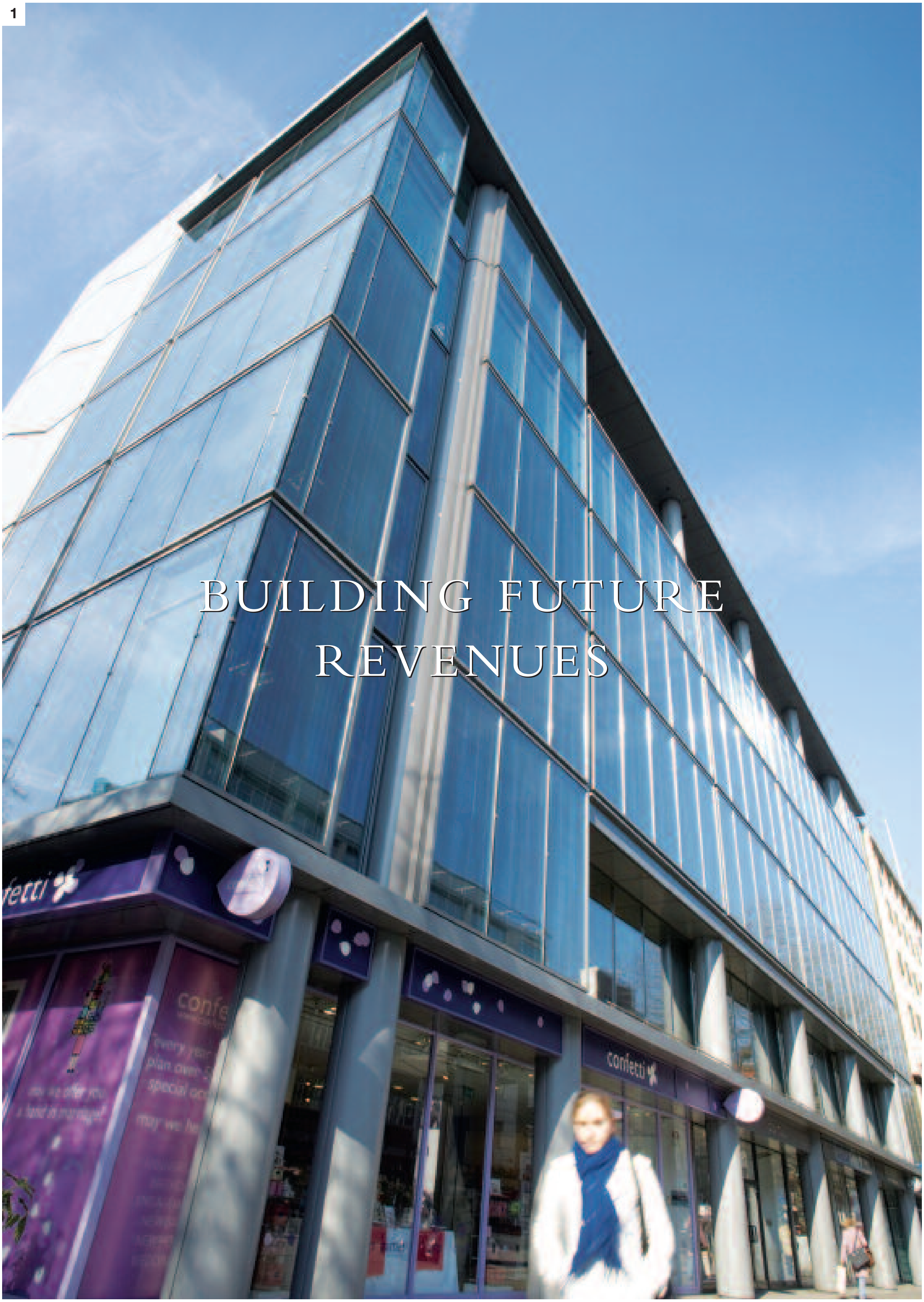
4 CGI of City Road Estate, London EC1

3


OLD STREET

1

BUILDING FUTURE REVENUES



2

Building future revenues by:

- Delivering long-term and secure revenue streams
- Actively managing properties to maximise revenues

1 85 Tottenham Court Road, London W1

2 The Angel Centre, St John Street, London EC1

3 Reception, 85 Tottenham Court Road

4 Ian Mayhew, Asset Manager for Fitzrovia, London and Richard Gammie, Head of Property Management

3

4

1

2

3

1 Lion and Lamb Yard, Farnham, Surrey

2, 3 and 4 Selection of our tennants

5 Mark Hurst, Asset Manager for Retail and Leisure across the UK

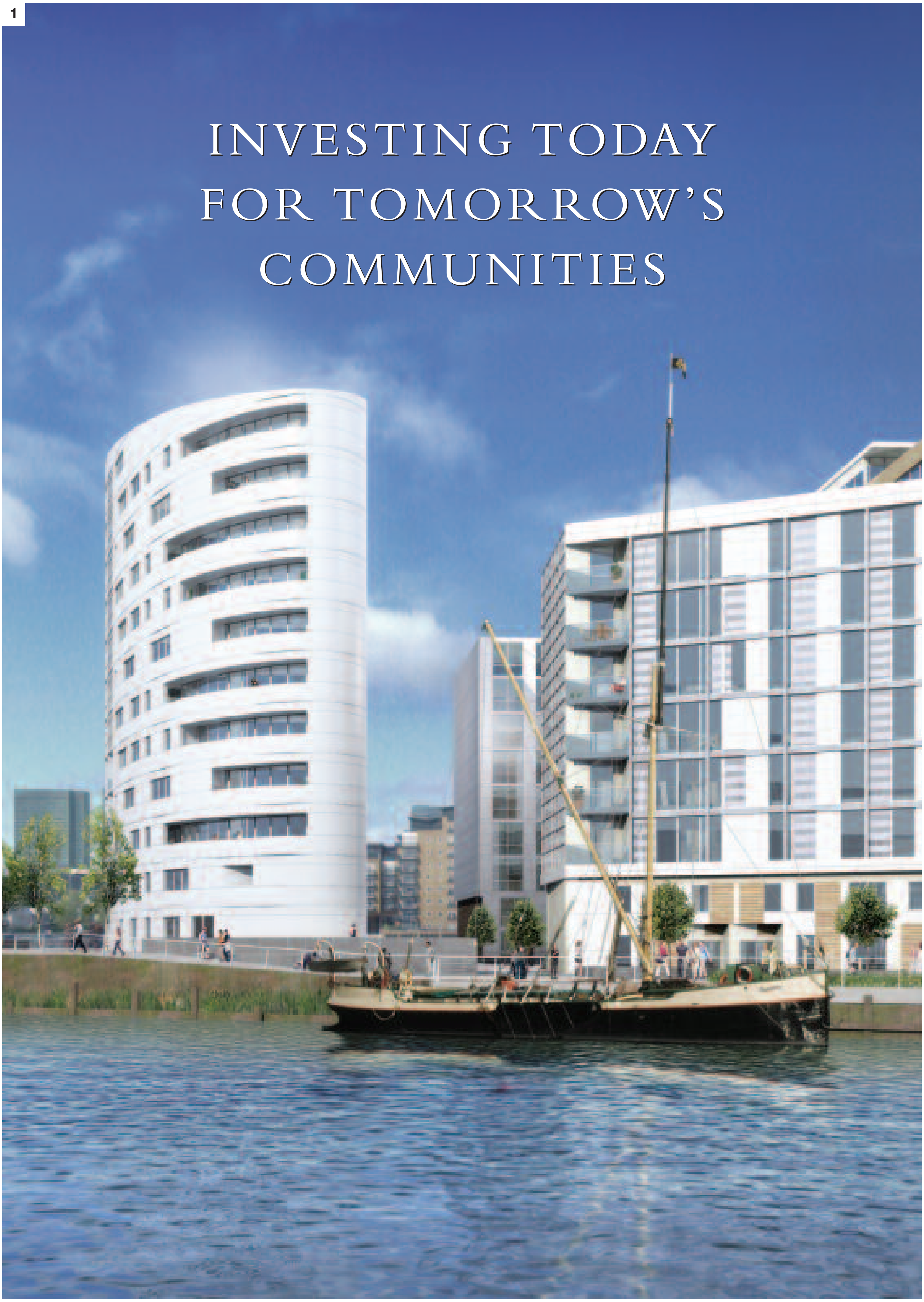
6 The Rotunda, Kingston upon Thames

5

4


ROTUNDA

INVESTING TODAY FOR TOMORROW'S COMMUNITIES



1 and 3 CGI of Greenwich Reach, Greenwich, London

2 Cutty Sark, Greenwich, London

4 Old Royal Naval College, Greenwich, London

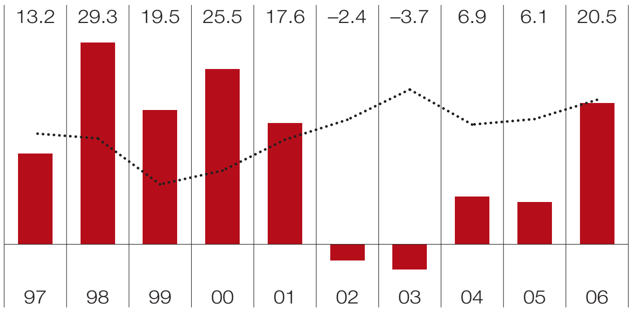
Regeneration to create new communities

Flagship scheme at Greenwich Reach

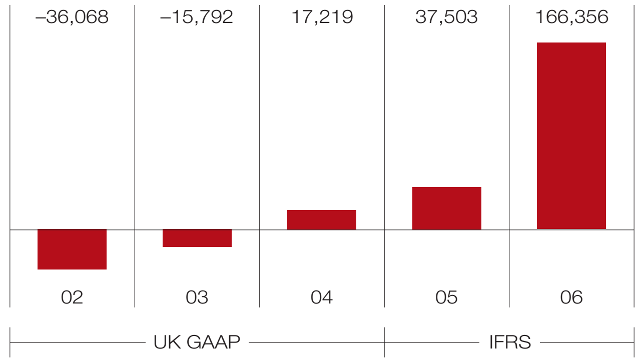
- 980 new homes and 70,000 sq ft of retail and commercial space
- food store, shops, office space, crèche and healthcare facilities
- riverside restaurants, cafés and a museum

Financial highlights

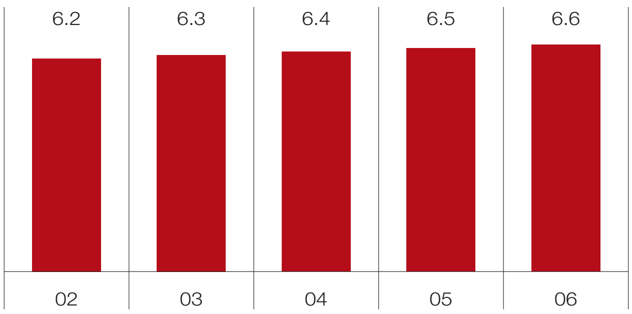
Ten year return on equity %
Average



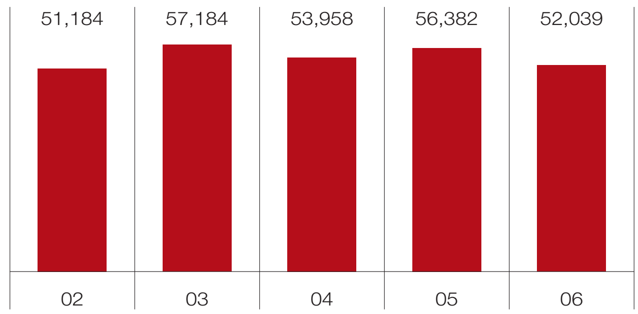
Profit/(loss) before tax
£000



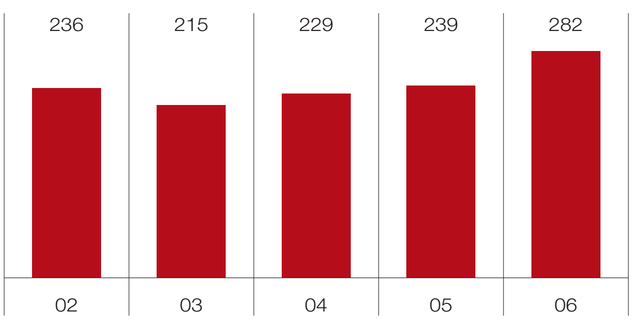
Dividend per share
Pence



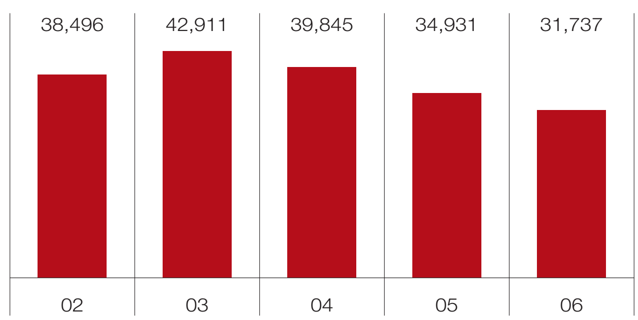
Net rental income
£000



Adjusted Shareholders' funds per share
Pence



Operating profit before net profit on investments
£000



Figures for 2005 and 2006 have been prepared under IFRS and are not directly comparable with the UK GAAP figures for previous years.

Chairman's statement

2005/2006 has been a year of intense activity, leading up to the demerger of the Investment Division as Leo Capital plc, which begins trading on AIM today. There has been significant progress in the development programme, several acquisitions have been made for site assembly adjacent to our existing London holdings, and £100 million of non-core property has been sold.

Following the demerger LMS will continue to pursue a clear property strategy, characterised by active asset management and a focus on development. The Group will be well positioned to take advantage of the advent of REITs in 2007. Shareholder value will also be enhanced by the restructuring of the balance sheet, with gearing appropriate to the high quality and stable rental income of the portfolio.

Leo Capital plc becomes a significant investment company on AIM, with the freedom to manage its assets, pursue an independent business plan and develop its own shareholder base.

There will be a transitional period as the separate managements of the two businesses are established and we hope to have made significant progress with this by the end of the calendar year 2006.

This is the first full year in which the Group has reported its results under International Financial Reporting Standards (IFRS). Notable consequences of this are the requirements to report gains on revaluation of the property investment portfolio as part of operating profit and to consolidate a number of Investment Division holdings.

Net assets at 31 March 2006 rose by 14.9% to £893.9 million (2005: £778.3 million). This breaks down into net assets of £624.4 million for the Property Division (2005: £529.5 million) and £269.5 million for the Investment Division (2005: £248.9 million). Equity Shareholders' funds at the year end were up by 13.9% to £826.9 million (2005: £725.9 million). Adjusted Shareholders' funds per share (undiluted) were 282p (2005: 239p), an increase of 18.0%. Gearing was 36.1% (2005: 49.9%).

Operating profit for the year, including the impact of the property revaluation, rose by 70.3% to £193.8 million (2005: £113.8 million), while profit after tax increased significantly to £126.6 million (2005: £46.7 million). The return on equity for the year was 20.5%, with a ten year rolling average of 21.0%.

Considerable progress has been made on the development programme during the year. Construction has started on Qube, 90 Whitfield Street, London W1, while the redevelopment of 28 Dorset Square, London NW1, and the Phase 2 development of Strathkelvin Retail Park, Glasgow, are near to completion. Planning consents were obtained for one million square feet of principally residential space at Greenwich Reach, London SE10, for Phases 2 and 3 of the redevelopment of Arup's headquarters in London, W1, where construction is about to commence, and for a residential development at Winchester Road, Swiss Cottage, London NW3.

In the Investment Division the Group took profits of £9.8 million from the sale of quoted investments, particularly in oilfield services, and from fund realisations. In addition, the majority stake in Inflexion plc is being realised for £24.5 million, against a cost of £18.0 million in early 2004. In advance of the demerger, writedowns totalling £33 million were made against the UK technology portfolio, offset by unrealised fair value movements on fund investments and securities, producing an overall negative fair value adjustment and goodwill impairment of £4.3 million.

Dividend

The Board is recommending a payment of 4.6p final dividend per Ordinary share, making a total of 6.6p for the year compared to 6.5p in the previous year.

The dividend going forward will be reduced, reflecting the demerger of Leo Capital plc, but the intention is that it should then grow at a faster rate than in recent years.

Board and management

In January 2006, The Hon. James Wilson stepped down from the Board, following his decision not to proceed as Chief Executive of Leo Capital plc. We thank him for his contribution to the Group.

On behalf of Shareholders I should like to record my thanks to the management and staff of the Group for their considerable efforts in executing the demerger and in delivering strong performance across the property portfolio.

Outlook

As a focused property group with a major development programme, LMS is well placed for the future. Prospects for rental growth in our core holdings in the West End are encouraging and we expect to see capital growth in existing holdings arising principally through this, rather than through significant further yield compression. The development programme will yield substantial additional rental income over the next five years as well as capital receipts from disposals of residential opportunities. The long-awaited arrival of REITs next year will also increase the range of options for the Group to add long-term value for Shareholders.

Graham Greene Chairman
12 June 2006

Operating review

Introduction

The major restructuring of the Group announced in November 2005 takes effect today, 12 June, with the creation of two separate publicly-quoted companies – the Property Division continuing as London Merchant Securities plc and the Investment Division being floated on AIM as Leo Capital plc. The demerger is the culmination of many months of work for the staff of the Group and its advisers.

At the same time, over the last year the Group has vigorously pursued the objectives set out in last year's Report:

- driving the property development programme to realise the full potential of LMS's asset base;
- looking for new property acquisitions and medium-term assemblies; and
- working closely with investee companies towards profitable realisation.

This Operating Review sets out in detail the achievements of the year. In particular there has been significant progress with developments actually on site, with planning applications and with pipeline schemes.

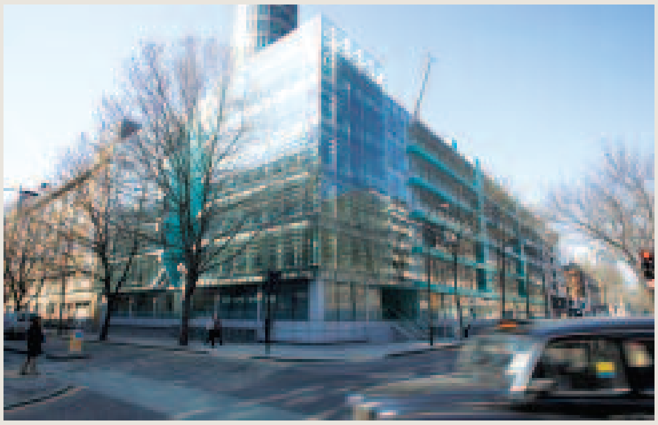
Performance has been strong in relation to the objective measures which the Board has established for the Group. These three Key Performance Indicators are intended to reflect returns in terms both of absolute performance and of the Group's valuation by the stock market. The Group's performance was as follows:

Total Property Return – this is a measure of like-for-like capital growth and net rental income from the property portfolio plus profit on disposals. In the year ended 31 March 2006 Total Property Return was 25.9%, an increase of 81% on the corresponding figure for 2005 of 14.3%. The benchmark Investment Property Databank figure for the relevant period was 20.7%, reflecting significant outperformance by the Group.

Return on Equity – this is a measure of growth in undiluted adjusted Shareholders' funds per share, adding back the value of the current year dividend. In the year ended 31 March 2006 Return on Equity was 20.5%, an increase of 236% on the corresponding figure for 2005 of 6.1%.

Total Shareholder Return (TSR) – this is a measure of total returns to Shareholders adding together the movement in the market value of their shares between the beginning and end of the financial year and the value of the dividend. In the year ended 31 March 2006 LMS's TSR was 42.7%, an increase of 78% on the corresponding figure for 2005 of 24.0%. The benchmark returns were 49.3% for the FTSE Real Estate Index and 41.7% for the FTSE 250.

Arup HQ, Phase 1, Fitzroy Street, Fitzrovia, London W1



30 Gloucester Place, London W1

Property

Strategy

LMS creates value by:

- upgrading and expanding its core holdings (particularly in the Fitzrovia and Islington/Clerkenwell areas of London), through a deep knowledge base, active asset management and a long-term perspective;
- pursuing an active development programme, both in core areas and in other locations where there is scope for renewal and reconfiguration;
- acquiring, developing and selling properties where value can be added on an opportunistic basis; and
- building long-term partnerships with tenants, the communities in which the Group operates, key suppliers and other property owners.

Performance in 2005/2006

Total return

The total property return was 25.9%, which compares favourably with the IPD all-property quarterly benchmark for the corresponding period of 20.7%. The annualised five year return was 14.1% and the ten year return 16.3%.

Capital Value

The portfolio valuation as at 31 March 2006 was £1,113.9 million (2005: £991.3 million). The like-for-like increase in capital value was 18.5%, of which approximately one third arose through asset management activity and two-thirds through a tightening of yields.

Income

Gross rental income for the year was £56.9 million (2005: £60.7 million), with net rental income of £52.0 million (2005: £56.4 million). The principal reason for the reduction was the disposal of the US portfolio and of a number of UK assets. Disposal proceeds totalled £99.3 million (£41.4 million for the US properties; £30.5 million of offices, £20.1 million of retail, £4.5 million of land and £2.8 million of residential).

The total passing rent under all leases at 31 March 2006 was £54.3 million (2005: £60.7 million). A reduction of £6 million attributable to disposals and £2.2 million to voids was offset by £1.5 million of rental income arising from lettings, reviews, renewals and the expiry of rent-free periods, together with an additional £0.3 million from acquisitions.

Voids during the year, excluding properties under and held for development, remained at 4.3%.

The average unexpired lease term is now 14.1 years, an increase from 13.9 years in the previous year. Taking lease breaks into account the average unexpired term is 13.0 years (2005: 12.8 years). Assuming all lease breaks are exercised and all properties are vacant on the expiry of their existing leases, 75.3% of the contracted rent roll is secured for five years, 51.2% for ten years and 33.1% for 15 years.

Onsite at Arup's HQ Phases 2 and 3, Fitzroy Street and Howland Street, Fitzrovia, London W1

CGI of the Reception at 28 Dorset Square, London NW1

There is currently 29,728 sq m (320,000 sq ft) of commercial property under development, with 102,190 sq m (1.1 million sq ft) of schemes with planning consent and a further 39,019 sq m (420,000 sq ft) of pipeline schemes.

Offices

Vacancy rates in the West End are reported to stand at 4.2%, with total supply in central London falling during the year. Rental growth during the year was slower than expected but we are now seeing rental increases as supply of prime space diminishes, and we expect this trend to continue. The investment market remains strong, with prime yields contracting to below 4% in the West End.

There were no major rent reviews and renewals during the year. The principal letting was of 30 Gloucester Place, London W1 (2,202 sq m; 23,705 sq ft), following the refurbishment of the building, with the FA Premier League taking a 15 year lease at an initial rent equivalent to £40.75 per sq ft.

Acquisitions during the year included the buy-in of the long leasehold interests at South Place, London EC2 (3,479 sq m; 37,400 sq ft) for £3.75 million. Acquisitions were also made in Fitzrovia. These included 73-75 Charlotte Street, London W1 (1,019 sq m; 10,970 sq ft), purchased for £4.5 million, let to an NHS Trust at a rent of £285,000 per annum, a net yield of 6%; and a vacant property at 7-8 Midford Place, London W1 (584 sq m; 6,290 sq ft), purchased for £1.95 million.

Shortly after the year end LMS contracted to acquire 210 Old Street, adjacent to the development site at City Road, for £10.4 million, a net yield of 6.1%. This 2,053 sq m (22,100 sq ft) building is let to the Government until 2017 at £675,000 per annum.

Disposals during the year included 63 St James's Street, London SW1 for £22.5 million, an increase of 18.4% on the March 2005 valuation of £19 million at a yield of 4.4%. The vacant office block at City House, Croydon, was sold for £8 million.

Voids in the office portfolio increased from 3.1% to 3.2%.

Retail and leisure

The occupational market across the UK has been mixed, but the LMS portfolio has continued to attract strong interest from a variety of retailers. The electrical and home improvement retailers in out-of-town locations have generally had a more difficult year, but there is still good demand for space in retail parks. The leisure market has had a better year, in particular the restaurant sector, with the emergence of some new, fast-growing operators.

The investment market for retail property remained strong during the year, although there are signs that it may have peaked. The opportunity was taken to dispose of a number of non-core properties around the country totalling £20.1 million. These included five restaurant investments (in Brighton, Bath, Cardiff, Chiswick and Shrewsbury) sold as 'The Italian Job' for £17.9 million in total, a yield of 4.9%. Properties were also sold in Oswestry and Southampton.

Only 2% of the total retail and leisure portfolio was vacant at the year end. Rent reviews and renewals added an additional rent of £0.3 million per annum.

Strategic sites

During the year 11 acres of land to the north of Glasgow was sold for housing, with net receipts of £4.5 million. A further payment is expected during the current year for an additional 9.5 acre site with detailed planning consent which is currently under offer to a national house builder.

An option payment of £3.4 million, including interest, was received in relation to land owned by the Group at Turnford. An application for outline planning consent for 1.2 hectares (2.9 acres) re-zoned for housing is due to be submitted in September this year.

US portfolio

The US property portfolio was sold during the year for $72 million (£41.4 million). The four properties – 340 Pine Street, 275 Sacramento Street, 3706 Geary Boulevard and 1149 South Main Street, Walnut Creek – produced a net rental income of £1.6 million per annum – a net yield on sale of 4%.

Development programme

28 Dorset Square, London NW1

The redevelopment of this 2,183 sq m (23,500 sq ft) office building adjacent to Marylebone station is very close to completion. There has been strong interest from potential occupiers and letting discussions are at an advanced stage. The development cost was £6.4 million and the guiding rent is £1.1 million per annum (£45 per sq ft).

CGI of Winchester Road, Swiss Cottage, London NW3

160–166 Brompton Road, London SW3

Strathkelvin Retail Park, Glasgow - Phase 2

This 4,180 sq m (45,000 sq ft) extension to the existing retail warehousing is due for completion in November 2006. The estimated construction cost, which includes the comprehensive refurbishment of the retail park, is £8.2 million and the ERV of the new units is in excess of £0.9 million per annum (£20 per sq ft). Strong interest has been received from a number of major retailers and discussions are in progress to extend usage beyond bulky goods. On completion of this phase the retail park will have 27,405 sq m (295,000 sq ft) of retail warehousing.

Qube, 90 Whitfield Street, London W1

Construction of this 10,126 sq m (109,000 sq ft) development is proceeding to plan, with groundworks and foundations completed and the superstructure under way. The design includes 1,672 sq m (18,000 sq ft) floor plates for offices on five floors around a central atrium, with ground floor retail units fronting Tottenham Court Road and a small residential element. Given the shortage of grade A space in the West End, the prospects for letting prior to completion in mid-2007 are strong. The development cost is £36 million and the guiding rent is of the order of £50 per sq ft.

Arup's HQ, London W1 – Phases 2 and 3

This 13,239 sq m (142,500 sq ft) office development on Howland Street, London W1 forms the second and third phases of the redevelopment of Arup's offices in the area. The site has been cleared and construction begins shortly, with Phase 2 due for completion in August 2007 and Phase 3 in May 2009. The development cost to LMS is capped at £43 million with an agreed rent of £6 million per annum, equating to £42 per sq ft. The development is pre-let to Arup and a new 25 year lease will be entered into on completion.

Winchester Road, Swiss Cottage, London NW3

Planning consent, subject to a Section 106 agreement, has been granted for the redevelopment of this 1960s retail/residential parade. There will be 76 residential units including 25 affordable homes and 465 sq m (5,000 sq ft) of retail on the ground floor, all totalling 9,605 sq m (103,390 sq ft). Work is likely to start in early 2007 with completion due in 2008.

Greenwich Reach, London SE10

Detailed planning consent for this scheme was obtained in February 2006, subject to a Section 106 agreement. There will be approximately 83,600 sq m (900,000 sq ft) of residential accommodation, providing 980 apartments, of which 35% will be social rented and key worker units. There will also be 6,503 sq m (70,000 sq ft) of retail, restaurant, cafes and waterfront cultural uses. Negotiations with Registered Social Landlords and food store operators are well advanced and consideration is now being given to potential joint venture partners.

City Road Estate, London EC1

This one acre site adjacent to Old Street roundabout has potential for a major mixed-use development including separate office and residential elements. A planning application has just been submitted for a mixed use scheme of approximately 28,800 sq m (310,000 sq ft) designed by Squire and Partners. Vacant possession of the site is available at the end of 2007 enabling work to start, subject to planning consent, in 2008, with completion due by 2010.

160-166 Brompton Road, London SW3

A planning application is being worked up for the conversion of the upper floors of this office building into 13 luxury residential apartments.

3-4 South Place, London EC2

Plans for the redevelopment of this building are being prepared by architects Allies & Morrison, with potential for in excess of 5,000 sq m (50,000 – 60,000 sq ft) of new office space. A planning application is likely to be submitted by the fourth quarter of 2006.

Tottenham Court Road/Goodge Street, London W1

Proposals are being worked up with Allies & Morrison for the redevelopment of the holdings on the corner of Tottenham Court Road and Goodge Street, totalling 2,694 sq m (29,000 sq ft) of retail and residential space. A planning application is expected to be submitted in Q3 of 2006.

Weatherford offshore in Singapore

Investment

The Investment Division, which has now been demerged into Leo Capital plc, had a successful year. It continued the policy of risk-diversification, with holdings in quoted and unquoted companies at different stages of development in the UK and US, together with a number of fund investments.

This is the first full year in which investments were included in the accounts at 'fair value', as required by IFRS. At 31 March 2006, the total fair value to be reported under IFRS for investment management was £186.3 million (2005: £181.8 million). The total investment value of those portfolio companies requiring to be consolidated was £40.3 million (2005: £46.6 million). Adding these amounts back to the reported investment value produces a total fair value for the investment portfolio of £226.6 million (2005: £228.4 million).

Adjustments to the carrying value of a number of investments have been made, reflecting unrealised fair value movements and goodwill impairment. The overall impact is a reduction of £4.3 million for the year, with mark-ups for quoted, US unquoted and fund investments being offset by the write-downs on the UK unquoted holdings reported at the half year.

Realisations of £38.7 million produced profits of £9.8 million (2005: £17.9 million). Among the disposals were a number of companies in the fund portfolio and some quoted energy stocks, including Ivanhoe Energy, a Canadian oil and gas exploration company.

At the end of the year, LMS's 58.8% subsidiary, Inflexion plc, disposed of its business and assets, following which the company entered members' voluntary liquidation. The total proceeds to LMS from the liquidation are expected to be approximately £24.5 million compared to the £18.0 million invested in 2004, producing an IRR in excess of 15%. Including the Inflexion disposal, total profits from the Investment Division were £16.3 million.

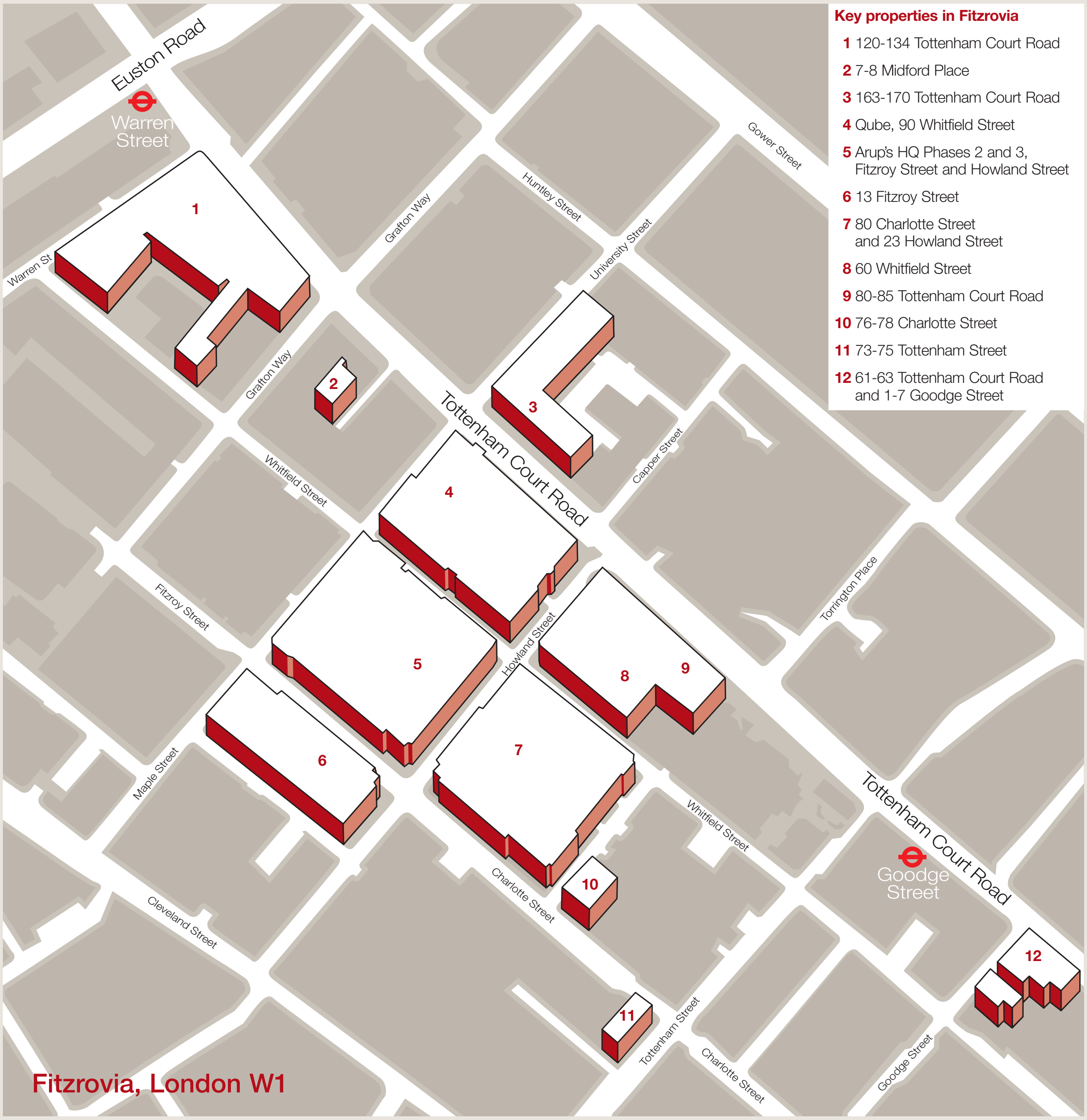
The Group's largest investment, Energy Cranes International had a successful year, growing revenue to £76 million and increasing margins. In January 2006 it expanded its rental crane fleet through the acquisition of Dynamic Cranes in the Gulf of Mexico.

New investment during the year totalled £57.9 million, which included £24.9 million into funds, £23.3 million into the unquoted portfolio, mainly in the UK, and £9.7 million into quoted stocks.

Top Ten Investments[1]

Company	Activity	Fair value at 31 March 2006 £000	Quoted/ unquoted or fund	Country
Weatherford International Inc	Oilfield services	18,612	Quoted	USA
ProStrakan Group plc	Speciality pharmaceuticals	17,392	Quoted	UK
San Francisco Equity Partners	Venture capital fund	16,514	Fund	USA
Spectrum Equity Partners IV	Buyout fund	8,762	Fund	USA
Rave Review Cinemas	Movie theatre operators	8,244	Unquoted	USA
Citizen Limited (Vio Worldwide Limited)	Digital workflow management solutions	7,819	Unquoted	UK
Boston Ventures Limited Partnership VI	Buyout fund	7,537	Fund	USA
WeSupply Ltd	Supply chain execution management software	6,694	Unquoted	UK
7 Global Limited	Software hosting services	5,985	Unquoted	UK
CopperEye Limited	Database indexing technology and software	5,294	Unquoted	UK

[1]The Group's consolidated investments are not included in the table above. The fair value at 31 March 2006 of the Group's investment in Energy Cranes International is £21.5 million and in Entuity is £8.4 million.



Outlook

With the demerger of Leo Capital plc, LMS has reverted to its core property investment and development roots. The Group will continue to focus on active asset management and long-term assembly of development opportunities. It now has the largest development programme and pipeline in its history.

The current development programme has a Gross Development Value of some £240 million, which, when combined with projects where planning has been obtained, or is in the course of being obtained, produces a potential Gross Development Value of some £800 million. A significant proportion of the capital expenditure required to complete these projects is expected to be financed from the sale of the residential components in these developments.

This substantial development potential, when added to the prospects for rental growth in the core West End holdings, and the opportunities presented by REITs, gives considerable confidence in the outlook for the Group and for returns to its Shareholders.

Robert Rayne Chief Executive
12 June 2006

Principal properties

as at 31 March 2006

Values in excess of £70 million

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

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

Values in excess of £40 million

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

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

2-10 Fitzroy Street and
18-24 Howland Street, London WI
Arup's HQ Phases 2 & 3 Under Development
13,240 sq m (142,500 sq ft)

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

Greenwich Reach
Greenwich, London
3.1 hectare site (consent for 980 residential units and
6,967 sq m (70,000 sq ft) commercial space)

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

19-35 Baker Street, London W1
7,135 sq m (76,800 sq ft)

Qube
90 Whitfield Street, London W1
Under Development 10,126 sq m (109,000 sq ft)

Values in excess of £30 million

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

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

Values in excess of £20 million

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

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

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

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

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

Values in excess of £15 million

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

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

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

†Full value of jointly-owned investment property

London, Fitzrovia
London, Other West End
London, Islington, and City
Scotland
Other UK

Office
Retail/Leisure
Other
Strategic sites

Values in excess of £10 million

- 30 Gloucester Place, London W1
  2,202 sq m (23,705 sq ft)
- 17-39 George Street, London W1
  1,973 sq m (21,235 sq ft)
- 58-64 City Road, London EC1
  3,860 sq m (42,000 sq ft)
- 28 Dorset Square, London NW1
  2,186 sq m (23,500 sq ft)
- Dukes Lane, Brighton
  2,278 sq m (24,523 sq ft)
- Bush House, South West Wing, London WC2
  9,618 sq m (103,530 sq ft)
- The Quadrant Arcade, Romford
  6,364 sq m (68,500 sq ft)
- The Quadrant Centre, Bournemouth
  7,673 sq m (82,775 sq ft)

Values in excess of £7.5 million

- 5-8 Hardwick Street and
  161 Rosebery Avenue, London EC1
  3,180 sq m (34,230 sq ft)
- 151 Rosebery Avenue, London EC1
  2,251 sq m (24,230 sq ft)
- 3-4 South Place, London EC2
  3,344 sq m (36,000 sq ft)
- 67-69 Whitfield Street and
  8-15 Chitty Street, London W1
  2,478 sq m (26,675 sq ft)
- 96 Bishops Bridge Road, London W2
  790 sq m (8,505 sq ft)
- 2-12 Pentonville Road, London N1
  2,443 sq m (26,300 sq ft)
- 2-20 Winchester Road and
  157a-173 Fellows Road, London NW3
  880 sq m (8,400 sq ft)
- 22-66 Myddelton Square, London EC1

Values in excess of £5 million

- The Bargate Centre, Southampton
  7,525 sq m (81,000 sq ft)
- 21-23 and 25-31 South Street, Romford
  1,126 sq m (12,125 sq ft)
- 60 Commercial Road, London E1
  2,179 sq m (23,455 sq ft)
- 14 Pentonville Road, London N1
  1,733 sq m (18,654 sq ft)
- 83 Farringdon Street, London N1
  1,325 sq m (14,263 sq ft)
- 76-78 Charlotte Street, London W1
  1,002 sq m (10,787 sq ft)
- Burlington Arcade, Bournemouth
  1,208 sq m (13,000 sq ft)
- 16-20 Baker Street, London W1
  1,178 sq m (12,685 sq ft)

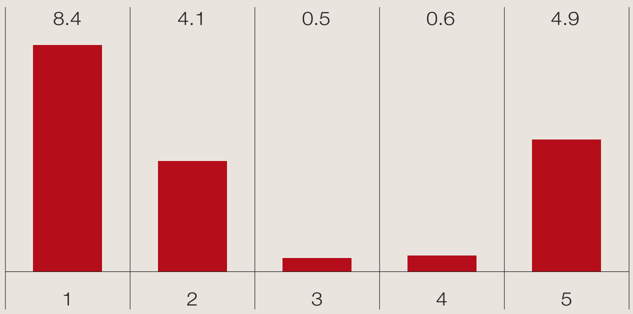
Property portfolio breakdown

as at 31 March 2006

Portfolio breakdown	Values (£m)	Percentage of portfolio (%)	Percentage like for like change (%)	Gross rent roll (£m pa)	Initial yield (%)
London, Fitzrovia	**369.0**	**33.1**	**23.6**	**16.2**	**4.4**
Office	293.7	26.3	24.6	12.9	4.4
Retail and Leisure	66.4	6.0	19.8	3.0	4.5
Other	8.9	0.8	20.2	0.3	3.4
London, Other West End	**174.7**	**15.7**	**23.1**	**7.8**	**4.5**
Office	111.1	10.0	22.4	5.3	4.8
Retail and Leisure	30.6	2.7	24.5	1.9	6.2
Other	33.0	3.0	24.1	0.6	1.8
London, Islington and City	**217.4**	**19.5**	**11.0**	**14.4**	**6.6**
Office	196.0	17.6	10.7	13.5	6.9
Retail and Leisure	5.6	0.5	1.5	0.3	5.4
Other	15.8	1.4	19.0	0.6	3.8
Scotland	**135.8**	**12.2**	**13.0**	**5.8**	**4.3**
Office	4.2	0.4	11.2	0.3	7.1
Retail and Leisure	94.7	8.5	5.6	4.5	4.8
Other	1.1	0.1	26.7	0.1	9.1
Strategic sites	35.8	3.2	38.9	0.9	2.5
Other UK (including outer London)	**217.0**	**19.5**	**18.1**	**10.1**	**4.7**
Office	8.8	0.8	37.6	0.5	5.7
Retail and Leisure	154.8	13.9	10.3	9.3	6.0
Other	4.0	0.4	19.8	0.3	7.5
Strategic sites	49.4	4.4	46.9	0.0	0.0
Total	**1,113.9**	**100.0**	**18.5**	**54.3**	**4.9**
Combined Fitzrovia and Other West End	**543.7**	**48.8**	**23.4**	**24.0**	**4.4**
Office	404.8	36.3	24.0	18.2	4.5
Retail and Leisure	97.0	8.7	21.2	4.9	5.1
Other	41.9	3.8	23.3	0.9	2.1

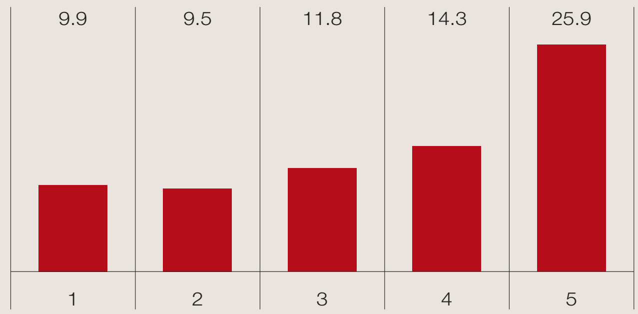
Summary use breakdown	Values (£m)	Percentage of portfolio (%)	Percentage like-for-like change (%)	Gross rent roll (£m pa)	Initial yield (%)
Office	613.8	55.1	19.5	32.5	5.3
Retail and Leisure	352.1	31.6	11.6	19.0	5.4
Other	62.8	5.7	22.0	1.9	3.0
Strategic sites	85.2	7.6	43.4	0.9	1.1
	1,113.9	**100.0**	**18.5**	**54.3**	**4.9**

Void rate by location*
%



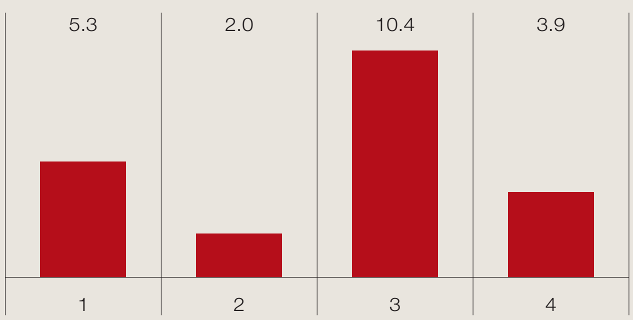
1 London, Fitzrovia
2 London, Other West End
3 London, Islington and City
4 Scotland
5 Other UK
*excluding developments and properties held for development

Total property returns
%



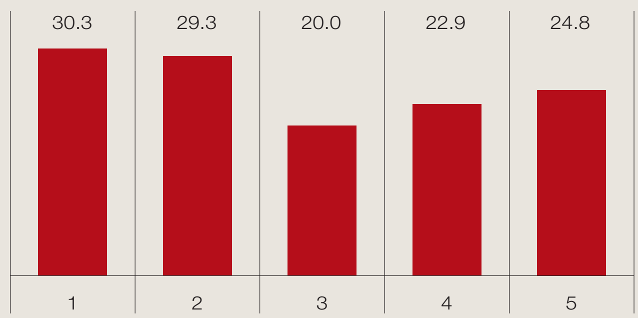
1 2002
2 2003
3 2004
4 2005
5 2006†

Void rate by use*
%



1 Office
2 Retail and Leisure
3 Other
4 Strategic sites
*excluding developments and properties held for development

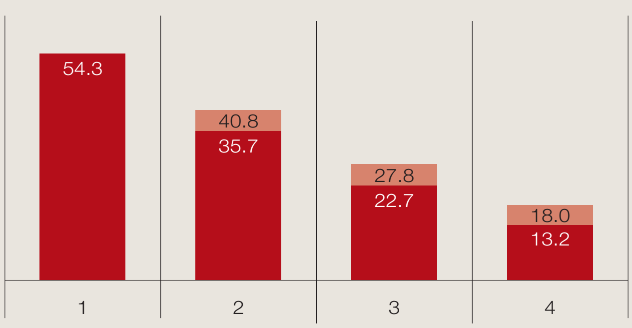
Total property returns by location†
%



1 London, Fitzrovia
2 London, Other West End
3 London, Islington and City
4 Scotland
5 Other UK

†Source: IPD

Security of income Gross rent roll £m pa



1 31st March 2006
2 5 years
3 10 years
4 15 years

Gross rent roll
All contracted

Financial review

International Financial Reporting Standards (IFRS)

The results for the year to 31 March 2006 are the Group's first audited results to be published under IFRS. The comparative figures for the year to 31 March 2005 have been restated under IFRS.

The adoption of IFRS has introduced considerable complexity into the Group's financial reporting, in particular in relation to the Investment Division. This complexity will to an extent be diminished in next year's accounts following the demerger.

An explanation of the impact of conversion to IFRS on the prior period's results and a reconciliation to previous GAAP are included in note 32 to these audited accounts.

For the Property Division the main changes to the financial statements have been the inclusion of the effect of movements in the valuation of investment properties in the income statement, rather than being taken directly to reserves, and the recognition as a liability of the tax that could become payable were the property assets to be disposed of at their revalued amounts.

For the Investment Division the main change has been the requirement to consolidate the results of certain of its portfolio companies, rather than to account for those companies as investments. The Investment Division results therefore include not only investment management activity, in respect of the bulk of the investment portfolio, but also the turnover, profits and assets of a number of its portfolio companies. In order to facilitate the presentation, the Investment Division activities have been broken down into a number of subsidiary segments as follows:

- **Investment Management** – The results of managing investments other than those which are required to be consolidated.
- **Energy Cranes** – This portfolio company is consolidated and is of sufficient size that it requires to be disclosed as a segment on its own.
- **Consolidated LMS Investments** – Comprises a further three companies in the LMS managed portfolio which require to be consolidated.
- **Inflexion** – Comprises the investment management activities of Inflexion plc plus the activities of those Inflexion portfolio companies which need to be consolidated.

Adjusted Shareholders' funds and Return on Equity

Growth of adjusted Shareholders' funds per share for the year to 31 March 2006 was 18%. Property Division and Investment Division adjusted Shareholders' funds per share were 206p and 76p respectively. The Property Division borrowings at 31 March 2006 include a net £19 million invested in the Investment Division during the year. After adjusting for this, the growth in Property Division Shareholders' funds for the period was 22% and for the Investment Division 7%.

The key driver of growth in the Property Division has been growth in the value of the property portfolio which, on a like-for-like basis, has shown 18.5% growth in the year. This result is discussed in more detail in the Operating review. The Investment Division has achieved its growth after allowing for the reduction in fair value of £27.9 million recognised at the half year stage. In the second half of the year it has grown in excess of 20%.

The dividend and growth in adjusted Shareholders' funds in aggregate produce a return on equity of 20.5% (2005: 6.1%) on the opening adjusted Shareholders' funds.

Dividend

An interim dividend for the year to 31 March 2006 of 2.0p per share was paid in January 2006. The directors are recommending a final dividend of 4.6p per share which, if approved by the AGM, will be paid in on 3 August 2006.

Property operating results

	2006 £m	2005 £m
Profit before tax	**170.3**	42.5
Adjust for		
– Revaluation gains	**(150.0)**	(67.5)
– Investment profits on disposal	**(9.2)**	(1.8)
– Trading profits on disposal	**(4.2)**	–
– JV profit after tax	**(2.5)**	0.1
– Exceptional items and debt breakage costs	**12.7**	48.2
Underlying profit	**17.1**	21.5
Made up as follows:		
Gross rental	**56.9**	60.7
Net rental	**52.0**	56.4
Administrative expenses	**(10.4)**	(9.3)
Interest	**(24.5)**	(25.6)
	17.1	21.5

The underlying profit before tax has reduced by £4.4 million compared to the prior year, principally due to the reduction in the gross rental income which is analysed in the table below.

Changes in gross rental income

	Effect in 2005/2006 £m	Full year effect £m
Development and refurbishment projects	**(1.6)**	(1.6)
Property disposals	**(2.3)**	(6.0)
New lettings	**0.4**	1.0
Other movements compared to prior year	**(0.3)**	
	(3.8)	(6.6)

Administrative costs for the year are higher due to the inclusion of a number of 'one-off' items relating to staff changes and reorganisation, implementation of IFRS and one-off consulting costs.

Investment Division results

The results of the Investment Division segments, excluding Inflexion which is shown as a Discontinued Activity, are set out below.

	2006 £m	2005 £m
Loss before tax	**(4.0)**	(5.0)
Made up as follows:		
Net operating costs of Investment Management activity	**(6.5)**	(4.9)
Realised profits on disposals	**7.2**	6.7
Fair value changes	**(4.3)**	(5.2)
Operating profits/(losses) of consolidated portfolio companies	**1.9**	(7.2)
Other	**(2.3)**	5.6
	(4.0)	(5.0)

The net operating costs of investment management activity include a one-off item in connection with settlement with two investment managers leaving the business and who were entitled to carried interest payments.

Realised profits on disposal arose on disposals from the quoted portfolio and distributions by funds.

Fair value changes comprise net reductions in fair value of £26.6 million on the unquoted portfolio largely offset by increases in fair value of £12.8 million in respect of the quoted portfolio and £12.2 million in respect of the fund investments. The reduction in fair value on the unquoted investments includes the effects of the adjustment to the valuation bases adopted by the directors at the half year in the light of the impending demerger.

The operating losses on the consolidated portfolio companies comprise the aggregated results of Energy Cranes, Offshore Tool & Energy, Entuity and Assethouse.

The other items relate to finance costs in the consolidated portfolio companies.

Inflexion

On 16 March 2006 Inflexion plc disposed of its business for cash and on 29 March 2006 entered a members' voluntary liquidation. The results of Inflexion and its subsidiaries are shown in these accounts as discontinued activity and are reported post tax as a single line item in the income statement. The disposal gave rise to a profit of £6.5 million in LMS's consolidated accounts.

The investment was made in February 2004 and showed an internal rate of return in excess of 15% over its life. The consolidated net assets of Inflexion at 31 March 2006 were £41.8 million of which £43.1 million comprise cash. LMS received its first distribution under the winding up, of £23 million, during April 2006.

Property Division balance sheet

Property portfolio

The Group's total property holdings, based on open market valuations by external valuers was £1,113.9 million (2005: £991.3 million). Overall the portfolio showed a 18.5% increase over the prior year on a like-for-like basis.

A significant proportion of this growth has been driven by compression of yields in the investment property market. This factor as a driver for growth may reduce in future. The Group is well placed to take advantage of valuation increase from growth in underlying rental levels and from active management of its investment and development portfolio.

The property portfolio is included in the balance sheet as follows:

	£m
– £1,028 million of investment property minus £6.8 million SIC 15 prepayment plus £2.4 million grossed up headlease liabilities	1,023.6
– £51.9 million of assets under construction and owner-occupied property held within property, plant and equipment	51.9
– £15 million of land classified as trading properties and carried in balance sheet at historic cost	0.4
– £19 million being a 50% share of properties held in joint venture shown net of share of joint venture liabilities	7.9

The total revaluation gain on the Group's property interests in the year amounted to £173.0 million (2005: £67.3 million).

During the year the Group has completed two major refurbishment projects at its properties at 85 Tottenham Court Road, London W1 and 30 Gloucester Place, London W1, and at the year end had four development projects underway (Qube, 90 Whitfield Street, London W1, 28 Dorset Square, London W1, Arup HQ Phases 2 & 3, Fitzroy Street and Howland Street, London W1, Strathkelvin Retail Park, Phase 2, Glasgow). The development projects in progress have a combined value at the year end of £150.8 million. Capital expenditure on the refurbishment and development projects during the year amounted to £19.7 million. Approximately £73.4 million, excluding finance costs, remains to be spent on the schemes in progress.

Acquisitions and capital expenditure on other properties in the year amounted to £13.7 million.

Borrowings

With the exception of cash and borrowings held in Inflexion plc and its subsidiaries and in the consolidated portfolio companies, all the Group's cash and borrowings are treated as Property Division assets. The Group's net indebtedness both including and excluding the Investment Division is set out in the table below.

Net indebtedness

	2006 £m	2005 £m
Excluding Investment Division		
External borrowings		
– £375 million Revolving Bank Loan 2013	**206.3**	–
– 6.5% Secured Bond 2026	**173.2**	173.1
– £140 million Revolving Bank Loan 2012	**–**	139.1
– £60 million Revolving Bank Loan 2009	**–**	30.6
– 9.69% Mortgage 2018	**20.0**	20.0
– Other mortgages and unsecured loans	**9.8**	29.8
Net liquid resources	**(52.9)**	(16.1)
Net indebtedness excluding Investment Division	**356.4**	376.5
Net (cash)/indebtedness of Investment Division	**(33.9)**	11.7
Group net indebtedness	**322.5**	388.2
Gearing excluding Investment Division net assets/indebtedness	**57.7%**	71.1%
Gearing for Group	**36.1%**	49.9%
Weighted average maturity of debt	**12.3 years**	12.0 years
Weighted average effective interest rate	**6.2%**	5.9%

In order to provide the resources necessary to complete the demerger and to provide finance to complete the current development projects, a new £375 million seven year Revolving bank facility was put in place in March 2006. This facility refinanced substantially all of the Group's other bank borrowings and mortgages and simplified the security structures in the Group.

The Group has swapped £140 million of its seven year interest rate exposure to fixed. This involved restructuring its existing interest rate swaps and putting additional swaps in place. The cost of restructuring the previous interest rate swaps was £1.4 million and has been recognised in finance charges in the income statement.

The weighted average effective interest rate of the Group's debt at 31 March 2006 was 6.2% (2005: 5.9%).

Investment Division balance sheet and effect of demerger

The Investment Division balance sheet comprises the division's investments at fair value plus the assets, liabilities and goodwill arising on consolidation of those portfolio companies required to be consolidated.

The Investment Division balance sheet includes £47.5 million of cash, of which £43.1 million is held in Inflexion and will be distributed to Shareholders. The first such distribution was received by the Group during April 2006.

Following the demerger, the Investment Division assets will no longer be part of the continuing LMS Group and will instead belong to Leo Capital plc. The table below shows the impact of the demerger.

As noted on the previous page, gearing in the Property Divsion at the year end was 57.7%.

As part of the demerger, LMS plc will transfer £65 million cash to Leo Capital plc. It will also pay an estimated £5 million under a working capital adjustment mechanism designed to adjust for the effects of net cash receipts and payments incurred by the divisions in the period immediately prior to the demerger. LMS plc is entitled under the demerger agreement, to retain the first £22.8 million of cash received from the Inflexion liquidators. Adjusting for the foregoing items, the 31 March 2006 gearing on a post demerger proforma basis is 70%.

Taxation

The Group's overall current and deferred tax charge represents 27.7% of the reported profits before tax. The current year rate is increased by approximately 3.5% as a result of disallowable costs which are abnormally high in the current year, principally as a result of transaction costs in connection with the demerger.

Pension

At 1 April 2005 the Group showed a balance sheet deficit in respect of its defined benefit pension plan of £6.8 million before tax.

The Group made contributions to its defined benefit pension plan during the year totalling £9.8 million.

After charging £0.7 million to the current year income statement and £0.6 million to reserves in respect of actuarial losses, there is a balance sheet asset of £1.7 million in respect of the scheme at the year end.

Future financing

Outstanding capital expenditure on the four development schemes underway at the year end amounts to approximately £73 million, excluding finance costs. In addition, in connection with the demerger, the Group will transfer £65 million of cash to Leo Capital plc. These commitments will be funded using the Group's new bank facility.

The Group has a significant development pipeline beyond the four developments currently underway. Due to the significant residential element to these schemes, which will be sold, the schemes are to an extent self-financing. Some additional financing will be required. The Group will use a combination of its own equity, joint ventures and bank finance.

Nicholas Friedlos Finance Director
12 June 2006

	LMS 31 March 2006 £m	LMS Continuing Group £m	Leo Capital plc £m
LMS Shareholders' funds at 31 March 2006	**826.9**		
– Property	**(575.6)**	**575.6**	
– Investment	**(251.3)**		**251.3**
Demerger adjustment			
– Working capital adjustment		**(5.0)**	**5.0**
– Transfer of £65 million to Leo Capital plc		**(65.0)**	**65.0**
– £22.8 million of Inflexion distribution retained by LMS plc		**22.8**	**(22.8)**
LMS Shareholders' funds at 31 March 2006 adjusted for demerger		**528.4**	
Leo Capital plc's share of demerger costs			**(2.4)**
Reversal of IFRS adjustments by Leo Capital plc			**(0.6)**
Leo Capital plc Shareholders' funds adjusted for demerger			**295.5**

Board of directors

Graham Greene CBE
Chairman

Term of Office
Appointed to the Board in January 1996 and Chairman since July 2000. Mr Greene was last re-elected in 2003 and is retiring by rotation and standing for re-election in 2006.

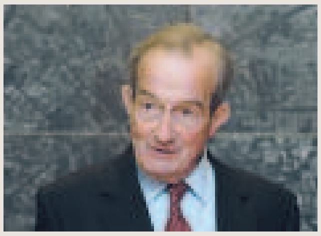
Board Committee membership

- Chairman of the Nomination Committee
- Audit Committee
- Remuneration Committee

Mr Greene has been a chairman and director of a number of international publishing companies for over 25 years. He has also sat on the boards of a number of City companies. Age 70

Other directorships and offices

- Chairman of Governors, Compton Verney House Trust
- Director of Garsington Opera Limited
- Chairman of Chatto, Virago, Bodley Head & Jonathan Cape Ltd (1970 – 88)
- Non-executive director of Guinness Peat Group plc (1973 – 87)
- Non-executive director of Guinness Mahon Holdings Ltd (1968 – 79)
- Non-executive director of Greene King plc (1979 – 2004)
- Non-executive director of Jupiter International Green Investment Trust (1989 – 2001)
- Chairman of Trustees of the British Museum (1996 – 2002)
- Member of the Board of the British Council (1977 – 88)



Peter Grant CBE
Deputy Chairman

Term of Office
Appointed to the Board in September 1984 and Deputy Chairman since 1994. Mr Grant was last re-elected in 2003 and is retiring by rotation and standing for re-election in 2006.

Board Committee membership

- Chairman of the Remuneration Committee
- Audit Committee
- Remuneration Committee

Mr Grant has substantial experience gained through a career in investment banking. Age 76

Other directorships and offices

- Chairman of Sun Life Assurance Society plc (1983 to 1995)
- Non-executive director of BNP Paribas UK Holdings Limited (1991 – 2005)
- Joined Lazard Brothers & Co. Limited in 1952, Managing Director from 1968 and Deputy Chairman from 1985 to 1988

Robert Rayne
Chief Executive

Term of Office
Appointed as Chief Executive Officer in May 2001. The Hon R A Rayne was last re-elected in 2004 and is not retiring or standing for re-election in 2006.

Board Committee membership

- Nomination Committee

The Hon R A Rayne has 38 years of experience working within the LMS Group in the UK and overseas. He was initially involved in the development of LMS' properties in the US and later returned to the UK with responsibility for LMS' properties in Scotland. He was appointed Investment Director in 1983, Joint Managing Director in 1998 and Chief Executive in May 2001. Age 57.

Other directorships and offices

- Acting Chief Executive Officer of Leo Capital plc
- Non-executive chairman of Energy Cranes International Limited
- Non-executive director of Weatherford International Limited and Chairman of its audit committee
- Non-executive director of Inflexion plc
- Non-executive director of Crown Sports plc (2001 to 2003)
- Non-executive director of First Leisure plc (1983 to 2000)

Nick Friedlos
Finance Director

Term of Office
Appointed to the Board in January 2003. Mr Friedlos was last re-elected in 2003 and is retiring and standing for re-election in 2006.

Board Committee membership

- Nomination Committee

Mr. Friedlos' has considerable financial experience, gained whilst working for PricewaterhouseCoopers and as finance director for Land Securities Trillium. Age 48.

Other directorships and offices

- Non-executive director of Energy Cranes International Limited
- Finance Director Land Securities Trillium (1998 to 2000)
- Joined PricewaterhouseCoopers in 1986 and partner from 1992 to 1998

Martin Pexton
Director of Corporate Development

Term of Office
Appointed to the Board in October 2002. Mr Pexton was last re-elected in 2005 and is not retiring or standing for re-election in 2006.

Board Committee membership

Nomination Committee

Mr Pexton has a general management role, and is responsible for a wide range of corporate activities. He has an MBA from the London Business School. Age 49

Other directorships and offices

Non-executive director of Energy Cranes International Limited

Non-executive director of Inflexion plc

Director at Allen & Overy (1990 – 2002)

Bernard J. Duroc-Danner
Non-executive director

Term of Office
Appointed to the Board in September 2004. Dr Duroc-Danner was last re-elected in 2005 and is not retiring or standing for re-election in 2006.

Board Committee membership

Nomination Committee

Dr Duroc-Danner has extensive knowledge of, and experience in, acquisitions and multinational business. Age 52.

Other directorships and offices

Chairman, President and Chief Executive Officer, Weatherford International Limited

Non-executive director of Leo Capital plc

Non-executive director Helix Energy Solutions Group, Inc.

Non-executive director of Dresser, Inc.

Former non-executive director Universal Compression Holdings, Inc.

Former President and Chief Executive Officer of EVI, Inc. (Weatherford's predecessor company)

June de Moller
Non-executive director

Term of Office
Appointed to the Board in May 2002. Mrs de Moller was last re-elected in 2005 and is not retiring or standing for re-election in 2006.

Board Committee membership

Audit Committee

Remuneration Committee

Nomination Committee

Mrs de Moller has considerable business acumen and experience gained from a wide variety of businesses. Age 58

Other directorships and offices

Non-executive director of Temple Bar Investment Trust Plc

Non-executive director of Archant Limited

Non-executive director of J Sainsbury plc (1999 – 2005)

Non-executive director of Cookson Group plc (1999 – 2004)

Non-executive director BT Group plc (1999 – 2002)

Non-executive director of AWG plc (1992 – 2000)

Former Managing Director of Carlton Communications plc (1992 – 1999)

Donald Newell
Non-executive director

Term of Office
Appointed to the Board in September 1998. Mr Newell was last re-elected in 2003 and is retiring and standing for re-election in 2006.

Board Committee membership

Chairman of the Audit Committee

Remuneration Committee

Nomination Committee

A Chartered Surveyor, Mr Newell has considerable business experience gained from a career in the property industry. Age 63.

Other directorships and offices

Senior Partner of Hillier Parker May & Rowden until 1998

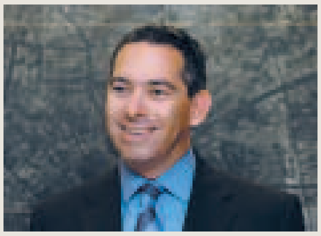
Co-chairman of the Europe, Middle East and Africa division of CB Richard Ellis Services Inc. until December 2000

Past President of the British Council of Offices

Senior management

Chris Dancer
Property Development Manager

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

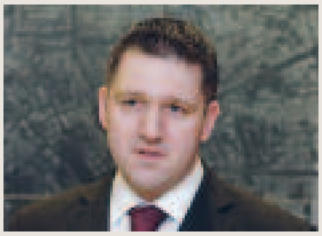


Steven Dykes
Head of Retail and Leisure

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

Nick Groves
Group Property Manager

Nick joined the Company in June 1994 and was appointed Group Property Manager in April 2002. He is responsible for the coordination of the Group's property activities with specific focus on the strategic management of the Group's Central London office portfolio. Prior to joining LMS Nick was associate partner at Gooch & Wagstaff.



Simon Mitchley
Company Secretary

Simon joined LMS in 1995 as Deputy Company Secretary and was appointed Company Secretary in February 2002. Appointed to the Executive Committee in October 2002. Prior to joining LMS, Simon worked for Forte plc and Royal Insurance plc.

Liz Horler
Group Financial Controller

Liz joined the Company in January 2005. She was formerly Financial Controller of Antisoma plc, a listed biotechnology company specialising in the development of anti-cancer drugs. Liz previously worked at Arthur Andersen, Chartered Accountants.

Directors' report

The directors submit their report and the financial statements of the Group for the year ended 31 March 2006.

Principal activities

The principal subsidiary undertakings of the Group and their activities are shown in note 16 on page 68. Further details of these activities are given in the Operating review on pages 14 to 19 and the Financial review on pages 24 to 27.

Business review

Our Chairman's Statement and the Operating and Financial reviews report on the development and performance of the business during the year, the position at the year end and the early part of the new financial year and our likely future development. Any financial risks are reported on in the Corporate Governance report on page 37. We do not currently undertake any research and development.

Results and dividends

The Consolidated income statement for the year is set out on page 44. An interim dividend of 2p per share was paid on the Ordinary shares on 17 January 2006. The directors recommend a final dividend of 4.6p per Ordinary share making 6.6p (2005: 6.5p) per Ordinary share for the year. If the final dividend is approved, it will be paid on 3 August 2006 to the holders of the issued Ordinary shares on the register at the close of business on 23 June 2006.

Property

The Group's investment properties were valued at 31 March 2006 on the basis explained in note 13 on page 66. The resultant surplus is shown in the note.

Corporate governance

A report on the Company's policy on corporate governance is shown on pages 34 to 37.

Corporate Responsibility

The Corporate Responsibility report is on pages 32 to 33 and includes information on environmental, social and community matters. The Group's Environmental and Health and Safety Statements can be found on our website, www.lms-plc.com.

Directors

The directors of the Company are those listed on pages 28 to 29. The Hon J M Wilson resigned from the Board on 26 January 2006.

Messrs G C Greene, P J Grant, D Newell and N R Friedlos will all retire by rotation and offer themselves for re-election at the forthcoming Annual General Meeting in accordance with the Company's Articles of Association. The biographies of the directors are given on pages 28 to 29.

Directors' interests and service contracts

These are disclosed in the Directors' Remuneration report shown on pages 38 to 41.

Employees

Our report on employees is disclosed in the Corporate Responsibility report on page 33.

Share capital

Details of changes in the issued share capital during the year ended 31 March 2006 are given in note 25 on page 76.

Payment of suppliers

The Group does not have a formal policy for the payment of suppliers. However, most invoices are paid within 28 days of receipt. The amounts owed by the Company to suppliers at 31 March 2006 represented some 26 days' purchases.

Auditors

A resolution concerning the reappointment of KPMG Audit Plc as auditors and their remuneration will be submitted to the Annual General Meeting. Details of the auditors fees, both for audit and non-audit work, are given in note 7 on page 60.

Political and charitable donations

It is the Group's policy not to make donations to the funds of political parties.

LMS is a member of Business in the Community, a registered charity. The membership fee is £7,500 per annum. Further details of the Group's charitable donations are given in the Corporate Responsibility report on page 33.

Substantial shareholdings

The Company has been notified of the following material interests of 3% or more of its share capital at 12 June 2006. Because of common non-beneficial interests some shares are included against the names of more than one Shareholder as noted below:

	Ordinary shares	Total of issued share capital %
Lady Rayne[1]	73,095,358	22.22
Michael Bernard Conn[2]	54,546,539	16.58
The Estate of Lord Rayne[3]	46,720,624	14.20
Robert Anthony Rayne[4]	29,344,451	8.92
Trustees of the Rayne Foundation[5]	14,817,277	4.50
HBOS plc	12,363,661	3.76

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

The Company has not been notified of any non-material interests of 10% or more of its share capital at 12 June 2006.

Directors' Responsibility Statement

The directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each director has taken all the steps that they ought to have taken as a director to make themself aware of any relevant audit information and to establish that the Company's auditors are aware of that information. The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board

Simon Mitchley Company Secretary
12 June 2006

Corporate responsibility report

Environment

The Group's Environmental policy has been in place since 2001. The Group is committed to effective environmental management and regards regulatory compliance as a minimum standard.

We adhere to our policy in the following ways:

- We are committed to achieving sustainable development. This commitment can add value to our schemes and makes for a better long-term investment.

  The design of all major schemes aims to achieve an Excellent BREEAM assessment with a minimum standard of Very Good being set. Our recently completed office scheme at 28 Dorset Square, London NW1 has achieved a Very Good BREEAM assessment. Similarly, proposals for our residential schemes are designed to achieve a BRE EcoHomes rating of Excellent, such as our Winchester Road, Swiss Cottage project.

  We are actively involved in urban regeneration through our developments on brownfield sites such as Greenwich Reach. We always analyse a site's potential for refurbishment along with full redevelopment during our feasibility studies.

  We are committed to achieving reductions in energy use in all new developments and major refurbishment projects. Compliance with the new part L of the Building Regulations aimed at reducing energy consumption is considered as an absolute minimum standard. Within London all developments are currently being designed to enable them to comply with the GLA requirement for 10% of the energy consumption to be from renewable sources. In addition, we are working to ensure that our buildings achieve good results if assessed for Energy Performance Certificates. These are likely to be introduced in line with the EU's Energy Performance of Buildings Directive.

  We consider the environmental impact of property management and the environmental standards for building use. In partnership with our tenant Arup, the development of Phases 2 and 3 of its new HQ in Howland Street and Fitzroy Street, London W1, is designed to be energy efficient. The façade of the new building has been designed to work in tandem with a low energy cooling system. Using a combination of opaque, translucent and clear glazing panels, two panel types have been developed which, when arranged across the façade, combine to reduce up to 50% of the heat gain through the façade.

  Where possible we consider the potential to improve all forms of transportation leading into a site, for example upgrading bus routes or reviewing traffic calming measures.

  Furthermore, we include green transport plans in new development proposals, promoting measures such as the use of car clubs and providing ample cycle storage and showers. We will look to include electricity recharging points.

- When acquiring new sites for development we place high priority on locations with easy access to public transport links and particularly those close to nodal transport interchanges.

- Where possible, we make our tenants aware of our environmental requirements. We look to minimise waste and at our head office approximately three tonnes of waste paper was recycled during 2005/2006. We also look to minimise water usage and have introduced 'hippo' devices at two of our sites to reduce water consumption by over 100,000 litres a year.

- We are committed to reporting our progress on initiatives. During 2006, the Group will review its Environmental Management System, looking at ways of improving the managing, recording and reporting of the various actions that the Group currently undertakes, as well as new actions that should be undertaken. To assist with this review the Group has employed Upstream, a strategic sustainability consultancy that helps companies to develop strategies for economic, environmental and social responsibility. Upstream works with many leading property companies and we will therefore be able to benchmark our performance in this area on a regular basis.

The Group's environmental statement can be found on our website, www.lms-plc.com.

External indices

The Group has been a member of FTSE4Good since July 2001. The index measures performance of companies that meet globally recognised corporate responsibility standards. The Group is also a member of Business in the Community, which actively encourages companies to improve their impact on the communities in which they operate.

FTSE4Good

Health and safety

The Group is committed to the highest standards of health and safety compliance throughout our portfolio. Regular on-site inspections and risk audits are undertaken by external consultants and procedures updated as a result. This ensures that changes in legislation are monitored and implemented as required. This relates to both our managed portfolio and our development and refurbishment works where CDM has to be complied with.

The Group's health and safety statement can be found on our website, www.lms-plc.com.

Community

The Group works with those communities in which we have developments. We liaise with them prior to developing a site, and throughout the development stages, to ensure that they are kept fully informed through the regular use of newsletters. All principal contractors on developments and major refurbishments are required to be members of the Considerate Contractors Scheme.

Employees

The average number of employees of the Group was 1,449 (2005: 1,390). The areas of the Group's operations in which they are employed were: Property Management 45 (2005: 44), Investment Division 1,392 (2005: 1,333) and 12 staff (2005: 13) who were employed directly at the Group's properties and their costs recharged to tenants.

The Investment Division allocation includes 418 people (2005: 285) employed by Inflexion plc and its consolidated subsidiaries, 826 people (2005: 791) employed by Energy Cranes International and 134 people (2005: 243) employed by companies in the LMS consolidated subsidiaries segment.

LMS employs people based on their experience and abilities, regardless of their race, colour, ethnic or national origin, gender, sexual orientation, age, religion, marital status or disability. All of our employees are encouraged to attend courses and seminars to learn new skills and to keep current on changes to their areas of expertise.

The companies comprising the Investment Division pay contributions to pension schemes for their employees.

Details of retirement benefits available to employees are disclosed on pages 60 to 62.

Employee share ownership is actively encouraged and LMS offers a Share Incentive Plan which involves participation on favourable terms. 83% of employees have chosen to participate. New employees are eligible to join the Plan on commencement of their employment with LMS. A Save-As-You-Earn Share Option Scheme is also available and LMS employees are invited to join when an offer is made.

Charity

The Group does not make charitable donations, except for the support it provides to the Rayne Foundation.

The Group does, however, support its employees in their charity work and fund raising activities. In 2005/2006, our employees voted for Great Ormond Street Children's Charity as their chosen charity of the year and raised £8,210 through a range of social activities. Great Ormond Street Hospital is an international centre of excellence for treating sick children and training children's specialists.

For 2006/2007, our employees nominated Fitzrovia Youth in Action, a community-based youth action project local to many of our developments as charity of the year. Fitzrovia Youth in Action uses sports and youth work to encourage young people and support them in developing projects in the community and to improve relationships between people from different ethnic and age groups.

LMS operates a Give As You Earn scheme and in 2005/2006, over £4,000 was donated to charities supported by its employees.

LMS encourages its employees to be involved in the charities that it supports. For example, two employees provide support and expertise to The Place2Be, an innovative, growing charity that gives children in primary schools a place where they can express their feelings through talking, creative work and play.

The Rayne Foundation

LMS has donated in-kind staff costs and administrative support estimated to be worth £240,000 to the Rayne Foundation and related trusts. The Rayne Foundation is a registered charity which aims to understand and engage with the needs of UK society, and to help address those needs through a range of social investments (funding initiatives designed to achieve a social return). The focus is on work which is nationally important or which has potential for wider than local and immediate application. Its areas of interest are: the arts, education, health and medicine, social welfare and development. Further details can be found on its website, www.raynefoundation.org.uk.

Corporate governance report

Statement of Compliance and Explanation

The UK Listing Authority Listing Rules require the Company to report on its compliance with the principles and provisions of the Combined Code and to provide an explanation where it departs from the Combined Code. For the year ended 31 March 2006, the Board confirms that the Company has complied with the Principles and Provisions of the Combined Code with the exceptions explained in detail in this report. This report should be read in conjunction with the Directors' Remuneration report on pages 38 to 41 and the biographies of the directors on pages 28 to 29.

The Board responsibilities

The Board is collectively responsible for the success of the Company. The Board's main aim is to produce high long-term rates of return to Shareholders. The Board is responsible for setting strategic aims, ensuring necessary resources are in place to meet its objectives, reviewing management performance, ensuring the integrity of financial information and financial controls, and the systems for managing risk. The Board is also responsible for ensuring that all information, including all price sensitive information reported by the Company, is presented as a balanced and understandable assessment of the Company's position and prospects. As such, the Company has a written policy on the disclosure of price sensitive information. The Board has a formal schedule of matters reserved for its decision which includes major investment expenditure, financing and dividend policy. This schedule is reviewed annually. The Board has delegated authority to management to approve capital expenditure below defined thresholds. The levels of delegated authority are regularly reviewed by the Board. Some powers are delegated by the Board to its Committees and full details of the Committees' terms of reference can be obtained from the Company's website, www.lms-plc.com.

Internal control

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. The Group's system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against misstatement or loss. The Audit Committee reviews the system and reports to the Board. Management continually monitors risk management processes and reports at each Board meeting on the chief risks affecting the Group. The Board confirms that throughout the year under review and up to the date of the approval of this annual report and accounts there has been a process in place for identifying, evaluating and managing the significant risks faced by the Group. Further detail on the risk management and internal control procedures are described separately under the section on the Audit Committee on page 37.

Financial statements

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

Structure

The Board has eight directors, three executive and five non-executive, their details, experience and committee membership are given on pages 28 to 29. The make up of the Board is specifically designed to provide a balance of skills and experience. The Board has Nomination, Remuneration and Audit Committees, and details of the Committees of the Board, their responsibilities, membership and activities during the year are provided separately in this report. Directors' concerns which cannot be resolved are recorded in the Board minutes. There is appropriate insurance cover in respect of legal action against the directors.

Chairman and Chief Executive

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

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

The Chief Executive's principal responsibilities are:

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

Non-executive directors

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

Independence

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

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

- Dr Duroc-Danner is Chairman, President and Chief Executive Officer of Weatherford International and he has a depth of knowledge and experience in acquisitions and multinational business and is of considerable benefit to the Board. The Board is satisfied that the independence of Dr Duroc-Danner is not compromised and that he has demonstrated he is independent in character and judgement, notwithstanding that he and Mr Rayne hold cross-directorships in Weatherford International and Leo Capital plc.

Appointments

There is a transparent procedure for the appointment of new directors and the prime responsibility for the appointment of directors rests with the Board. The Nomination Committee is responsible for identifying and nominating candidates for the approval of the Board to fill Board vacancies as and when they arise as well as put in place plans for succession of the Chairman and the Chief Executive. Further details of the role of the Nomination Committee are provided separately in this report. None of the executive directors has a non-executive directorship in a FTSE 100 company. Full account of the Board's view would be taken if the issue arose and would be considered on a case by case basis. Mr Rayne has a non-executive directorship in a NYSE listed company and the fees in respect of this directorship are paid to the Company.

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

Attendance

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

	Board	Audit	Remuneration	Nomination
Number of meetings held	11	6	6	1
G C Greene	11	6	6	1
P J Grant	11	5	5	1
B J Duroc-Danner	4	n/a	n/a	–
N R Friedlos[1]	11	6	n/a	1
J F de Moller	11	6	6	1
D Newell	10	6	6	1
M A Pexton[1]	11	n/a	6	1
R A Rayne[1]	10	n/a	n/a	–
J M Wilson[2]	4	n/a	n/a	–

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

1 Executive directors are not members of the Audit or Remuneration Committees but attend when invited.
2 Resigned on 26 January 2006 and prior to this there were eight Board meetings.

Information and development

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

Performance evaluation

The Board has undertaken a comprehensive evaluation of its performance including its Committees and individual directors. The evaluation of the Board and its Committees was carried out through a questionnaire, facilitated by the Company Secretary. The evaluation covered structure, objectives, decision making, meeting processes, induction and training and relations with management. The conclusion of the evaluation demonstrated that the Board and its Committees continued to operate effectively. The evaluation of individual non-executive directors was carried out by the Chairman. The evaluation of the Chief Executive was undertaken by the Chairman with the other non-executive directors. Evaluation of the other executive directors was undertaken by the Chief Executive. The conclusions of the evaluations were that the directors demonstrated commitment and continue to contribute effectively to their role. The senior independent director carried out an appraisal of the Chairman's performance with the other non-executives. The evaluation concluded that the Chairman continued to demonstrate commitment and effective leadership of the Board.

Re-election

The terms of appointment of non-executive directors are subject to the provisions of the Company's Articles of Association relating to retirement by rotation. All directors are subject to retirement by rotation at least every three years. The Nomination Committee considered the effectiveness of the contribution of the directors retiring by rotation and concluded that each makes a valuable and effective contribution to the Company and recommends to Shareholders that their periods of appointment should continue for a further three years. The biographies of Mr Greene, Mr Grant, Mr Friedlos and Mr Newell, who are seeking re-election are on pages 28 to 29.

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

Going concern

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

Shareholders

Led by the Chief Executive and the Finance Director, the Company conducts a continual programme of meeting equity and debt investors as well as analysts and a rating agency. During the year management met with institutional Shareholders as and when requested and as part of formal road show of meetings with investors. Meetings are conducted within the guidance provided by the UKLA Listing Rules on the dissemination of price sensitive information. Presentations are made to investors and analysts after the interim and year end results as well as during the year to improve understanding of particular areas of the business or to update them on current activities. These presentations, as well as a regular flow of news releases made through a Regulatory Information Service, are posted on the Company's website, www.lms-plc.com. The Chairman, the senior independent director and non-executive directors are available to attend meetings requested by major Shareholders. The Board is regularly apprised of the views of investors, analysts and the media. Reports are made available to the Board on feedback received on an unattributable basis from analyst briefings and investor road shows carried out regularly by management.

The Annual General Meeting

The Board believes that the Annual General Meeting is a good opportunity to communicate with all investors and the Company provides time for Shareholders attending to meet and discuss matters with members of the Board outside the formal meeting. At each Annual General Meeting all proxy votes are counted and, after each resolution has been dealt with on a show of hands, the level of proxies lodged and the number of votes is indicated. The number of proxy votes lodged, how they were voted and the result of the resolution voted at the Annual General Meeting, will be available on the Company's website after the Annual General Meeting. Members of CREST are given the opportunity to vote electronically to maximise the number of votes cast. All substantially separate issues are proposed as separate resolutions at the Annual General Meeting. All directors attend the Company's Annual General Meeting, where Shareholders have the opportunity to put questions to the Chairmen of the Audit, Remuneration and Nomination Committees. Notice of the Annual General Meeting is sent to Shareholders at least 20 working days before the meeting to allow time for proxy votes to be returned by institutional Shareholders.

Report of the Nomination Committee

The Board has a Nomination Committee of which a majority are independent non-executive directors. The members, appointed by the Board and chaired by Mr Greene, also comprise Dr Duroc-Danner, Mr Friedlos, Mr Grant, Mrs Moller, Mr Newell, Mr Pexton and Mr Rayne. Their experience is given on pages 28 to 29. The main role and responsibilities of the Nomination Committee are set in written terms of reference in accordance with best practice and are reviewed annually. The remit of the Nomination Committee is available on the Company's website, www.lms-plc.com. The Nomination Committee carried out its responsibilities in accordance with its terms of reference, including reviewing its own performance and its terms of reference. The Committee considers the skills and experience of the Board and during the year it considered the effectiveness of the contribution of the directors retiring by rotation and concluded that each makes a valuable and effective contribution to the Company and recommended that their periods of appointment should continue for a further three years.

Report of the Remuneration Committee

The Board has a Remuneration Committee appointed by the Board and chaired by the senior independent director, Mr Grant. It also includes Mr Greene, Mrs de Moller and Mr Newell. Their experience is given on pages 28 to 29. The Board believe that the interests of the Company are better served with Mr Greene as a member of the Remuneration Committee notwithstanding the requirement of the Combined Code that all members of the Remuneration Committee should be independent. Mr Greene is not involved in determining his own remuneration. The main role and responsibilities of the Remuneration Committee are set in written terms of reference, which are reviewed annually. The remit of the Remuneration Committee is available on the Company's website, www.lms-plc.com. During the year the Remuneration Committee carried out its responsibilities in accordance with its terms of reference and its activities are described in the Directors' Remuneration report on pages 38 to 41. No director was involved in deciding his or her own remuneration. The Committee also considered the impact of the demerger on the Company's share schemes, the new long-term incentive scheme, as well as the incentive arrangements for Leo Capital plc. The new schemes for both the Company and Leo Capital are described in detail in the circular posted to Shareholders on 12 April 2006 and approved at the Extraordinary General Meeting held on 17 May 2006.

Report of the Audit Committee

Membership

The Board has an Audit Committee of non-executive directors. The members are appointed by the Board and chaired by Mr Newell. It also includes Mr Grant, Mr Greene and Mrs de Moller. Their experience is given on pages 28 to 29. The Board believe that the interests of the Company are better served with Mr Greene as a member of the Audit Committee and that his membership does not compromise the Committee's ability to discharge its duties properly. The Board consider that collectively the Audit Committee has significant financial experience and ability to discharge its duties properly, gained from managing business of similar or greater size and complexity and through extensive service on the Boards and Audit

Committees of listed companies. The Company does not comply with C.3.1 of the Combined Code that states that all members of the Audit Committee must be independent and that at least one member of the Audit Committee should have recent relevant financial experience.

Responsibilities

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

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

Financial reporting

The Audit Committee has reviewed the significant financial reporting issues and judgements made in connection with the preparation of the Group's financial statements including significant accounting policies, any changes to them and any significant estimates and judgements. The Audit Committee has also reviewed the clarity and completeness of disclosures in the financial statements and considered whether the disclosures made were set properly in context. The review of the financial statements also included a review of the operating and financial review and corporate governance reports, including statements relating to audit and risk management. In addition, the Audit Committee has considered and overseen the implementation of International Accounting Standards and have put in place processes to monitor the effectiveness of the systems to meet the applicable requirements.

Internal control and risk management

The Audit Committee has a responsibility to review the Group's internal control system and risk management system and make appropriate recommendations to the Board. Management is responsible for the identification and evaluation of significant risks in the business together with the design and operation of a suitable system of control to manage those risks. Management is also responsible for ensuring that the risk profile of the business is kept under continuous review and that significant changes in the business or the external environment which affect the risk profile are identified and acted upon. To enable it to do this, the Audit Committee reviews the risks identified and the system of control in place to manage those risks. It gives consideration in particular to the following:

- a review of the inherent risks in the business which have been identified by management;
- the appropriateness of the authority, resources and co-ordination of those involved in the identification, assessment and management of significant risks faced by the Group;
- the effectiveness of management's response to the significant risks which have been identified;
- a review of risk monitoring and reporting procedures in place;
- the Group policies and employee procedures for the reporting and resolution of suspected fraudulent activities. As part of its reporting, management provides the Audit Committee with risk indicators and recommendations for improvement in the system of risk management; and
- relationships with stakeholders, such as tenants, which are likely to directly or indirectly influence the performance of the business. No such significant relationships were identified.

The principal risks identified are economic climate, legislative, market factors, property development and management.

Internal audit

The Audit Committee carried out its annual review of the requirement for an internal audit function. The Committee concluded that such a function was not required due to the size of the Group and number of employees. The Board, on the recommendation of the Audit Committee, has adopted a policy whereby staff of the Company may, in confidence, raise concerns about possible improprieties in financial reporting or other matters. The Audit Committee is responsible for implementing and reviewing the policy.

Auditors

In accordance with the Committee's terms of reference, the Audit Committee carries out an annual review of the independence of the Group's Auditors, KPMG Audit Plc. Senior members of the audit team are rotated on a regular basis. The Company has a policy on the provision of non-audit services by the Auditors. The implementation of the policy is continually monitored by the Audit Committee. The policy excludes the Auditors from providing services in relation to the outsourcing of internal audit and any other consultancy work that the Audit Committee considers is contrary to the ethical principles laid down by the Audit Committee. The Committee's considerations included the provision of non-audit services carried out by the Auditors (described in note 7 on page 60) and was satisfied that they were objective and independent of the Group. The Committee reviewed the policy on the provision of non-audit services by the Auditors and the Board considers that the policy provides adequate protection of the Auditors' independence.

Directors' Remuneration report

Remuneration Committee

The members of the Remuneration Committee are:

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

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

Policy on directors' remuneration

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

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

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

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

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

Basic salary

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

Annual bonus

Each executive director is eligible for an annual bonus based on the performance of the Company and of the individual, including those aspects of the business for which they are directly responsible. During the year ended 31 March 2006, executive directors could receive a bonus of up to 100% of basic salary. The measures used in assessing corporate performance include Total Shareholder Return, both in absolute terms and in relation to the FTSE 250 and FTSE Real Estate indices; realised profits and growth in net asset value.

Long-term incentives

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

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

The Chief Executive, Mr R A Rayne, participates in the ***Carried Interest Plan***, which applies to certain executives who have responsibility for investments made by the venture capital division, and was approved by Shareholders in 2001. The Plan is intended to correspond to the incentive arrangements applicable in the venture capital industry. Mr Rayne is entitled to 7% of the pre-tax net capital gains realised on the cost of direct investments (i.e. excluding investment in funds) after a preferred return to LMS of 6.5%. The percentage of realised capital gains which may be allocated to participants in aggregate may not exceed 20%, after the return of capital. No payment was made to Mr Rayne under the Plan in the year ended 31 March 2006.

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

Notice periods

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

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

Executive directors' service contracts

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

Non-executive directors' appointment letters

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

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

Performance graphs

The graphs below show the total return for holders of LMS Ordinary shares for the one year, three year and five year periods ending 31 March 2006. Also shown are the total Shareholder return for the FTSE 250 Index and the FTSE Real Estate Index, which have been selected as broad-based comparative indices for quoted companies. In all cases dividends are assumed to have been reinvested at the date of payment.

Five Year Total Shareholder Return to 31 March 2006

Three Year Total Shareholder Return to 31 March 2006

One Year Total Shareholder Return to 31 March 2006

Directors' emoluments

Name	Basic salary £000	Fees £000	Bonus £000	Benefits[1] £000	Total excluding pensions 2006 £000	Total excluding pensions 2005 £000	Share option gains 2006 £000	Share option gains 2005 £000
Executive								
Executive								
N R Friedlos	**250**	**–**	**237**	**21**	**508**	412	**–**	–
M A Pexton	**250**	**–**	**237**	**23**	**510**	414	**–**	–
Hon R A Rayne	**499**	**–**	**474**	**21**	**994**	970	**–**	–
Non-executive								
Dr B J Duroc-Danner[2]	**–**	**35**	**–**	**–**	**35**	18	**–**	–
P J Grant	**–**	**62**	**–**	**–**	**62**	60	**–**	–
G C Greene	**–**	**132**	**–**	**–**	**132**	125	**–**	–
Mrs J de Moller	**–**	**35**	**–**	**–**	**35**	30	**–**	–
D Newell	**–**	**42**	**–**	**–**	**42**	35	**–**	–
Hon J M Wilson[3]	**–**	**29**	**–**	**–**	**29**	30	**–**	–
Total	**999**	**335**	**948**	**65**	**2,347**	2,094	**–**	–

Notes to the table
1 Benefits comprise car allowance, private medical insurance and Unapproved life insurance together with the value of shares granted under the Company's Share Incentive Plan.
2 Dr B J Duroc-Danner was appointed as a director during the year to 31 March 2005.
3 The Hon J M Wilson retired as a director on 26 January 2006.
4 Mr N G E Driver retired as a director in March 2004 but continued as a consultant to the Company. During the year to 31 March 2006 he received a fee of £60,000 per annum and benefits of £2,000, bringing total emoluments for the year to £62,000. His consultancy ended on 31 March 2006.
5 Mr W Millsom retired as a director in July 2002 but continued as a consultant to the Company. During the year to 31 March 2006 he received a fee of £178,000 and benefits of £2,000, bringing total emoluments for the year to £180,000.
6 The basic salaries payable to executive directors with effect from 1 April 2006 were unchanged, as follows: Mr R A Rayne £499,000; Mr N R Friedlos £250,000; Mr M A Pexton £250,000.
7 The fees payable to non-executive directors with effect from 1 April 2006 were unchanged, as follows: Mr G C Greene £132,500; Mr P J Grant £62,500; Mr D Newell £42,500; other non-executives £35,000.

Directors' share options and long-term incentive awards

The number of shares subject to options/awards as at 31 March 2006 is set out below.

Name and scheme	Exercise price (p)	Ordinary balance at 31 March 2006	Ordinary balance at 1 April 2005	First exercise date[3]	Expiry date[3]
NR Friedlos					
Executive	**104.0**	**229,175**	229,175	01 Apr 2006	01 Apr 2013
Executive	**137.5**	**207,401**	207,401	29 Aug 2006	29 Aug 2013
Executive	**181.0**	**132,596**	132,596	01 Sept 2007	01 Sept 2014
Executive[1]	**219.5**	**113,898**	–	28 June 2008	28 June 2015
SAYE	**130.0**	**7,096**	7,096	01 Feb 2007	31 July 2007
MA Pexton					
Executive	**137.5**	**166,666**	166,666	29 Aug 2006	29 Aug 2013
Executive	**181.0**	**132,596**	132,596	01 Sept 2007	01 Sept 2014
Executive[1]	**219.5**	**113,898**	–	28 June 2008	28 June 2015
SAYE	**130.0**	**7,096**	7,096	01 Feb 2007	31 July 2007
Hon RA Rayne					
Executive	**174.0**	**1,235,420**	1,235,420	05 Jan 2004	05 Jan 2011
Executive	**137.5**	**359,635**	359,635	29 Aug 2006	29 Aug 2013
Executive	**181.0**	**275,555**	275,555	01 Sept 2007	01 Sept 2014
Executive[1]	**219.5**	**227,223**	–	28 June 2008	28 June 2015

Notes to the table
1 Executive options over Ordinary shares were granted to Mr N R Friedlos, Mr M A Pexton and Mr R A Rayne on 28 June 2005 at an exercise price of 219.5p.
2 The performance condition for the executive options first exercisable in January 2004 is that in *any* three year period following the grant of the options Shareholders' funds must increase by a percentage greater than the increase in the Retail Prices Index plus 9%. The performance condition for the options first exercisable in April 2006 and August 2006 is that in the *first* three year period following the grant of the options Shareholders' funds must increase by a percentage greater than the increase in the Retail Prices Index plus 9%. The performance condition for the options first exercisable in September 2007 and June 2008 is that the Total Shareholder Return (TSR) over the first three year period after grant must exceed the arithmetic average of the TSR for the FTSE 250 and the TSR for the FTSE Real Estate index for the same period.
3 The first exercise date shown in the table above is in each case three years from the date of grant. Under the rules of the LMS Executive Share Option Scheme and the LMS Sharesave Scheme, if the Company enters into a Scheme of Arrangement options may be exercisable earlier than three years from the date of grant. Pursuant to the demerger of Leo Capital plc a Scheme of Arrangement was sanctioned by the Court on 8 June 2006 and the Remuneration Committee treated the performance conditions for grants under the Executive Share Option Scheme as satisfied. All options are therefore now exercisable.
4 The market price of an Ordinary share at 31 March 2006 was 285.75p and the range during the year was 203.75p to 295p.

Pensions

During the year to 31 March 2006 Mr R A Rayne was a member of the LMS (1973) Pension Scheme, which is an Inland Revenue approved defined benefit scheme, of which the principal features for executive directors are a normal retirement age of 60 and a pension at normal retirement age after 20 years' service of two-thirds of final pensionable salary.

	Age	Years of service	Accrued pension entitlement at age 60 at 31 March 2006 £000	Accrued pension entitlement at age 60 at 31 March 2005 £000	Transfer value at 31 March 2006 £000	Transfer value at 31 March 2005 £000	Employee contributions £000	Change in transfer value during the year less employee contributions £000
Hon RA Rayne	**57**	**31**	**304**	287	**8,921**	7,158	**30**	1,733

Subsequent to 31 March 2006 Mr Rayne left the Scheme and an augmented transfer payment of £10 million was made, representing the amount actually reserved for him and funded in the Scheme on an ongoing valuation basis, including the past service reserve. No further pension contribution will be made.

Mr N R Friedlos and Mr MA Pexton each received pension contributions of £50,000 during the year.

Directors' share interests

At 31 March 2006 the share interests of the directors and their families, as defined by the Companies Act 1985, in London Merchant Securities plc were as follows:

	At 31 March 2006 Ordinary	At 31 March 2005 Ordinary
Beneficial		
Dr B J Duroc-Danner	**–**	–
N R Friedlos	**19,994**	17,228
P J Grant	**1,247**	1,247
G C Greene	**16,400**	16,400
Mrs J de Moller	**20,000**	20,000
D Newell	**10,000**	10,000
M A Pexton	**63,778**	61,161
Hon R A Rayne	**7,645,793**	7,645,793
Non-beneficial		
G C Greene	**7,294,156**	7,294,156
Hon R A Rayne	**21,582,900**	21,582,900

Changes in directors' shareholdings between 31 March 2006 and 31 May 2006 were as follows:

	Ordinary
Beneficial	
NR Friedlos	**184**
MA Pexton	**182**

Approved by the Board on 12 June 2006 and signed on its behalf by:

Simon Mitchley Company Secretary

Statement of directors' responsibilities in respect of the annual report and the financial statements

The directors are responsible for preparing the Annual Report and the Group and Parent Company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and Parent Company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the Parent Company financial statements in accordance with UK Accounting Standards.

The Group financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and the performance of the Group; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The Parent Company financial statements are required by law to give a true and fair view of the state of affairs of the Parent Company and of the profit or loss of the parent company for that period.

In preparing each of the Group and Parent Company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the Parent Company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Parent Company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Parent Company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Directors' report, Directors' Remuneration report and Corporate Governance report that comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent auditors' report

to the members of London Merchant Securities plc

We have audited the Group and Parent Company financial statements (the "financial statements") of London Merchant Securities plc for the year ended 31 March 2006 which comprise the Consolidated Income Statement, the Consolidated and Company Balance Sheets, the Consolidated Cash Flow Statement, the Consolidated Statement of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration report that is described as having been audited.

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, and for preparing the Parent Company financial statements and the Directors' Remuneration report in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of directors' responsibilities on page 42.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements. The information given in the Directors' report includes that specific information presented in the Chairman's Statement, the Operating and Financial reviews that is cross referenced from the Business review section of the Directors' report. We also report to you if, in our opinion, 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 review whether the Corporate Governance report reflects the Company's compliance with the nine provisions of the 2003 FRC 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 form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

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 and the part of the Directors' Remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and 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 part of the Directors' Remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration report to be audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at 31 March 2006 and of its profit for the year then ended;
- the Parent Company financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the Parent Company's affairs as at 31 March 2006;
- the financial statements and the part of the Directors' Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation; and
- the information given in the Directors' report is consistent with the financial statements.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
12 June 2006
London

Consolidated income statement

For the year ended 31 March 2006	Notes	2006 Property £000	2006 Investments £000	2006 Total £000	2005 Property £000	2005 Investments £000	2005 Total £000
Turnover	2	**61,404**	**86,946**	**148,350**	60,729	89,347	150,076
Cost of sales		**(5,207)**	**(69,690)**	**(74,897)**	(4,347)	(73,107)	(77,454)
Gross profit	2	**56,197**	**17,256**	**73,453**	56,382	16,240	72,622
Exceptional administrative expenses associated with demerger		**(9,347)**	**–**	**(9,347)**	–	–	–
Other administrative expenses		**(10,439)**	**(21,930)**	**(32,369)**	(9,280)	(28,411)	(37,691)
Operating profit/(loss) before net profit on investments	2	**36,411**	**(4,674)**	**31,737**	47,102	(12,171)	34,931
Realised gains on disposal of investments		**9,234**	**7,190**	**16,424**	1,769	6,717	8,486
Unrealised gains/(losses) on investments		**149,963**	**(1,635)**	**148,328**	67,493	(5,175)	62,318
Goodwill impairment		**–**	**(2,667)**	**(2,667)**	–	–	–
Fair value gains arising on recognition as investments, of entities previously consolidated	5	**–**	**–**	**–**	–	8,035	8,035
Investment income		**–**	**–**	**–**	–	19	19
Operating profit/(loss)		**195,608**	**(1,786)**	**193,822**	116,364	(2,575)	113,789
Finance income		**2,188**	**269**	**2,457**	1,287	570	1,857
Finance costs on repurchase of debt		**(3,355)**	**–**	**(3,355)**	(48,213)	–	(48,213)
Other finance costs		**(26,654)**	**(2,462)**	**(29,116)**	(26,915)	(3,009)	(29,924)
Net finance costs	9	**(27,821)**	**(2,193)**	**(30,014)**	(73,841)	(2,439)	(76,280)
Share of profit/(loss) of joint venture after tax		**2,548**	**–**	**2,548**	(47)	41	(6)
Profit/(loss) before tax		**170,335**	**(3,979)**	**166,356**	42,476	(4,973)	37,503
Income tax expense	10	**(36,848)**	**(9,208)**	**(46,056)**	(5,213)	(1,992)	(7,205)
Profit/(loss) for the year – continuing operations	2	**133,487**	**(13,187)**	**120,300**	37,263	(6,965)	30,298
Profit for the year – discontinued operations (net of tax)	2	**–**	**6,297**	**6,297**	–	16,441	16,441
Profit/(loss) for the year		**133,487**	**(6,890)**	**126,597**	37,263	9,476	46,739
Attributable to:							
– Equity holders of the parent	26	**122,914**	**(13,472)**	**109,442**	32,012	1,041	33,053
– Minority interest		**10,573**	**6,582**	**17,155**	5,251	8,435	13,686
Profit/(loss) for the year		**133,487**	**(6,890)**	**126,597**	37,263	9,476	46,739
Earnings per share	11						
– Basic		**37.38p**	**(4.10)p**	**33.28p**	10.57p	0.36p	10.93p
– Diluted		**37.19p**	**(4.08)p**	**33.11p**	9.71p	0.33p	10.04p

Adjusted earnings per share are shown in note 11.

A final dividend of 4.6p per share was declared on 12 June 2006 (2005: 4.5p), making a total of 6.6p for the year (2005: 6.5p).

Consolidated balance sheet

At 31 March 2006	Notes	2006 Property £000	2006 Investments £000	2006 Total £000	2005 Property £000	2005 Investments £000	2005 Total £000
Non-current assets							
Intangible assets	12	**–**	**33,645**	**33,645**	–	56,292	56,292
Investment properties	13	**1,023,565**	**–**	**1,023,565**	926,013	–	926,013
Property, plant and equipment	14	**53,139**	**6,925**	**60,064**	36,083	8,992	45,075
Investment in joint venture	15	**7,870**	**269**	**8,139**	4,108	162	4,270
Other investments	17	**2,824**	**187,557**	**190,381**	–	181,808	181,808
Pension scheme surplus	8	**1,703**	**–**	**1,703**	–	–	–
Deferred tax assets	24	**5,916**	**69**	**5,985**	11,361	7,135	18,496
Total non-current assets		**1,095,017**	**228,465**	**1,323,482**	977,565	254,389	1,231,954
Current assets							
Inventories		**–**	**4,586**	**4,586**	–	5,890	5,890
Trading properties	18	**375**	**–**	**375**	606	–	606
Trade and other receivables	19	**20,866**	**24,987**	**45,853**	20,746	27,080	47,826
Cash and cash equivalents	20	**52,889**	**47,551**	**100,440**	16,131	26,175	42,306
Total current assets		**74,130**	**77,124**	**151,254**	37,483	59,145	96,628
Total assets		**1,169,147**	**305,589**	**1,474,736**	1,015,048	313,534	1,328,582
Current liabilities							
Borrowings	22	**4,696**	**8,152**	**12,848**	4,789	10,543	15,332
Trade and other payables	21	**36,907**	**20,860**	**57,767**	22,795	25,213	48,008
Tax liabilities		**4,730**	**857**	**5,587**	–	539	539
Total current liabilities		**46,333**	**29,869**	**76,202**	27,584	36,295	63,879
Non-current liabilities							
Borrowings	22	**404,573**	**5,477**	**410,050**	387,783	27,286	415,069
Pension scheme deficit	8	**–**	**–**	**–**	6,842	–	6,842
Deferred tax provision	24	**91,428**	**199**	**91,627**	61,203	234	61,437
Other payables		**2,414**	**581**	**2,995**	2,169	839	3,008
Total non-current liabilities		**498,415**	**6,257**	**504,672**	457,997	28,359	486,356
Total liabilities		**544,748**	**36,126**	**580,874**	485,581	64,654	550,235
Net assets	3	**624,399**	**269,463**	**893,862**	529,467	248,880	778,347
Equity							
Issued share capital	25			**90,275**			90,256
Share premium	26			**20,687**			20,575
Revaluation reserve	26			**26,897**			12,331
Capital reduction reserve	26			**2,868**			2,868
Other reserves	26			**2,235**			(269)
Retained earnings	26			**683,960**			600,151
Equity attributable to equity Shareholders of the parent				**826,922**			725,912
Minority interest	26			**66,940**			52,435
Total equity				**893,862**			778,347
Shareholders' funds per share	11						
– Basic		**175p**	**76p**	**251p**	150p	71p	221p
– Diluted		**174p**	**76p**	**250p**	149p	71p	220p
Adjusted Shareholders' funds per share							
– Basic		**206p**	**76p**	**282p**	173p	66p	239p
– Diluted		**204p**	**76p**	**280p**	172p	66p	238p

The financial statements on pages 44 to 82 were approved by the Board of Directors on 12 June 2006 and were signed on its behalf by

Robert Rayne Director

Nicholas Friedlos Director

Consolidated statement of cash flows

For the year ended 31 March 2006	Notes	2006 £000	2005 £000
Cash flow from operating activities			
Profit for the year		**126,597**	46,739
Depreciation		**2,679**	1,757
Impairment of goodwill		**2,667**	–
Foreign exchange losses		**856**	167
Share of operating (profit)/loss of joint venture		**(2,548)**	6
Profit on disposal of investment properties and other investments		**(22,927)**	(17,847)
Gains on revaluation of properties and investments		**(148,328)**	(75,862)
Investment income		**(3,488)**	(2,866)
Interest expense		**34,796**	78,588
Tax expense		**46,794**	7,283
Equity settled share-based payment expenses		**327**	197
Operating profit before changes in working capital and provisions		**37,425**	38,162
Decrease/(increase) in trade and other receivables		**446**	(6,560)
Decrease/(increase) in inventories		**1,304**	(1,445)
Increase/(decrease) in trade and other payables		**9,175**	(3,022)
Increase in provisions and employee benefits		**34,727**	5,342
Cash generated from operations		**83,077**	32,477
Interest paid		**(34,119)**	(74,679)
Tax paid		**(2,414)**	(3,212)
Net cash flow from operating activities		**46,544**	(45,414)
Cash flow from investing activities			
Acquisitions of investments		**(62,536)**	(55,353)
Acquisition of property, plant and equipment		**(10,568)**	(3,144)
Proceeds from sale of plant and equipment		**7,007**	–
Investment income received		**3**	163
Purchase of subsidiaries and joint venture net of cash acquired		**(6,164)**	(13,298)
Disposal of subsidiary undertakings (net of cash disposed of)		**38,216**	(1,245)
Repayment of debt of subsidiaries disposed of		**(20,652)**	–
Interest received		**1,674**	2,102
Property developments and investment property acquisitions		**(27,145)**	(25,511)
Proceeds from sale of investment property		**91,186**	11,265
Proceeds from sale of investments		**9,109**	64,636
Net cash from investing activities		**20,130**	(20,385)
Cash flows from financing activities			
Drawdown of new loans		**229,852**	169,824
Repayment of borrowings		**(216,099)**	(109,648)
Dividend paid		**(21,402)**	(18,855)
Proceeds from issue of share capital		**399**	1,896
Net cash from financing activities		**(7,250)**	43,217
Net increase/(decrease) in cash and cash equivalents		**59,424**	(22,582)
Cash and cash equivalents at 1 April		**35,499**	57,649
Effect of exchange rate fluctuations on cash held		**40**	432
Cash and cash equivalents at 31 March	20	**94,963**	35,499

Consolidated statement of recognised income and expense

For the year ended 31 March 2006	2006 £000	2005 £000
Foreign exchange translation differences	**2,942**	(271)
Revaluation of owner-occupied property and assets under construction	**14,566**	(1,900)
Movement in deferred tax liability on revaluation of owner-occupied property and assets under construction	**(4,060)**	1,160
Effective portion of changes in fair value of interest rate cash flow hedges	**(626)**	–
Deferred tax on change in fair value of interest rate cash flow hedges	**188**	–
Actuarial (losses)/gains on defined benefits pension scheme	**(570)**	169
Deferred tax on actuarial (losses)/gains taken directly to equity	**171**	(50)
Net profit/(loss) recognised directly in equity	**12,611**	(892)
Profit for the year	**126,597**	46,739
Total recognised income and expense for the year	**139,208**	45,847
Attributable to:		
Equity holders of the parent	**122,053**	32,161
Minority interest	**17,155**	13,686
Total recognised income and expense for the year	**139,208**	45,847

Notes to the consolidated financial statements

1 Accounting policies

(a) Basis of preparation

London Merchant Securities plc ('the Company') is a company domiciled in the United Kingdom.

The Group financial statements consolidate those of the Company and its subsidiaries (together referred to as the 'Group') and equity account the Group's interest in its jointly controlled entity. The Parent Company financial statements present information about the Company as a separate entity and not about its Group.

The Group financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards as adopted by the EU ('Adopted IFRSs'). The Company has elected to prepare its Parent Company financial statements in accordance with UK GAAP; these are presented on pages 83 to 86.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these Group financial statements and in preparing an opening IFRS balance sheet at 1 April 2004 for the purposes of the transition to Adopted IFRSs.

The financial statements are prepared on the historical cost basis, except that the following assets and liabilities are stated at their fair value: derivative financial instruments, investment property, assets under construction, owner occupied property and Investment Division investments.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets and liabilities, income and expenses, in particular in relation to valuation of investment property, valuation of investments and pension scheme actuarial assumptions. Although management considers that these estimates and assumptions are reasonable, actual results may differ from those estimates.

Transition to Adopted IFRSs

The Group is preparing its financial statements in accordance with Adopted IFRS for the first time and consequently has applied IFRS 1. An explanation of how the transition to Adopted IFRSs has affected the reported financial position, financial performance and cash flows of the Group is provided in note 32.

IFRS 1 contains certain optional exemptions to assist in the transition to IFRS. The Group has elected to use the exemptions as follows:

IFRS 2 'Share-based payments' – Under the transitional arrangements within IFRS 2, the requirements of this standard have only been applied to options granted after 7 November 2002.

IFRS 3 'Business combinations' – Under IFRS 1, the Group has taken advantage of the optional exemption not to apply the requirements of IFRS 3 to business combinations prior to the date of transition and to account for these 'business combinations' based on the carrying value at the date of transition of the assets and liabilities at that date. Any goodwill arising on acquisition of subsidiaries has also been calculated on the basis of its fair value at 1 April 2004.

IAS 19 'Employee benefits' – Under IFRS 1, the Group has elected to recognise the actuarial gains and losses in full at the date of transition, with initial recognition of the defined benefit pension scheme deficit at 1 April 2004 taken through reserves. The Group has applied the amended requirements of IAS 19 with effect from 1 April 2004, with any subsequent actuarial gains or losses recognised in full in the period they are incurred via the statement of recognised income and expense.

IAS 21 'The effects of changes in foreign exchange rates' – Under IFRS 1, the Group has deemed cumulative translation differences relating to foreign operations as zero at the date of transition.

The Group has elected to adopt IAS 32 'Financial Instruments – disclosure and presentation' and IAS 39 'Financial Instruments – recognition and measurement' from the date of transition and has not taken advantage of the exemption to adopt these standards from 1 April 2005.

(b) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The accounts of subsidiaries are included in the consolidated interim accounts from the date that control commences until the date that control ceases.

Application of the IFRS definition of a subsidiary to the LMS Group results in two distinct types of entity being classified as subsidiary undertakings.

First, are those entities in both the Property Division and the Investment Division, through which LMS undertakes its business activities of owning, managing and developing properties and making and managing investments.

Second, as part of its Investment Division activities, the Group makes investments in portfolio companies which in some cases, by virtue of the size of the shareholding or other control rights may result in those portfolio investments falling within the definition of subsidiaries. These portfolio investment companies are consolidated, although they continue to be managed by the Group as portfolio investments held for capital appreciation. The consolidated results of these entities are shown as separate business segments.

1 Accounting policies continued

(ii) Joint ventures

Joint ventures are those entities over whose activities the Group has joint control, established by contractual agreement. The consolidated interim accounts include the Group's share of the total recognised gains and losses of joint ventures on an equity accounted basis, from the date that joint control commences until the date that joint control ceases.

(c) Segment reporting

A segment is a distinguishable component of the Group that reflects the way the Group manages its business, and which is subject to risks and rewards that are different from those of other segments.

The Group has identified five segments for financial reporting purposes.

- Property – comprising the results and assets employed in the Group's business of owning, managing and developing properties.
- Investment management – comprising the results and assets employed in the Group's business of making and managing investments for capital appreciation in portfolio companies and funds.
- Energy Cranes International Limited as explained above, the Group is required to consolidate certain of its portfolio companies. These investments continue to be managed by the Group as part of its portfolio held for capital appreciation. This segment comprises the consolidated results and assets of Energy Cranes International Limited, which manufactures cranes and provides crane-related services to the offshore energy industry, and by virtue of its size constitutes a separate business segment.
- Consolidated LMS investments – the consolidated results and assets of all other LMS managed portfolio companies that are held and managed as investments but required to be consolidated, are grouped together as one business segment.
- Inflexion – the consolidated results and assets employed by Inflexion plc and its subsidiaries, including portfolio companies managed as investments by Inflexion plc but required to be consolidated.

(d) Goodwill and impairment

All business combinations are accounted for by applying the purchase method. Goodwill has been recognised in acquisitions of subsidiaries. In respect of business acquisitions that have occurred since 1 April 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired. In respect of acquisitions prior to this date, goodwill is included on the basis of its deemed cost at 1 April 2004, which represents the amount recorded under previous GAAP.

Negative goodwill arising on an acquisition is recognised directly in the income statement.

Goodwill is subject to annual impairment reviews or more regularly where indication of impairment exists. An impairment loss in respect of goodwill is not reversed. Goodwill is considered to have an indefinite life and therefore is not amortised but stated at cost less any accumulated impairment losses.

An impairment loss is recognised whenever the carrying amount of goodwill or its cash-generating unit exceeds its recoverable amount.

Goodwill was tested for impairment at 1 April 2004, the date of transition of IFRSs, even though no indication of impairment existed.

(e) Property assets

(i) Investment property

Investment properties are properties which are held either to earn rental income or for capital appreciation or for both. Leasehold properties are classified and accounted for as investment property where the Group holds the property to earn rental income, capital appreciation or both. Investment properties are stated at fair value. An external, independent valuer, having an appropriate recognised professional qualification and recent experience in the location and category of property being valued, values the portfolio every six months. The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. Additional disclosure on the basis of the fair value is included in the investment property note to the balance sheet.

Any gain or loss arising from a change in fair value is recognised in the income statement. Rental income from investment property is accounted for as described in the accounting policy 'Revenue'.

(ii) Investment property under development

Existing investment properties which are being redeveloped for continued future investment use are measured at fair value and remain classified as investment property.

1 Accounting policies continued

(iii) Assets under construction

Property assets acquired with the intention of subsequent development as investment property are included as assets under construction within property, plant and equipment, until the construction or development is complete, at which time they are reclassified as investment property. Assets under construction are included in the balance sheet at fair value, determined by an independent valuer on the same basis as used for investment properties. Changes in fair value of assets under construction are accounted for as set out in the accounting policy 'Property, plant and equipment'.

(iv) Owner occupied property

Property occupied by the Group for its own purposes is included in property, plant and equipment and stated at fair value. Changes in fair value are accounted for as set out in the accounting policy 'Property, plant and equipment'.

(v) Trading property

Properties included in inventory are those which were acquired exclusively with a view to resale or development and resale. Property in inventory is held at the lower of cost and net realisable value.

(vi) Expenditure prior to the commencement of a development

Expenditure incurred in connection with developments, including the cost of obtaining the necessary planning consents, prior to the commencement of the development, are capitalised as part of the cost of the development where it is probable that the costs will be recovered via a resulting increase in value of the development property.

Where it is not probable that the costs will add value to the property or the scheme is aborted, the costs are written off to the income statement.

Early stage costs incurred prior to the preparation of submission of a planning application, including costs in relation to evaluation of development options and establishing the feasibility of proposed schemes, are written off to the income statement in the period in which they are incurred.

(f) Property, plant and equipment

(i) Assets

Property, plant and equipment includes:

– Owned property occupied by the Group.

– Equipment, principally office and IT equipment, used by the Group.

– Assets under construction for future investment use.

Assets under construction and owned property occupied by the Group are stated at fair value. Equipment is stated at cost less accumulated depreciation.

(ii) Depreciation

Depreciation is charged to profit or loss on a straight-line basis over the estimated useful lives of each item of property, plant and equipment. Land and assets under construction are not depreciated. The estimated useful lives are as follows:

• buildings 30 years

• plant and equipment 3–5 years

The residual value is reassessed annually.

(iii) Treatment of gains and losses arising on revaluation of property, plant and equipment

If the carrying amount of an asset is increased as a result of revaluation, the increase is credited directly to the revaluation reserve, except to the extent that it reverses a revaluation decrease of the same asset which previously had been charged to the income statement.

If the carrying amount of the asset is decreased as a result of the revaluation, the decrease is recognised in the income statement, except to the extent that it reverses previous revaluation increases on the same asset which have been credited to the revaluation reserve, in which case it is charged against the revaluation reserve.

1 Accounting policies continued

(g) Investment Division investments

Investments are included in the balance sheet at fair value with changes in fair value taken through the income statement. Fair values have been determined by the directors in accordance with industry guidelines. These guidelines require the valuer to make judgements as to the most appropriate valuation method to be used and the results of the valuations. Each investment is reviewed individually with regards to the stage, nature and circumstances of the investment and the most appropriate valuation method selected. Investments are reviewed and revalued every six months.

Those investments that would otherwise be associated undertakings are treated in the same way as all other investments in accordance with the requirements for venture capital companies set out in IAS 28 – Investments in Associates.

(i) Quoted investments

Quoted investments for which an active market exists are valued at the closing bid price on the balance sheet date.

Quoted investments which are subject to contractual restrictions on when they may be sold, are valued at the closing bid price on the balance sheet date, discounted in accordance with industry guidelines as appropriate.

(ii) Unquoted direct investments

Unquoted direct investments for which there is no ready market are valued using the most appropriate valuation technique with regard to the stage and nature of the investment. Valuation methods that may be used include:

- Recent investments are valued based on the cost of the investment.
- Investments in which there has been a recent funding round involving significant financing from new investors are valued at the price of the recent funding, discounted if a new investor is motivated by strategic considerations.
- Investments in an established business which is generating sustainable profits and positive cash flows are valued using earnings multiples.
- Investments in a business whose value is derived mainly from its underlying net assets rather than its earnings are valued on the basis of net asset valuation.
- Investments in an established business which is generating sustainable profits and positive cash flows but for which other valuation methods are not appropriate are valued by calculating the discounted cash flow of future cash flows or earnings.
- Investments in a business which is not generating sustainable profits or positive cash flows and for which there has not been any recent independent funding are valued by calculating the estimated discounted cash flow of the investment to the investors. This valuation basis will primarily be used to determine whether there is any impairment to the carrying value of the asset and, due to the subjective nature of the calculation and the dependence on the outcome of unknown future events, will only give rise to a valuation increase in exceptional circumstances and where there is also additional significant evidence of an increase in value, such as additional funding or profit generation.

(iii) Funds

The General Partners of the funds are, in most cases, providing periodical valuations on a fair value basis. The Group adopts the General Partner valuation provided it is satisfied that the valuation methods used by the funds are not materially different from the Group valuation methods.

(h) Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

The cost of inventories is based on the first-in-first-out method and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes a share of overheads based on normal operating capacity.

(i) Cash and cash equivalents

Cash and cash equivalents comprises cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

1 Accounting policies continued

(j) Foreign currency

(i) Foreign currency transactions

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to sterling at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to sterling at foreign exchange rates ruling at the dates the fair value was determined.

(ii) Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to sterling at foreign exchange rates ruling at the balance sheet date. Revenues and expenses of foreign operations are translated at average foreign exchange rates for the relevant period.

Exchange differences arising from the translation of the net investment in foreign operations are taken to translation reserve. They are recycled and recognised in profit or loss upon disposal of the operation.

(k) Derivative financial instruments

The Group uses derivative financial instruments to hedge its exposure to interest rate risks arising from operational, financing and investment activities.

Derivative financial instruments are recognised initially at fair value. Subsequently, the gain or loss on remeasurement to fair value is recognised immediately in the income statement, except where derivatives qualify for cash flow hedge accounting in which case any gain or loss is taken to equity. Any gain or loss arising on measurement to fair value of ineffective hedges is recognised in the income statement. When a hedging instrument expires, is sold or ceases to qualify as a hedge, any cumulative gain or loss remains in equity until the hedged transaction is recognised in the income statement. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised in the income statement immediately.

The fair value of interest rate swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

(l) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

(m) Employee benefits

(i) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement in the period to which they relate.

(ii) Defined benefit plans

The Group's net obligation in respect of defined benefit post-employment plans, including pension plans, is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value, and the fair value of any plan assets is deducted. The discount rate is the yield at the balance sheet date on AA credit rated bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

All actuarial gains and losses at 1 April 2004, the date of transition to IFRSs, were recognised. The Group recognises actuarial gains and losses that arise subsequent to 1 April 2004 in full in the statement of recognised income and expense.

(iii) Share-based payment transactions

The share option programme allows Group employees to acquire shares of the Company. The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using a Black-Scholes valuation model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where forfeiture is only due to share prices not achieving the threshold for vesting.

1 Accounting policies continued

(n) Revenue

(i) Rental income and operating lease incentives

Rental income from operating leases of investment property is recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

Operating lease incentives include rent free periods and other incentives (such as contributions towards fitting out costs) given to lessees on entering into lease agreements. In accordance with SIC 15 'Operating Lease Incentives', rent receivable in the period from lease commencement to lease end or tenant break option if appropriate, is spread evenly over the term of the lease. The cost of other incentives is spread evenly over the term of the lease.

(ii) Goods sold and services rendered

Revenue from the sale of goods is recognised in profit or loss when the significant risks and rewards of ownership have been transferred to the buyer. Revenue from services rendered is recognised in profit or loss in proportion to the stage of completion of the transaction at the balance sheet date. The stage of completion is assessed by reference to surveys of work performed. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due, associated costs or the possible return of goods. No revenue is recognised if there is significant continuing management involvement with the goods.

(o) Net financing costs

Net financing costs comprise interest payable on borrowings calculated using the effective interest rate method, interest receivable on funds invested, dividend income, foreign exchange gains and losses, and gains and losses on hedging instruments that are recognised in the income statement.

Interest income is recognised in the income statement as it accrues, using the effective interest method. Dividend income is recognised in the income statement on the date the entity's right to receive payments is established which in the case of quoted securities is the ex-dividend date.

(p) Income tax

Income tax on the profit or loss for the periods presented comprises current and deferred tax. Where income tax relates to items recognised directly in equity the tax charge or credit is also recognised directly in equity. All other tax is recognised in the income statement.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes and the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, other than in business combinations. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax on the revaluation of properties is calculated taking account of the benefit of indexation relief. The impact of this is disclosed in note 24.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend.

(q) Non-current assets held for sale and discontinued operations

Non-current assets (or disposal groups) are classified as held for sale and stated at the lower of carrying amount and fair value less costs to sell if their carrying amount will be recovered principally through sale rather than through continuing use.

A discontinued operation is a component of the Group's operations that either has been disposed of, or is classified as held for sale, which represents a separate major line of business or geographical area of operations, is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale.

(r) Financial guarantees

The Group has not adopted amendments to IAS 39 and IFRS 4 in relation to financial guarantee contracts which will apply for periods commencing on or after 1 April 2006.

The Group does not expect the amendments to have any impact on the financial statements for the period commencing 1 April 2006.

2 Segmental income statement

Year ended 31 March 2006	Property £000	Investments: Investment management £000	Investments: Energy Cranes £000	Investments: Consolidated LMS investments £000	Total continuing operations £000	Discontinued: Inflexion £000	Total £000
Turnover							
Gross rental income	56,914	–	–	–	56,914	–	56,914
Property trading income	4,490	–	–	–	4,490	–	4,490
Other revenue	–	135	75,980	10,831	86,946	43,654	130,600
Total turnover	61,404	135	75,980	10,831	148,350	43,654	192,004
Cost of sales							
Property outgoings	(4,875)	–	–	–	(4,875)	–	(4,875)
Property trading cost of sales	(332)	–	–	–	(332)	–	(332)
Other cost of sales	–	–	(61,681)	(8,009)	(69,690)	(18,763)	(88,453)
Total cost of sales	(5,207)	–	(61,681)	(8,009)	(74,897)	(18,763)	(93,660)
Net rental income	52,039	–	–	–	52,039	–	52,039
Property trading profit	4,158	–	–	–	4,158	–	4,158
Other net income	–	135	14,299	2,822	17,256	24,891	42,147
Gross profit	56,197	135	14,299	2,822	73,453	24,891	98,344
Exceptional administrative							
Expenses associated with demerger	(9,347)	–	–	–	(9,347)	–	(9,347)
Other administrative expenses	(10,439)	(6,680)	(9,454)	(5,796)	(32,369)	(22,821)	(55,190)
Operating profit/(loss) before net profit on investments	36,411	(6,545)	4,845	(2,974)	31,737	2,070	33,807
Realised gains on disposal of investments	9,234	5,858	–	1,332	16,424	6,503	22,927
Unrealised gains/(losses) on investments	149,963	(2,284)	–	649	148,328	–	148,328
Goodwill impairment	–	–	–	(2,667)	(2,667)	–	(2,667)
Fair value gains arising on recognition as investments, of entities previously consolidated	–	–	–	–	–	–	–
Investment income	–	–	–	–	–	–	–
Operating profit/(loss)	195,608	(2,971)	4,845	(3,660)	193,822	8,573	202,395
Finance income	2,188	206	–	63	2,457	1,031	3,488
Finance costs on repurchase of debt	(3,355)	–	–	–	(3,355)	–	(3,355)
Other finance costs	(26,654)	(41)	(1,708)	(713)	(29,116)	(2,569)	(31,685)
Net finance costs	(27,821)	165	(1,708)	(650)	(30,014)	(1,538)	(31,552)
Share of profit/(loss) of joint venture after tax	2,548	–	–	–	2,548	–	2,548
Profit/(loss) before tax	170,335	(2,806)	3,137	(4,310)	166,356	7,035	173,391
Income tax expense							
– current	(6,188)	(816)	(1,313)	64	(8,253)	(738)	(8,991)
– deferred	(30,660)	(7,143)	–	–	(37,803)	–	(37,803)
Tax credit on exceptional finance costs	–	–	–	–	–	–	–
	(36,848)	(7,959)	(1,313)	64	(46,056)	(738)	(46,794)
Profit/(loss) for the year	133,487	(10,765)	1,824	(4,246)	120,300	6,297	126,597
Other administrative expenses includes:							
Depreciation	633	–	1,096	246	1,975	704	2,679

2 Segmental income statement continued

Year ended 31 March 2005	Property £000	Investments: Investment management £000	Investments: Energy Cranes £000	Investments: Consolidated LMS investments £000	Total continuing operations £000	Discontinued: Inflexion £000	Total £000
Turnover							
Gross rental income	60,729	–	–	–	60,729	–	60,729
Property trading income	–	–	–	–	–	–	–
Other revenue	–	70	74,260	15,017	89,347	11,145	100,492
Total turnover	60,729	70	74,260	15,017	150,076	11,145	161,221
Cost of sales							
Property outgoings	(4,347)	–	–	–	(4,347)	–	(4,347)
Property trading cost of sales	–	–	–	–	–	–	–
Other cost of sales	–	–	(61,835)	(11,272)	(73,107)	(4,120)	(77,227)
Total cost of sales	(4,347)	–	(61,835)	(11,272)	(77,454)	(4,120)	(81,574)
Net rental income	56,382	–	–	–	56,382	–	56,382
Property trading profit	–	–	–	–	–	–	–
Other net income	–	70	12,425	3,745	16,240	7,025	23,265
Gross profit	56,382	70	12,425	3,745	72,622	7,025	79,647
Administrative expenses	(9,280)	(4,992)	(8,205)	(15,214)	(37,691)	(5,735)	(43,426)
Operating profit/(loss) before net profit on investments	47,102	(4,922)	4,220	(11,469)	34,931	1,290	36,221
Realised gains on disposal of investments	1,769	6,717	–	–	8,486	9,361	17,847
Unrealised gains/(losses) on investments	67,493	(5,175)	–	–	62,318	5,509	67,827
Goodwill impairment	–	–	–	–	–	–	–
Fair value gains arising on recognition as investments of entities previously consolidated	–	–	–	8,035	8,035	–	8,035
Investment income	–	19	–	–	19	143	162
Operating profit/(loss)	116,364	(3,361)	4,220	(3,434)	113,789	16,303	130,092
Finance income	1,287	467	–	103	1,857	889	2,746
Finance costs on repurchase of debt	(48,213)	–	–	–	(48,213)	–	(48,213)
Other finance costs	(26,915)	–	(1,862)	(1,147)	(29,924)	(673)	(30,597)
Net finance costs	(73,841)	467	(1,862)	(1,044)	(76,280)	216	(76,064)
Share of (loss)/profit of joint venture after tax	(47)	–	41	–	(6)	–	(6)
Profit/(loss) before tax	42,476	(2,894)	2,399	(4,478)	37,503	16,519	54,022
Income tax expense							
– current	(4,230)	(1,334)	(767)	378	(5,953)	(76)	(6,029)
– deferred	(15,447)	(180)	(89)	–	(15,716)	(2)	(15,718)
Tax credit on repurchase of debt	14,464	–	–	–	14,464	–	14,464
	(5,213)	(1,514)	(856)	378	(7,205)	(78)	(7,283)
Profit/(loss) for the year	37,263	(4,408)	1,543	(4,100)	30,298	16,441	46,739
Other administrative expenses includes:							
Depreciation	453	–	920	43	1,416	176	1,592

3 Segmental analysis of net assets

At 31 March 2006	Property £000	Investments: Investment management £000	Energy Cranes £000	Consolidated LMS investments £000	Inflexion £000	Total £000
Non-current assets						
Intangible assets	–	–	20,332	13,313	–	33,645
Investment properties	1,023,565	–	–	–	–	1,023,565
Property, plant and equipment	53,139	–	5,176	1,749	–	60,064
Investment in joint venture	7,870	–	269	–	–	8,139
Other investments	2,824	186,349	–	1,208	–	190,381
Pension scheme surplus	1,703	–	–	–	–	1,703
Deferred tax assets	5,916	(8)	–	77	–	5,985
Total non-current assets	1,095,017	186,341	25,777	16,347	–	1,323,482
Current assets						
Inventories	–	–	4,586	–	–	4,586
Trading properties	375	–	–	–	–	375
Trade and other receivables	20,866	1,018	19,887	4,005	77	45,853
Cash and cash equivalents	52,889	870	2,467	1,072	43,142	100,440
Total current assets	74,130	1,888	26,940	5,077	43,219	151,254
Total assets	1,169,147	188,229	52,717	21,424	43,219	1,474,736
Current liabilities						
Borrowings	4,696	–	7,703	449	–	12,848
Trade and other payables	36,907	629	14,557	4,213	1,461	57,767
Tax liabilities	4,730	379	478	–	–	5,587
Total current liabilities	46,333	1,008	22,738	4,662	1,461	76,202
Non-current liabilities						
Borrowings	404,573	–	4,612	865	–	410,050
Pension scheme deficit	–	–	–	–	–	–
Deferred tax provision	91,428	–	–	199	–	91,627
Other payables	2,414	–	190	391	–	2,995
Total non-current liabilities	498,415	–	4,802	1,455	–	504,672
Total liabilities	544,748	1,008	27,540	6,117	1,461	580,874
Net assets	624,399	187,221	25,177	15,307	41,758	893,862
Capital expenditure in the year amounted to:						
Capital expenditure	32,478	61,821	1,680	689	4,530	101,198

3 Segmental analysis of net assets continued

	Property	Investments				
At 31 March 2005	£000	Investment management £000	Energy Cranes £000	Consolidated LMS investments £000	Inflexion £000	Total £000
Non-current assets						
Intangible assets	–	–	20,332	15,982	19,978	56,292
Investment properties	926,013	–	–	–	–	926,013
Property, plant and equipment	36,083	–	5,509	1,381	2,102	45,075
Investment in joint venture	4,108	–	162	–	–	4,270
Other investments	–	164,261	–	2,126	15,421	181,808
Pension scheme surplus	–	–	–	–	–	–
Deferred tax assets	11,361	7,135	–	–	–	18,496
Total non-current assets	977,565	171,396	26,003	19,489	37,501	1,231,954
Current assets						
Inventories	–	–	5,149	–	741	5,890
Trading properties	606	–	–	–	–	606
Trade and other receivables	20,746	339	17,527	3,116	6,098	47,826
Cash and cash equivalents	16,131	1,347	160	862	23,806	42,306
Total current assets	37,483	1,686	22,836	3,978	30,645	96,628
Total assets	1,015,048	173,082	48,839	23,467	68,146	1,328,582
Current liabilities						
Borrowings	4,789	–	8,771	71	1,701	15,332
Trade and other payables	22,795	92	13,484	3,612	8,025	48,008
Tax liabilities	–	–	–	25	514	539
Total current liabilities	27,584	92	22,255	3,708	10,240	63,879
Non-current liabilities						
Borrowings	387,783	–	7,040	1,093	19,153	415,069
Pension scheme deficit	6,842	–	–	–	–	6,842
Deferred tax provision	61,203	–	119	–	115	61,437
Other payables	2,169	–	–	–	839	3,008
Total non-current liabilities	457,997	–	7,159	1,093	20,107	486,356
Total liabilities	485,581	92	29,414	4,801	30,347	550,235
Net assets	529,467	172,990	19,425	18,666	37,799	778,347
Capital expenditure in the year amounted to:						
Capital expenditure	27,319	90,330	470	64	372	118,555

4 Discontinued operations – additional information

Acquisitions of subsidiaries by Inflexion plc

During the year Inflexion plc acquired one subsidiary, Advanced Communications and Information Systems Limited. (2005: three subsidiaries were acquired, Healthcare Knowledge International, Ilchester Holdings Limited and Harrington Brooks). In the period since acquisition the subsidiary contributed net loss of £0.8 million to the consolidated net profit for the year (2005: three subsidiaries contributed net profit of £1.7 million).

The book value and fair value of the assets acquired in the subsidiaries is shown below:

	Book value at acquisition 2006 £000	Fair value adjustments 2006 £000	Fair value 2006 £000	Book value at acquisition 2005 £000	Fair value adjustments 2005 £000	Fair value 2005 £000
Net assets acquired						
Property, plant and equipment	**1,811**	**–**	**1,811**	1,997	–	1,997
Inventories	**874**	**–**	**874**	741	–	741
Trade and other receivables	**9,659**	**–**	**9,659**	5,197	–	5,197
Cash and cash equivalents	**836**	**–**	**836**	3,936	–	3,936
Trade and other payables	**(13,040)**	**–**	**(13,040)**	(9,093)	–	(9,093)
Tax liabilities	**–**	**–**	**–**	(661)	–	(661)
Borrowings	**(12,522)**	**–**	**(12,522)**	(19,306)	–	(19,306)
Net identifiable liabilities			**(12,382)**			(17,189)
Share of liabilities acquired			**(3,071)**			(7,635)
Goodwill arising on acquisition			**10,071**			19,979
Cost of acquisition			**7,000**			12,344
Consideration paid			**7,000**			12,344
Cash (acquired)			**(836)**			(3,936)
Net cash outflow			**6,164**			8,408

Disposal by Inflexion plc of its business

On 16 March 2006 Inflexion plc, the Group's 58.8% owned subsidiary, disposed of its business assets for cash. Inflexion has subsequently entered a members voluntary liquidation and the net cash assets of the company will be distributed to its shareholders. The first such distribution to LMS amounting to £23.0 million was received in April 2006.

The net assets disposed of by Inflexion plc were as follows:

	At 16 March 2006 £000
Intangible assets	**30,051**
Property, plant and equipment	**5,927**
Other investments	**27,654**
Inventories	**1,820**
Trade and other receivables	**16,899**
Cash and cash equivalents	**8,908**
Total current liabilities	**(23,908)**
Total non current liabilities	**(32,095)**
Net assets	**35,256**
Gain on disposal	**6,503**
Total consideration (satisfied by cash)	**41,759**
Net cash inflow arising on disposal:	
Cash consideration	**41,759**
Cash and cash equivalents disposed of	**(3,543)**
	38,216

4 Discontinued operations – additional information continued

Additional information on consolidated subsidiaries within Inflexion plc

The table below provides additional information on investee companies consolidated within the 'Inflexion' segment.

Investment	Activity	Turnover 2006 £000	Turnover 2005 £000
Healthcare Knowledge International	Value-added healthcare information services to hospitals	**7,703**	4,592
Ilchester Holdings Limited	Manufacturer of blended cheeses	**16,417**	5,521
Harrington Brooks	Debt management and consolidation services	**7,644**	–
Advanced Communications and Information Systems Limited	Traffic management and real time passenger information systems	**10,763**	–

5 Continuing operations – additional information

Deconsolidation of LMS consolidated investments investee companies

During the year ended 31 March 2005, the Group restructured four of its investee companies, 7 Holdings Limited, Cityspace Limited, CopperEye Limited and Citizen Limited ('Vio'). On restructuring, these companies were no longer controlled by the Group and ceased to be subsidiaries and were held as investments at 31 March 2005.

The aggregated net assets of these entities at the date of deconsolidation were as follows:

	At deconsolidation 2005 £000
Intangible assets	28,484
Property, plant and equipment	3,509
Trade and other receivables	2,497
Cash and cash equivalents	1,245
Total current liabilities	(8,522)
Total non current liabilities	(50)
Net assets	27,163
Gain on deconsolidation of LMS consolidated investments' investee companies	8,035
Total investment value of these previously consolidated companies	35,198

Additional information on consolidated subsidiaries

The table below provides additional information on the portfolio companies consolidated within the 'LMS Consolidated Investments' segment. There were three such companies at 31 March 2006 and 31 March 2005. For part of the year to 31 March 2005 an additional four portfolio companies were consolidated, these however ceased to be subsidiaries and, as set out above, became investments prior to 31 March 2005.

Investment	Activity	Turnover 2006 £000	Turnover 2005 £000
Offshore Tool & Energy	Specialist engineering design and fabrication for the energy industry	**8,326**	7,510
Entuity	Network management software	**2,130**	2,449
AssetHouse	Content services infrastructure software	**375**	192
7 Holdings Limited	Software hosting services	**–**	742
Cityspace Limited	Urban information networks	**–**	1,737
CopperEye Limited	Data indexing technology and software	**–**	26
Citizen Limited ('Vio')	Digital workflow management solutions	**–**	2,303

6 Employees

	2006 £000	2005 £000
Wages and salaries	**48,792**	48,285
Share-based payments	**327**	197
Social security costs	**4,673**	4,755
Pension contributions	**1,210**	1,246
	55,002	54,483

The average monthly number of employees (including executive directors) was:

	2006	2005
Property management	**45**	44
Investment management	**14**	14
Inflexion	**12**	10
Other Investment Division	**1,366**	1,309
Staff recharged to tenants	**12**	13
	1,449	1,390

The Other Investment Division allocation includes 406 people (2005: 275) employed by Inflexion plc's consolidated subsidiaries, 826 people (2005: 791) employed by ECI and 134 people (2005: 243) employed by companies in the LMS consolidated subsidiaries segment.

7 Expenses and auditors' remuneration

	2006 £000	2005 £000
Included in profit/(loss) are the following:		
Depreciation of property, plant and equipment (continuing operations)	**1,975**	1,416
Auditors' remuneration (Group and Company)	**233**	169
Remuneration for other services to KPMG plc and its associates		
– Taxation advice	**12**	90
– Audit related services	**117**	36
– Relating to demerger	**2,075**	–

Included within the profit for the year are exceptional administrative expenses of £9.3 million relating to the demerger of the Investment Division, see note 31.

8 Pension costs

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

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

The pension charge for the Group was £1.2 million, including £0.6 million relating to the LMS defined benefit scheme, £0.1 million relating to the LMS defined contribution scheme and £0.5 million relating to defined contribution pension schemes operated by companies in the consolidated investment portfolio companies (2005: £1.2 million, £0.1 million and £0.4 million respectively).

The pension charge for the defined benefit scheme is assessed in accordance with the advice of a qualified actuary. The most important assumptions made in connection with the establishment of this charge were that interest will be earned on the fund at the rate of 5% per annum and that salaries will be increased at 4.6% per annum. The market value of assets of the scheme at 31 March 2006 was £19.0 million and the actuarial value of those assets on an ongoing basis represented 109.8% of the benefit of £17.3 million that had accrued to members allowing for expected future increases in earnings. Net of the related deferred tax liability the pension surplus is £1.2 million.

8 Pension costs continued

Defined benefit obligations

	2006 £000	2005 £000
Present value of funded obligations	**(17,301)**	(14,279)
Fair value of plan assets	**19,004**	7,437
Recognised surplus/(liability) for defined benefit obligations	**1,703**	(6,842)

Movements in present value of defined benefit obligations recognised in the balance sheet

	2006 £000	2005 £000
Net liability for defined benefit obligations at 1 April	**(6,842)**	(8,347)
Contributions by employer	**9,847**	2,429
Expense recognised in the income statement	**(732)**	(1,093)
Actuarial (losses)/gains recognised in reserves	**(570)**	169
Net surplus/(liability) for defined benefit obligations at 31 March	**1,703**	(6,842)

Expense recognised in the income statement

	2006 £000	2005 £000
Current service costs	**599**	692
Interest on obligation	**795**	722
Expected return on plan assets	**(662)**	(361)
	732	1,053

The expense is recognised in the following line items in the income statement.

	2006 £000	2005 £000
Administrative expenses	**599**	692
Other finance costs	**795**	722
Finance income	**(662)**	(361)
	732	1,053

The Group expects to contribute approximately £1.6 million to its defined benefit plans in the next financial year.

Changes in the fair value of plan assets

	2006 £000	2005 £000
Fair value of plan assets at 1 April	**7,437**	4,573
Expected return	**662**	361
Total contributions	**9,958**	2,429
Benefits paid	**(567)**	(73)
Actuarial gains	**1,514**	147
At 31 March	**19,004**	7,437

The actual return on the plan assets for the year was £2.2 million (2005: £0.5 million).

8 Pension costs continued

Changes in the present value of defined benefit obligations

	2006 £000	2005 £000
Defined benefit obligation at 1 April	**14,279**	12,920
Service cost	**599**	733
Interest cost	**795**	721
Member contributions	**111**	–
Benefits	**(567)**	(73)
Actuarial losses/(gains)	**2,084**	(22)
At 31 March	**17,301**	14,279

Experience gains and losses

	2006 £000	2005 £000
Experience gain on plan assets	**1,514**	147
Experience losses/(gains) on plan liabilities	**2,084**	(22)

Analysis of plan assets

	2006 £000	2005 £000
Equities	**15,826**	5,500
Bonds	**1,858**	1,239
Property	**660**	366
Cash	**660**	207
Other	**–**	125
Total	**19,004**	7,437

Principal actuarial assumptions

	2006 % per annum	2005 % per annum
Discount rate at 31 March	**5.00%**	5.54%
Expected return on plan assets at 31 March	**6.50%**	6.97%
Future salary increases	**4.60%**	4.50%
Inflation	**3.10%**	3.00%
Future pension increases	**5.00%**	5.00%

Defined contribution plans

The Group operates a defined contribution pension plan. The total expense relating to these plans in the current year was £0.1 million (2005: £0.1 million). The total expense relating to defined contribution plans operated by companies in the LMS consolidated subsidiaries segment was £0.4 million (2005: £0.4 million).

9 Net finance costs

	2006 £000	2005 £000
Finance costs		
Interest expense		
– 10% 2018 First Mortgage Debenture Stock	**–**	9,031
– 6.5% Secured Bond 2026	**11,375**	11,375
– £140 million Revolving Bank Loan 2012	**7,380**	393
– £60 million Revolving Bank Loan 2009	**1,535**	586
– Other mortgages and bank loans	**4,151**	3,618
– Amortisation of issue costs and discounts on issue of mortgages and bonds	**484**	1,531
– Bank loans and bank overdrafts	**3,331**	1,594
– Exchange losses on dollar deposits	**65**	179
– Mortgage breakage costs	**–**	895
– Pension interest costs	**795**	722
	29,116	29,924
Finance income		
Pension return on plan assets	**(662)**	(361)
Other interest income	**(1,795)**	(1,496)
	(2,457)	(1,857)
	26,659	28,067
Finance costs on repurchase of debt	**3,355**	48,213
	30,014	76,280

10 Income tax expense

Analysis of tax charge for the year

	2006 £000	2005 £000
UK corporation tax on profit	**1,768**	4,273
Tax credit on repurchase of debt	**–**	(3,103)
Adjustments relating to prior years	**96**	(523)
US taxation	**6,389**	2,202
Total current tax	**8,253**	2,849
Deferred tax		
Origination and reversal of capital allowances and other timing differences	**1,330**	1,708
Deferred tax asset on repurchase of debt utilised/(originated)	**3,820**	(11,361)
Deferred tax on investment properties	**31,466**	13,699
Deferred tax reversal on disposal of investment properties	**(3,251)**	–
Deferred tax on other investments and other losses	**2,578**	(15)
Adjustments relating to prior years	**1,860**	325
Total deferred tax	**37,803**	4,356
Total tax charge for the year	**46,056**	7,205

Tax charge reconciliation

	2006 £000	2005 £000
Profit before taxation	**166,356**	37,503
Profit before taxation multiplied by the standard UK rate of corporation tax at 30%	**49,907**	11,251
Non deductible expenses	**3,620**	404
Unused tax losses	**(5,902)**	–
Indexation relief on property and investments	**(12,920)**	(6,903)
Fair value movement on investments	**9,497**	1,529
Difference in overseas tax rates	**1,042**	(254)
Non UK profits and losses not taxable	**(490)**	406
Adjustments to tax charge in respect of prior years	**1,956**	(198)
Other items	**(654)**	970
Total tax charge for the year	**46,056**	7,205

11 Earnings per share and Shareholders' funds per share

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

	Basic	
	2006	2005
Earnings per share		
Weighted average shares in issue (000) (See (a) below)	**328,844**	302,477
Earnings per share (See (c) below)	**33.28p**	10.93p
– Property	**37.38p**	10.57p
– Investments	**(4.10)p**	0.36p
Adjusted earnings per share	**(2.81)p**	(0.02p)
– Property	**2.26p**	4.98p
– Investments	**(5.07)p**	(5.00p)
Shareholders' funds per share		
Shares in issue at 31 March (000) (See (b) below)	**328,884**	328,663
Shareholders' funds per share (See (d) below)	**251.43p**	220.87p
– Property	**175.02p**	149.74p
– Investments	**76.41p**	71.13p
Adjusted shareholders' funds per share	**281.52p**	239.25p
– Property	**205.11p**	173.03p
– Investments	**76.41p**	66.22p

	Diluted	
	2006	2005
Earnings per share		
Weighted average shares in issue (000) (See (a) below)	**330,580**	329,185
Earnings per share (See (c) below)	**33.11p**	10.04p
– Property	**37.19p**	9.71p
– Investments	**(4.08)p**	0.33p
Adjusted earnings per share	**(2.80)p**	(0.02p)
– Property	**2.25p**	4.57p
– Investments	**(5.05)p**	(4.59p)
Shareholders' funds per share		
Shares in issue at 31 March (000) (See (b) below)	**335,443**	334,288
Shareholders' funds per share (See (d) below)	**249.87p**	219.83p
– Property	**173.94p**	149.03p
– Investments	**75.93p**	70.80p
Adjusted shareholders' funds per share	**279.37p**	237.90p
– Property	**203.54p**	172.05p
– Investments	**75.83p**	65.85p

11 Earnings per share and Shareholders' funds per share continued

	2006 000	2005 000
(a) Calculation of basic and diluted weighted average shares in issue		
Basic		
– Weighted average Ordinary shares in issue	**328,844**	302,477
– Weighted average Deferred Ordinary shares in issue	**–**	25,777
– Adjustment in respect of shares issuable under share option schemes	**1,736**	931
Diluted		
– Weighted average number of shares in issue	**330,580**	329,185
(b) Calculation of basic and diluted shares in issue at 31 March		
Basic		
– Ordinary shares in issue	**328,884**	328,663
– Adjustment in respect of shares under option	**6,559**	5,625
Diluted		
– Ordinary and Deferred Ordinary shares in issue	**335,443**	334,288

	2006 £000	2005 £000
(c) Calculation of earnings and adjusted earnings		
Profit for the year	**109,442**	33,053
– Unrealised revaluation (gains)/losses net of deferred tax	**(103,925)**	(50,089)
– Realised gains on disposals net of tax	**(28,260)**	(17,847)
– Impairment of goodwill	**2,667**	–
– Deferred tax on capital allowances	**(870)**	1,061
– Finance costs on repurchase of debt net of tax	**2,349**	33,749
– Exceptional costs relating to demerger	**9,347**	–
Adjusted profit for the year	**(9,250)**	(73)
– Property	**7,434**	15,051
– Investments	**(16,684)**	(15,124)
(d) Shareholders' funds and adjusted Shareholders' funds		
Equity attributable to equity holders of the parent per balance sheet	**826,922**	725,912
– Adjustment for deferred tax on capital allowances	**8,404**	9,274
– Adjustment for deferred tax on unrealised gains/(losses)	**93,409**	54,268
– Adjustment for other deferred tax balances on realised capital losses	**(13,550)**	(9,000)
– Adjustment to trading properties to fair value net of tax	**10,238**	5,883
– Adjustment for changes in fair value of financial instruments net of tax	**438**	–
Adjusted Shareholders' funds	**925,861**	786,337
– Property	**674,558**	568,689
– Investments	**251,303**	217,648

At 31 March 2006, the fair value of financial liabilities attributable to LMS equity holders exceeded their book value by £26.7 million after tax (2005: £18.4 million) equivalent of 8.1p per share (2005: 5.6p per share) on a basic Shareholders' funds per share basis and 8.0p per share (2005: 5.5p per share) on a diluted Shareholders' funds per share basis.

The European Public Real Estate Association ('EPRA') has issued guidelines on a standard calculation of earnings per share and shareholders' funds per share. These have been applied in the calculations in the above tables.

12 Intangible assets

	2006 £000	2005 £000
Goodwill		
Cost		
Balance at 1 April	**56,292**	64,797
Acquisitions through business combinations	**10,071**	19,979
Disposal of business combinations	**(30,051)**	(28,484)
Balance at 31 March	**36,312**	56,292
Amortisation and impairment		
Balance at 1 April	**–**	–
Impairment charge	**(2,667)**	–
Balance at 31 March	**(2,667)**	–
Net book value		
At 31 March	**33,645**	56,292

During the year the Group booked an impairment charge of £2.7 million against goodwill relating to Offshore Tool & Energy. This arose as part of a review of investment values at 30 September 2005 in light of the impending demerger.

13 Investment property

	Group Freehold £000	Group Leasehold unexpired term over 50 years £000	Group Leasehold unexpired term of 50 years or less £000	Total £000
Balance at 1 April 2004	762,808	84,446	2,045	**849,299**
Amount included in prepayments under SIC 15	6,740	110	35	**6,885**
	769,548	84,556	2,080	**856,184**
Additions	22,324	204	–	**22,528**
Transfers	(5,300)	3,300	2,000	**–**
Disposals	(11,747)	–	–	**(11,747)**
Exchange adjustment	(946)	–	–	**(946)**
Revaluation	61,729	6,445	430	**68,604**
Market value at 31 March 2005	835,608	94,505	4,510	**934,623**
Amount included in prepayments under SIC 15	(8,361)	(100)	(149)	**(8,610)**
Balance at 31 March 2005	827,247	94,405	4,361	**926,013**

	Group Freehold £000	Group Leasehold unexpired term over 50 years £000	Group Leasehold unexpired term of 50 years or less £000	Total £000
Balance at 1 April 2005	827,247	94,394	4,372	**926,013**
Amount included in prepayments under SIC 15	8,361	111	138	**8,610**
	835,608	94,505	4,510	**934,623**
Additions	26,642	2,655	–	**29,297**
Disposals	(81,952)	–	–	**(81,952)**
Revaluation	126,169	21,312	970	**148,451**
Market value at 31 March 2006	906,467	118,472	5,480	**1,030,419**
Amount included in prepayments under SIC 15	(6,534)	(179)	(141)	**(6,854)**
Balance at 31 March 2006	899,933	118,293	5,339	**1,023,565**

Included within the revaluation is £0.2 million (2005: £0.2 million) relating to the movement in the grossed up headlease liabilities.

Included within Investment Property is investment property under development of £113.6 million as at 31 March 2006 (2005: £nil).

13 Investment property continued

All investment properties and land and buildings held within property, plant and equipment have been valued at 31 March 2006 on the basis of 'market value' in accordance with the Approved Valuation Manual of the Royal Institution of Chartered Surveyors.

98.0% by value of the properties have been valued by CB Richard Ellis, Chartered Surveyors. The remaining 2.0% have been valued by Smiths Gore. Swinton Shopping Centre, which is included in the Group's joint venture interests in note 15 and which is not included in the table above, has been valued by Colliers CRE.

The historical cost of Group investment properties at 31 March 2006 was £352.2 million (2005: £378.4 million).

14 Property, plant and equipment

	Assets under construction £000	Owner occupied property £000	Total land and buildings £000	Plant and Equipment £000	Total £000
Cost or valuation					
At 1 April 2004	30,000	3,160	33,160	16,125	**49,285**
Additions	3,265	–	3,265	2,432	**5,697**
Disposals	–	–	–	(2,721)	**(2,721)**
Revaluation	(3,265)	1,365	(1,900)	–	**(1,900)**
At 31 March 2005	30,000	4,525	**34,525**	15,836	**50,361**
Depreciation and impairment losses					
At 1 April 2004	–	–	–	3,910	**3,910**
Depreciation charge for the year	–	105	105	1,487	**1,592**
Disposals	–	–	–	(216)	**(216)**
At 31 March 2005	–	105	**105**	5,181	**5,286**
Net book value at 31 March 2005	30,000	4,420	**34,420**	10,655	**45,075**
Net book value at 1 April 2004	30,000	3,160	33,160	12,215	45,375

	Assets under construction £000	Owner occupied property £000	Total land and buildings £000	Plant and Equipment £000	Total £000
Cost or valuation					
At 1 April 2005	30,000	4,525	34,525	15,836	**50,361**
Additions	3,019	–	3,019	6,985	**10,004**
Disposals	–	–	–	(8,232)	**(8,232)**
Revaluation	13,981	585	14,566	–	**14,566**
At 31 March 2006	47,000	5,110	**52,110**	14,589	**66,699**
Depreciation and impairment losses					
At 1 April 2005	–	105	105	5,181	**5,286**
Depreciation charge for the year	–	105	105	2,574	**2,679**
Disposals	–	–	–	(1,330)	**(1,330)**
At 31 March 2006	–	210	**210**	6,425	**6,635**
Net book value at 31 March 2006	47,000	4,900	**51,900**	8,164	**60,064**
Net book value at 1 April 2005	30,000	4,420	34,420	10,655	45,075

The historical cost of land and buildings at 31 March 2006 was £25.2 million (2005: £22.2 million).

15 Investments in joint venture

	Country	Ownership 2006	Ownership 2005
Joint venture			
Miller (Swinton) Limited	United Kingdom	**50%**	50%

The valuation of the Group's share of the property asset held by Miller (Swinton) Limited at 31 March 2006 was £19.0 million (2005: £15.4 million). The Group's share of the associated debt at 31 March 2006 was £11.8 million (2005: £11.8 million).

The Group's share of Miller (Swinton) Limited's profit after tax at 31 March 2006 was £2.5 million, including unrealised gains relating to the property asset held by that company.

16 Principal consolidated subsidiary undertakings

Property investment companies – 100% owned by Group
British Commercial Property Investment Trust Limited*
Caledonian Property Investments Limited*
Central London Commercial Estates Limited*
City Commercial Real Estate Investments Limited*
Goodge Street Properties Limited*
Greenwich Reach 2000 Limited*
Kensington Commercial Property Investments Limited*
Lion Property Investments Limited
Lioness Property Investments Limited
LMS (City Road) Limited*
LMS (Goodge Street) Limited*
LMS Properties Limited
LMS Shops Limited*
LMS Offices Limited*
LMS (Kingston) Limited*
Palaville Limited*
Rainram Investments Limited*
The New River Company Limited*
Urbanfirst Limited
West London & Suburban Property Investments Limited*
340 Pine Street Inc – USA*

Property investment companies – 55% owned by Group
Portman Investments (Baker Street) Limited*
Portman Investments (Farnham) Limited*

Property investment companies – 58.5% owned by Group
Bargate Quarter Limited*

Property trading companies – 90% owned by Group
City Shops Limited*

Property trading companies – 100% owned by Group
Caledonian Properties Limited*
Corinium Estates Limited*
LMS Residential Limited*
LMS (Winchester Road) Limited*

Investment Division companies – 100% owned by Group
LMS Capital Limited
LMS Capital (Bermuda) Limited – Bermuda*
LMS Capital (GP)*
LMS Capital (GW) Limited*
LMS Tiger Investments Limited*
LMS Tiger Investments (II) Limited*
Lion Investments Limited*
Tiger Investments Limited*
Westpool Investment Trust plc

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

Other subsidiary companies – 100% owned by Group
LMS (DHL) Limited
LMS Finance Limited
LMS Finance (II) Limited*
LMS Industrial Finance Limited
LMS Industrial Finance (II) Limited*
LMS Services Limited
London Merchant Securities Inc – USA*

*Indicates subsidiary undertakings held indirectly.

In addition to the above, a number of the Group's investment portfolio companies are subsidiaries and require to be consolidated. Information on these companies is provided in notes 4 and 5.

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

17 Other investments

	Fund investments £000	Listed investments £000	Unlisted investments £000	Total £000
Group				
At 1 April 2004:				
Investment management	41,065	30,544	48,761	**120,370**
Consolidated LMS investments	–	561	1,283	**1,844**
Energy Cranes	–	–	140	**140**
Inflexion	2,919	10,207	2,985	**16,111**
	43,984	41,312	53,169	**138,465**
Additions at cost	22,675	8,600	59,055	**90,330**
Reclassification	(290)	1,758	(1,468)	**–**
Revaluation	659	7,424	(7,749)	**334**
Disposals	(20,697)	(15,253)	(11,371)	**(47,321)**
At 31 March 2005	46,331	43,841	91,636	**181,808**
Investment management	45,489	29,262	89,510	**164,261**
Consolidated LMS investments	–	–	2,126	**2,126**
Inflexion	842	14,579	–	**15,421**
	46,331	43,841	91,636	**181,808**

	Fund investments £000	Listed investments £000	Unlisted investments £000	Total £000
Group				
At 1 April 2005:				
Investment management	45,489	29,262	89,510	**164,261**
Consolidated LMS investments	–	–	2,126	**2,126**
Inflexion	842	14,579	–	**15,421**
	46,331	43,841	91,636	**181,808**
Additions at cost	28,584	9,804	23,433	**61,821**
Reclassification	8,271	13,756	(22,027)	**–**
Revaluation	12,171	12,756	(26,562)	**(1,635)**
Disposals	(20,142)	(23,282)	(8,189)	**(51,613)**
At 31 March 2006	75,215	56,875	58,291	**190,381**
Investment management	72,445	56,821	57,083	**186,349**
Consolidated LMS investments	–	–	1,208	**1,208**
Property	2,770	54	–	**2,824**
	75,215	56,875	58,291	**190,381**

The historical cost of Group investments at 31 March 2006 was £250.5 million (2005: £242.9 million).

During the year the Group invested in a property fund, which is accounted for using the same accounting policies applied to Investment Division fund investments.

18 Trading properties

	2006 £000	2005 £000
Trading properties	**375**	606

At 31 March 2006 the trading properties have been valued by Montagu Evans at £15.0 million (2005: £9.0 million).

19 Trade and other receivables

	2006 £000	2005 £000
Rents and service charges receivable	**4,918**	4,088
Other debtors	**31,357**	29,848
Other prepayments and accrued income	**9,501**	12,285
Corporation tax	**77**	1,605
	45,853	47,826

20 Cash and cash equivalents

	Property Total £000	Investments Total £000	At 31 March 2006 Total £000	At 31 March 2005 Total £000
Bank balances	19,384	47,509	**66,893**	9,434
Call deposits	33,505	42	**33,547**	32,872
Cash and cash equivalents	52,889	47,551	**100,440**	42,306
Bank overdrafts	(71)	(5,406)	**(5,477)**	(6,807)
Cash and cash equivalents in the statement of cash flows	52,818	42,145	**94,963**	35,499

Cash and cash equivalents in the Investment Division includes £43.1 million held by Inflexion plc, following the sale of its assets, for distribution to Inflexion shareholders.

21 Trade and other payables

	2006 £000	2005 £000
Rents received in advance	**11,492**	11,929
Other taxes and social security	**2,955**	3,106
Other creditors	**14,656**	13,220
Accruals	**28,664**	19,753
	57,767	48,008

22 Borrowings

	Property Total £000	Investment Total £000	Year ended 31st March 2006 Total £000	Year ended 31st March 2005 Total £000
Non-current borrowings				
6.5% Secured Bond 2026	173,158	–	**173,158**	173,066
£140 million Revolving Bank Loan 2012	–	–	**–**	139,063
£60 million Revolving Bank Loan 2009	–	–	**–**	30,641
£375 million Revolving Bank Loan 2013	206,352	–	**206,352**	–
Mortgages	23,516	–	**23,516**	43,466
Unsecured loans	1,547	–	**1,547**	1,547
Other non-current borrowings (all secured)				
– Inflexion portfolio companies	–	–	**–**	19,153
– Energy Cranes International	–	4,612	**4,612**	7,040
– LMS consolidated entities	–	865	**865**	1,093
	404,573	5,477	**410,050**	415,069
Current borrowings				
Bank overdraft:				
– LMS	71	–	**71**	165
– Inflexion	–	–	**–**	30
– Energy Cranes International	–	5,406	**5,406**	6,612
	71	5,406	**5,477**	6,807
Bank loans:				
– LMS	4,625	–	**4,625**	4,625
– Inflexion	–	–	**–**	1,670
– Energy Cranes International	–	2,297	**2,297**	2,159
– Entuity	–	268	**268**	71
– Offshore Tool and Energy	–	181	**181**	–
	4,625	2,746	**7,371**	8,525
	4,696	8,152	**12,848**	15,332
Total borrowings	409,269	13,629	**422,898**	430,401

During the year the Group restructured its borrowings, repaying outstanding balances on the £140 million and £60 million revolving bank loans and certain mortgages. These bank facilities were cancelled and replaced with a new £375 million bank loan, consisting of the following:

- £125 million seven year term loan expiring 29 March 2013.
- £210 million available on revolving basis for a seven year term expiring 29 March 2013.
- £40 million available on a revolving basis on a seven year term expiring 29 March 2013, but conditional upon and only available for use in effecting the demerger of the Group's Investment Division (refer note 31).

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

£1.5 million loans are unsecured. All other bank loans and mortgages are secured by first charge on individual investment property assets.

The Investment Division loans, all of which arise in the consolidated portfolio companies, are secured by a combination of fixed and floating charges over property and other assets of those companies.

22 Borrowings continued

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

	Property 2006 £000	Investment 2006 £000	Total 2006 £000	Property 2005 £000	Investment 2005 £000	Total 2005 £000
Borrowings – LMS						
– Repayable after more than five years	404,573	–	**404,573**	357,142	–	357,142
– Repayable within two to five years	–	–	**–**	30,641	–	30,641
– Repayable within one to two years	–	–	**–**	–	–	–
– Repayable within one year	4,696	–	**4,696**	4,790	–	4,790
Other consolidated entities						
– Repayable after more than five years	–	635	**635**	–	12,805	12,805
– Repayable within two to five years	–	4,601	**4,601**	–	10,278	10,278
– Repayable within one to two years	–	241	**241**	–	4,203	4,203
– Repayable within one year	–	8,152	**8,152**	–	10,542	10,542
	409,269	13,629	**422,898**	392,573	37,828	430,401

Unamortised discount and issue costs

Unamortised discount and issue costs at 31 March 2006 amounted to £5.7 million (2005: £3.7 million). The balance at 31 March 2006 relates to:

– £175 million Bonds 2026 (£1.8 million).

– £375 million Bank Loan 2013 (£3.7 million).

– Other (£0.2 million).

Unamortised issue costs of £1.3 million in connection with bank loans and mortgages repaid in the year have been charged to the income statement.

Undrawn committed borrowing facilities

The Group's undrawn committed borrowing facilities at 31 March were:

	2006 £000	2005 £000
Expiring within two to five years	**–**	29,000
Expiring after more than five years	**125,000**	–
	125,000	29,000

The Group's committed borrowing facilities under the £375 million seven year revolving bank loan will increase by £40 million to effect the demerger of the Group's Investment Division (refer note 31).

Interest rates

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

The £375 million seven year revolving bank loan is a floating rate loan. The Group has restructured its previous interest rate hedging arrangement and put additional hedging in place in respect of a proportion of its seven year rate exposure.

The interest rate profile of the Group's financial liabilities is:

	£m	Effective interest rate 2006	Weighted average life	£m	Effective interest rate 2005	Weighted average life
Fixed rate	**336.4**	**6.4%**	**14.0 years**	220.4	6.9%	18.5 years
Floating rate	**86.5**	**5.6%**	**5.7 years**	210.0	4.8%	5.1 years
	422.9	**6.2%**	**12.3 years**	430.4	5.9%	12.0 years

Fixed rate financial liabilities include £140 million (2005: £nil) of interest rate swaps at an effective interest rate of 5.6% and a weighted average life of seven years.

23 Financial Instruments

	£ sterling 2006 £m	US dollars 2006 £m	Total 2006 £m	£ sterling 2005 £m	US dollars 2005 £m	Total 2005 £m
Short-term borrowings						
Denomination of short-term borrowings	**12.6**	**0.2**	**12.8**	15.3	–	15.3
Long-term borrowings						
Denomination of long-term borrowings	**409.2**	**0.9**	**410.1**	414.0	1.1	415.1
Total borrowings	**421.8**	**1.1**	**422.9**	429.3	1.1	430.4
Effective interest rate of financial liabilities	**6.2%**	**5.1%**	**6.2%**	5.9%	4.8%	5.9%
Weighted average period for which interest rates on the financial liabilities are fixed	**12.3 years**	**1.2 years**	**12.3 years**	12.0 years	2.1 years	12.0 years

At 31 March 2006 and 2005 the US dollar denominated borrowings all relate to the Investment Division.

Fair values

There is no material difference between book value and fair value for short-term debtors and creditors and these are not included in the disclosure relating to fair value, with the exception of short-term borrowings. Cash deposits held by the Group are denominated £54.5 million sterling, £2.8 million US dollars, £nil euros and are predominantly held on short-term floating rate deposit accounts with a range of banks.

Mark to market of long-term borrowing adjustment

	Book value 2006 £m	Fair value 2006 £m	Excess over book value 2006 £m	Book value 2005 £m	Fair value 2005 £m	Excess over book value 2005 £m
Property Division non-current borrowings						
6.5% Secured Bond 2026	**173.2**	**205.8**	**32.6**	173.1	193.1	20.0
£375 million Revolving Bank Loan 2013	**206.4**	**206.4**	**–**	–	–	–
£140 million Revolving Bank Loan 2012	**–**	**–**	**–**	139.1	139.1	–
£60 million Revolving Bank Loan 2009	**–**	**–**	**–**	30.6	30.6	–
9.695% Mortgage 2018	**20.0**	**29.9**	**9.9**	20.0	30.0	10.0
7.135% Mortgage 2010–2015	**–**	**–**	**–**	9.6	10.0	0.4
6.675% Mortgage 2010–2015	**–**	**–**	**–**	3.9	4.1	0.2
6.68% Mortgage 2010–2015	**–**	**–**	**–**	3.7	3.9	0.2
6.7% Mortgage 2014	**2.3**	**2.4**	**0.1**	2.4	2.5	0.1
Floating rate Mortgage 2017	**1.2**	**1.2**	**–**	2.0	2.0	–
6.57% Mortgage 2010–2015	**–**	**–**	**–**	1.9	1.9	–
Unsecured loans	**1.5**	**1.5**	**–**	1.5	1.5	–
Investment Division non-current borrowings						
– Inflexion portfolio companies	**–**	**–**	**–**	19.2	19.2	–
– Energy Cranes International	**4.6**	**4.6**	**–**	7.0	7.0	–
– LMS consolidated entities	**0.9**	**0.9**	**–**	1.1	1.1	–
	410.1	**452.7**	**42.6**	415.1	446.0	30.9
Less: taxation			**(12.8)**			(9.3)
Less: minority share			**(3.1)**			(3.2)
Group share of fair value adjustment (net of taxation)			**26.7**			18.4

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

Financial instruments

Exposure to interest rate and currency risk arises in the normal course of the Group's business. Derivative financial instruments are used to hedge exposure to fluctuations in interest rates.

Interest rate risk

Hedging

The Group's principal floating rate exposure is on the Revolving Bank Loan 2013, and in respect of this loan it is the Group's policy that a substantial proportion of its exposure to changes in interest rates on borrowings is on a fixed rate basis.

23 Financial Instruments continued

Interest rate swaps have been entered into to achieve an appropriate mix of fixed and floating rate exposure within the Group's policy. The swaps mature over the next seven years following the maturity of the related loans and have fixed swap rates of approximately 4.8%.

At 31 March 2006 the Group had interest rate swaps with a notional contract amount of £140 million (2005: £nil), all of which were deemed to be effective hedges. The fair value adjustment arising in relation to these swaps at 31 March 2006 was £0.6 million liability, which was taken directly to reserves.

Effective interest rates and repricing

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they reprice.

	2006					
	Effective interest rate	Total £m	Less than 1 year	1-2 years	2-5 years	More than 5 years
Fixed rate						
6.5% Secured Bond 2026	**6.6%**	**173.2**	**–**	**–**	**–**	**173.2**
£375 million Revolving Bank Loan 2013						
– hedged portion	**5.6%**	**140.0**	**–**	**–**	**–**	**140.0**
9.695% Mortgage 2018	**9.7%**	**20.0**	**–**	**–**	**–**	**20.0**
6.7% Mortgage 2014	**6.8%**	**2.3**	**–**	**–**	**–**	**2.3**
Other non-current borrowings					**–**	**–**
– LMS consolidated entities	**4.9%**	**0.9**	**–**	**0.9**	**–**	**–**
	6.4%	**336.4**	**–**	**0.9**	**–**	**335.5**
Floating rate						
£375 million Revolving Bank Loan 2013						
– unhedged portion	**5.4%**	**66.4**	**66.4**	**–**	**–**	**–**
Floating rate Mortgage 2017	**5.4%**	**1.2**	**1.2**	**–**	**–**	**–**
Other bank debt	**5.4%**	**4.6**	**4.6**	**–**	**–**	**–**
Other non-current borrowings	**6.2%**	**14.3**	**14.3**	**–**	**–**	**–**
	5.6%	**86.5**	**86.5**	**–**	**–**	**–**
Total	**6.2%**	**422.9**	**86.5**	**0.9**	**–**	**335.5**

	2005					
	Effective interest rate	Total £m	Less than 1 year	1-2 years	2-5 years	More than 5 years
Fixed rate						
6.5% Secured Bond 2026	6.6%	173.1	–	–	–	173.1
9.695% Mortgage 2018	9.7%	20.0	–	–	–	20.0
7.135% Mortgage 2010-2015	6.9%	9.6	–	–	–	9.6
6.675% Mortgage 2010-2015	6.9%	3.9	–	–	–	3.9
6.68% Mortgage 2010-2015	6.9%	3.7	–	–	–	3.7
6.7% Mortgage 2014	6.8%	2.4	–	–	–	2.4
6.57% Mortgage 2010-2015	6.9%	1.9	–	–	–	1.9
Other non-current borrowings						
– LMS consolidated entities	4.8%	1.1	–	–	1.1	–
– Inflexion portfolio companies	8.0%	4.7	–	–	4.7	–
	6.9%	220.4	–	–	5.8	214.6
Floating rate						
£140 million Revolving Bank Loan 2012	4.55%	139.1	139.1	–	–	–
£60 million Revolving Bank Loan 2009	4.55%	30.6	30.6	–	–	–
Floating rate Mortgage 2017	4.55%	2.0	2.0	–	–	–
Other bank debt	4.55%	4.6	4.6	–	–	–
Other non-current borrowings						
– Inflexion portfolio companies	7.2%	16.1	16.1	–	–	–
– LMS consolidated entities	5.2%	17.6	17.6	–	–	–
	4.8%	210.0	210.0	–	–	–
Total	5.9%	430.4	210.0	–	5.8	214.6

24 Deferred tax

	Assets at 31 March 2006 £000	Liabilities 31 March 2006 £000	Net 31 March 2006 £000	Assets at 31 March 2005 £000	Liabilities 31 March 2005 £000	Net 31 March 2005 £000
Property, fixtures and fittings	**–**	**(8,404)**	**(8,404)**	–	(9,274)	(9,274)
Investment property	**–**	**(96,441)**	**(96,441)**	–	(62,952)	(62,952)
Other investments and other losses	**12,388**	**–**	**12,388**	16,135	–	16,135
Interest rate swaps	**188**	**–**	**188**	–	–	–
Employee benefits	**–**	**(511)**	**(511)**	2,052	–	2,052
Other items	**1,222**	**–**	**1,222**	–	(263)	(263)
Tax value of losses brought forward	**5,916**	**–**	**5,916**	11,361	–	11,361
Tax assets/(liabilities)	**19,714**	**(105,356)**	**(85,642)**	29,548	(72,489)	(42,941)
Set off of tax	**(13,729)**	**13,729**	**–**	(11,052)	11,052	–
Net tax assets/(liabilities)	**5,985**	**(91,627)**	**(85,642)**	18,496	(61,437)	(42,941)

	Balance at 1 April 2004 £000	Recognised in income £000	Recognised in reserves/equity £000	Balance at 31 March 2005 £000
Property, fixtures and fittings	(8,213)	(1,061)	–	(9,274)
Investment property	(50,413)	(13,699)	1,160	(62,952)
Other investments and other losses	16,120	15	–	16,135
Interest rate swaps	–	–	–	–
Employee benefits	2,504	(401)	(51)	2,052
Other items	474	(571)	(166)	(263)
Tax value of losses brought forward	–	11,361	–	11,361
	(39,528)	(4,356)	943	(42,941)

	Balance at 1 April 2005 £000	Recognised in income £000	Recognised in reserves/equity £000	Balance at 31 March 2006 £000
Property, fixtures and fittings	(9,274)	870	–	**(8,404)**
Investment property	(62,952)	(29,429)	(4,060)	**(96,441)**
Other investments and other losses	16,135	(3,747)	–	**12,388**
Interest rate swaps	–	–	188	**188**
Employee benefits	2,052	(2,734)	171	**(511)**
Other items	(148)	1,468	(98)	**1,222**
Tax value of losses brought forward	11,361	(5,445)	–	**5,916**
	(42,826)	(39,017)	(3,799)	**(85,642)**
Discontinued operations – Inflexion	(115)	–	115	**–**
	(42,941)	(39,017)	(3,684)	**(85,642)**
Share of tax on joint venture investment property – recognised in profit before tax		1,214		
		(37,803)		

The deferred tax liability on investment properties is calculated taking account of the benefit of indexation relief. The impact of this is to reduce the liability by £77.6 million at 31 March 2006 (2005: £67.3 million).

25 Called up share capital

	Authorised $27\frac{18}{41}$p Ordinary	Authorised $27\frac{18}{41}$p Deferred Ordinary	Authorised $27\frac{18}{41}$p Unclassified	Allotted called up and fully paid $27\frac{18}{41}$p Ordinary	Allotted called up and fully paid $27\frac{18}{41}$p Deferred Ordinary
Number of shares					
At 31 March 2004	272,850,398	83,984,203	7,609,843	243,636,971	83,947,574
Issued during the year	–	–	–	30,346	1,317,925
Conversion	85,302,128	(83,984,203)	(1,317,925)	85,265,499	(85,265,499)
Number of shares					
At 31 March 2005	358,152,526	–	6,291,918	328,932,816	–
Issued during the year	–	–	–	68,677	–
Number of shares					
At 31 March 2006	**358,152,526**	**–**	**6,291,918**	**329,001,493**	**–**
Nominal value					
At 31 March 2005	£98,273,559	–	£1,726,441	£90,255,956	–
Nominal value					
At 31 March 2006	£98,273,559	–	£1,726,441	£90,274,800	–

During the year 68,677 Ordinary shares were issued for consideration of 195.5p each under the LMS Executive Share Option Scheme.

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

31 March 2006

Executive Share Option Scheme

Number	Class	Exercise price	Grant date	Vesting conditions	Date from Which exercisable	Expiry date
50,524	Ordinary	195½p	28 Jul 2000	Notes 1 & 5	27 Jul 2003	27 Jul 2010
357,787	Ordinary	189½p	28 Jul 2000	Notes 1 & 5	27 Jul 2003	27 Jul 2010
5,630	Ordinary	161½p	5 Jan 2001	Notes 1 & 5	5 Jan 2004	5 Jan 2011
1,263,562	Ordinary	174p	5 Jan 2001	Notes 1 & 5	5 Jan 2004	5 Jan 2011
340,650	Ordinary	104p	1 Apr 2003	Notes 2 & 5	1 Apr 2006	31 Mar 2013
1,617,431	Ordinary	137½p	29 Aug 2003	Notes 2 & 5	29 Aug 2006	8 Aug 2013
1,739,849	Ordinary	181p	1 Sep 2004	Notes 3 & 5	1 Sep 2007	2 Sep 2014
1,183,934	Ordinary	219½p	28 Jun 2005	Notes 3 & 5	28 Jun 2008	28 Jun 2015

Sharesave Scheme

Number	Class	Exercise price	Grant date	Vesting conditions	Date from Which exercisable	Expiry date
8,265	Ordinary	122½p	27 Jul 2001	Notes 4 & 5	1 Sep 2006	31 Mar 2007
70,401	Ordinary	104½p	27 Jul 2001	Notes 4 & 5	1 Sep 2006	31 Mar 2007
74,901	Ordinary	104½p	27 Jul 2001	Notes 4 & 5	1 Sep 2008	31 Mar 2009
19,299	Ordinary	130p	23 Dec 2003	Notes 4 & 5	1 Feb 2007	31 Jul 2007
36,571	Ordinary	130p	23 Dec 2003	Notes 4 & 5	1 Feb 2009	31 Jul 2009
23,225	Ordinary	130p	23 Dec 2003	Notes 4 & 5	1 Feb 2011	31 Jul 2011

25 Called up share capital continued

31 March 2005

Executive Share Option Scheme

Number	Class	Exercise price	Grant date	Vesting conditions	Date from which exercisable	Expiry date
164,020	Ordinary	195½p	28 Jul 2000	Notes 1 & 5	27 Jul 2003	27 Jul 2010
357,787	Ordinary	189½p	28 Jul 2000	Notes 1 & 5	27 Jul 2003	27 Jul 2010
5,630	Ordinary	161½p	5 Jan 2001	Notes 1 & 5	5 Jan 2004	5 Jan 2011
1,263,562	Ordinary	174p	5 Jan 2001	Notes 1 & 5	5 Jan 2004	5 Jan 2011
377,112	Ordinary	104p	1 Apr 2003	Notes 2 & 5	1 Apr 2006	31 Mar 2013
1,617,431	Ordinary	137½p	29 Aug 2003	Notes 2 & 5	29 Aug 2006	28 Aug 2013
1,739,849	Ordinary	181p	1 Sep 2004	Notes 3 & 5	1 Sep 2007	2 Sep 2014

Sharesave Scheme

Number	Class	Exercise price	Grant date	Vesting conditions	Date from which exercisable	Expiry date
139,262	Ordinary	65¼p	9 Mar 1998	Notes 4 & 5	1 Apr 2005	3 Sep 2005
8,265	Ordinary	122½p	27 Jul 2001	Notes 4 & 5	1 Sep 2006	31 Mar 2007
70,401	Ordinary	104½p	27 Jul 2001	Notes 4 & 5	1 Sep 2006	31 Mar 2007
85,451	Ordinary	104½p	27 Jul 2001	Notes 4 & 5	1 Sep 2008	31 Mar 2009
19,299	Ordinary	130p	23 Dec 2003	Notes 4 & 5	1 Feb 2007	31 Jul 2007
56,077	Ordinary	130p	23 Dec 2003	Notes 4 & 5	1 Feb 2009	31 Jul 2009
28,386	Ordinary	130p	23 Dec 2003	Notes 4 & 5	1 Feb 2011	31 Jul 2011

In March 1998, the Company established a qualifying employee share ownership trust (QUEST) to acquire Ordinary and Deferred Ordinary shares of the Company for supply to employees exercising options under the LMS Savings-Related Share Option Scheme. The Trustee of the QUEST is LMS QUEST Trustee Limited, which is a wholly-owned subsidiary of the Company. All employees of the Company, including executive directors of the Company (except The Hon R A Rayne), are potential beneficiaries under the QUEST. At 31 March 2006, the QUEST held 117,778 Ordinary shares at a cost and valuation of £0.1 million (2005: 270,689 Ordinary shares at a cost and valuation of £0.2 million).

1. Vesting is after a performance condition has been satisfied. The performance condition for the executive options granted in July 2000 and January 2001 is that in any three year period following the grant of the options Shareholders' funds must increase by a percentage greater than the increase in the Retail Prices Index plus 9%.

2. Vesting is after a performance condition has been satisfied. The performance condition for the executive options granted in April 2003 and August 2003 is that in the first three year period following the grant of the options Shareholders' funds must increase by a percentage greater than the increase in the Retail Prices Index plus 9%.

3. Vesting is after a performance condition has been satisfied. The performance condition for the executive options granted after September 2004 is that the Total Shareholder Return (TSR) over the first three year period after grant must exceed the arithmetic average of the TSR for the FTSE 250 and the TSR for the FTSE Real Estate index for the same period.

4. Under the Scheme employees make regular payments into a savings account which, after a predetermined period of three, five or seven years, can be used to purchase shares at a price set at the start of the savings period.

5. The first exercise date shown in the table above is in each case three years from the date of grant. Under the rules of the LMS Executive Share Option Scheme and the LMS Sharesave Scheme, if the Company enters into a Scheme of Arrangement options may be exercisable earlier than three years from the date of grant. Pursuant to the demerger of Leo Capital plc a Scheme of Arrangement was sanctioned by the Court on 8 June 2006 and the Remuneration Committee treated the performance conditions for grants under the Executive Share Option Scheme as satisfied. All options, including those under the LMS Sharesave Scheme are therefore exercisable at the date of the demerger.

	2006 Weighted average exercise price	2006 Number of options	2005 Weighted average exercise price	2005 Number of options
Outstanding at the beginning of the period	**157.9p**	**5,932,532**	142.0p	7,624,160
Granted during the year	**219.5p**	**1,183,934**	181.0p	1,761,395
Exercised during the year	**123.3p**	**(223,608)**	157.1p	(1,398,479)
Lapsed during the year	**112.0p**	**(100,829)**	122.4p	(2,054,544)
Outstanding at the end of the year	**170.4p**	**6,792,029**	157.9p	5,932,532
Exercisable at the end of the year		**–**		–

The weighted average share price at the date of exercise of share options exercised during the year was 231.3p (2005: £179.2p).

25 Called up share capital continued

The options outstanding at the year end have an exercise price in the range of 104p to 219½p (2005: 65¼p to 195½p), and a remaining weighted average contractual life of 7.1 years (2005: 7.5 years).

The following information was used in the determination of the fair value of options granted during the year. The Black-Scholes option pricing model has been used.

	2006	2005
Share price at date of grant	**223.5p**	184.0p
Exercise price	**219.5p**	181.0p
Expected volatility	**20%**	20%
Term of option	**3 years**	3 years
Dividend yield	**3%**	3%
Risk free interest rate	**4.12%**	4.84%

26 Reserves

	Share premium account £000	Capital reduction account £000	Revaluation reserve £000	Translation reserve £000	Profit and loss account £000	Total parent equity £000	Minority interest £000	Total equity £000
At 1 April 2004	19,049	2,868	14,231	–	582,954	619,102	49,384	668,486
Issue of shares during the year	1,526	–	–	–	–	1,526	–	1,526
Deficit on revaluation of property, plant and equipment	–	–	(1,900)	–	–	(1,900)	–	(1,900)
Deferred tax on deficit on revaluation of property, plant and equipment	–	–	–	–	1,160	1,160	–	1,160
Actuarial gain on defined			–					
benefits pension scheme	–	–	–	–	169	169	–	169
Deferred tax on actuarial gains taken directly to equity				–	(50)	(50)	–	(50)
Issue of employee share options	–	–	–	–	197	197	–	197
Deferred tax benefit on issue of employee share options	–	–	–	–	(59)	(59)	–	(59)
Exchange difference	–	–	–	(269)	(2)	(271)	–	(271)
Acquisition and disposal of subsidiaries	–	–	–	–	–	–	(9,915)	(9,915)
Other	–	–	–	–	–	–	(720)	(720)
Profit for the year	–	–	–	–	33,053	33,053	13,686	46,739
Dividends paid	–	–	–	–	(17,271)	(17,271)	–	(17,271)
At 31 March 2005	20,575	2,868	12,331	(269)	600,151	635,656	52,435	688,091

26 Reserves continued

	Share premium account £000	Capital reduction account £000	Revaluation reserve £000	Translation reserve £000	Hedging reserve £000	Profit and loss account £000	Total parent equity £000	Minority interest £000	Total equity £000
At 1 April 2005	20,575	2,868	12,331	(269)	–	600,151	**635,656**	52,435	**688,091**
Issue of shares during the year	112	–	–	–	–	–	**112**	–	**112**
Surplus on revaluation of property, plant and equipment	–	–	14,566	–	–	–	**14,566**	–	**14,566**
Deferred tax on surplus on revaluation of property, plant and equipment	–	–	–	–	–	(4,060)	**(4,060)**	–	**(4,060)**
Actuarial loss on defined benefits pension scheme	–	–	–	–	–	(570)	**(570)**	–	**(570)**
Deferred tax on actuarial losses taken directly to equity	–	–	–	–	–	171	**171**	–	**171**
Issue of employee share options	–	–	–			327	**327**	–	**327**
Deferred tax benefit on issue of employee share options	–	–	–	–	–	(99)	**(99)**	–	**(99)**
Exchange difference	–	–	–	2,942	–	–	**2,942**	–	**2,942**
Acquisition of subsidiaries	–	–	–	–	–	–	–	(9,311)	**(9,311)**
Effective portion of changes in fair value of interest rate cash flow hedges	–	–	–	–	(626)	–	**(626)**	–	**(626)**
Deferred tax on changes in fair value of interest rate cash flow hedges	–	–	–	–	188	–	**188**	–	**188**
Other	–	–	–	–	–	–	–	7,907	**7,907**
Profit for the year	–	–	–	–	–	109,442	**109,442**	17,155	**126,597**
Dividends paid	–	–	–	–	–	(21,402)	**(21,402)**	(1,246)	**(22,648)**
At 31 March 2006	**20,687**	**2,868**	**26,897**	**2,673**	**(438)**	**683,960**	**736,647**	**66,940**	**803,587**

27 Reconciliation of movement in equity

For the year ended 31 March 2006	2006 £000	2005 £000
Opening Shareholders' funds	**725,912**	708,988
Issue of shares	**131**	1,896
Issue of employee share options	**327**	197
Deferred tax benefit on issue of employee share options	**(99)**	(59)
	726,271	711,022
Total recognised income and expense for the year	**122,053**	32,161
Dividends	**(21,402)**	(17,271)
Closing Shareholders' funds	**826,922**	725,912

28 Capital commitments

	2006 £000	2005 £000
Property division	**68,981**	52,455
Investment Division – commitments by LMS Capital	**69,034**	31,427
– commitments by Inflexion plc	**–**	15,129
Total	**138,015**	99,011

The Group had a commitment to subscribe for £15 million in cash for B Ordinary shares in Inflexion plc, the timing at the Group's option but no later than 30 September 2009. As part of the voluntary liquidation arrangements this amount was required to be paid on 10 April 2006 and immediately repaid by the liquidators and the obligation was extinguished.

29 Contingent liabilities

Guarantees have been given in respect of warranties on the sale of certain subsidiaries and other liabilities in the ordinary course of business.

30 Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed.

31 Subsequent events

On 12 April 2006 the Company announced details of the proposed demerger of its Investment business. The demerger proposals were approved by Shareholders at an Extraordinary General Meeting on 17 May 2006 and the capital reconstruction was sanctioned by the Court and the demerger became effective on 9 June 2006. The effect of the demerger on the continuing LMS plc Group is to leave it with its Property Division assets.

32 Explanation of transition to Adopted IFRS

As stated in note 1, these are the Group's first consolidated financial statements prepared in accordance with Adopted IFRS. The accounting policies set out in note 1 have been applied in preparing the financial statements for the year ended 31 March 2006, the comparative information presented in these financial statements for the year ended 31 March 2005 and in the preparation of an opening IFRS balance sheet at 1 April 2004 (the Group's date of IFRS transition).

In preparing the opening IFRS balance sheet, the Group has adjusted amounts reported previously in financial statements prepared in accordance with UK GAAP. An explanation of how the transition from UK GAAP to Adopted IFRS has affected the Group's financial performance, financial position and cash flows is set out in the reconciliations and accompanying notes below.

Reconciliation of loss after tax:

	Notes	Year ended 31 March 2005 £000
Previously reported – UK GAAP:		
Loss on ordinary activities after taxation before minority interests		(5,829)
Adjustments:		
Change in amortisation period for lease incentives	(a)	172
Revaluation gains on investment properties previously Classified as trading properties	(b)	6,953
Depreciation of owner-occupied property	(c)	(105)
Movement in gains on disposal of investments – includes fair value uplift in period and adjustments where part of profit recognised in previous periods	(d)	(2,079)
Revaluation gains on investment properties in the period	(e)	61,300
Current period impact of transfer of SIC 15 balance	(e)	(1,726)
Write-back of negative goodwill taken in previous periods	(f)	(392)
Current period charge (net of tax) arising on grant of share options	(g)	(138)
Defined benefit pension scheme net movement in liability	(h)	467
Net increase in deferred tax liability	(i)	(13,685)
Net impact of consolidation of Inflexion	(j)	7,376
Net impact of consolidation of subsidiaries previously classified as investments	(k)	(5,575)
		52,568
Restated – IFRS:		
Profit for the period after tax		46,739

32 Explanation of transition to Adopted IFRSs continued

Reconciliation of net assets:

	Notes	31 March 2005 £000	1 April 2004 £000
Previously reported – UK GAAP:			
Net assets		787,992	757,973
Adjustments:			
Impact of revaluation of former trading properties	(b)	25,786	18,833
Reversal of proposed dividends liability	(l)	14,838	10,742
Impact of revaluation of investments to fair value	(d)	7,778	9,857
Write-off of negative goodwill	(f)	–	392
Net impact of defined benefit pension liability	(h)	(5,786)	(6,372)
Net deferred tax liability	(i)	(46,817)	(34,293)
Reversal of proposed dividends liability to minority	(m)	1,247	–
Net impact of consolidation of Inflexion	(j)	(6,003)	2,884
Net impact of consolidation of subsidiaries previously classified as investments	(k)	(688)	(1,644)
		(9,645)	399
Restated – IFRS:			
Net assets		778,347	758,372

(a) Lease incentives – Under IFRS, rent free periods and other incentives, are amortised over the period to the first break option, or the full lease term, rather than the period to first open market rent review as under UK GAAP. At the date of transition the cumulative effect of incentives granted prior to that date has been adjusted for via retained earnings.

(b) Trading property (inventory) – property previously shown as trading property under UK GAAP but which does not fall under the definition of trading property (inventory) under IFRS has been reclassified as investment property, is held at fair value and gains and losses arising on revaluations are now recognised directly in the income statement. Any gains or losses on disposal of property previously classified as trading property which has been disposed of since the date of transition have also been adjusted to reflect the impact of revaluation to fair value in the opening balance sheet.

(c) Owner-occupied property – previously held as investment property at valuation, under IFRS the Group's offices have been reclassified as owner-occupied property within property, plant and equipment and are being depreciated over their useful economic life. The property will continue to be held at fair value with gains arising on revaluation taken via the revaluation reserve. Revaluation gains or losses are calculated after adjusting the cost of the asset for the accumulated depreciation.

(d) Investments – under IFRS, investments are held at fair value, as against cost less impairment under UK GAAP. Therefore, at the date of transition investments have been restated at fair value, with the resulting gain or loss on revaluation compared to the UK GAAP carrying amount recognised in retained earnings. Gains and losses arising on revaluations of investments since the date of transition are recognised directly in the income statement. Any gains or losses on disposal of investments disposed of since the date of transition have also been adjusted to reflect the impact of revaluation to fair value in the opening balance sheet.

(e) Investment properties – under IFRS, gains and losses arising on revaluation of investment properties are recognised directly in the income statement. Accumulated revaluation gains and losses (including SIC 15 balances) within the revaluation reserve at the date of transition have been transferred to retained earnings. The value of investment properties at each period end has been increased by the present value of ground rents payable on leasehold properties, with an equivalent liability also recognised.

(f) Negative goodwill – under IFRS, negative goodwill is not permitted and must be written back to the income statement. Therefore, an adjustment has been made to eliminate the negative goodwill arising on the acquisition of Inflexion plc held on the balance sheet under UK GAAP at the date of transition. Under UK GAAP this negative goodwill was written-off in the year ended 31 March 2005, therefore an adjustment has also been made to reverse this credit in the income statement.

(g) Share-based payments – under IFRS, the cost of granting share options is required to be recognised in the income statement over the vesting period. Under the transitional provisions, the cost has only been calculated for options granted after 7 November 2002 which had not vested at 1 January 2005. The resulting cost has been charged to administrative expenses in the income statement and credited to retained earnings.

32 Explanation of transition to Adopted IFRSs continued

(h) Pension obligations – under IFRS, the Group is required to account for the net liability or asset in respect of defined benefit pension schemes on the balance sheet. Under the transitional provisions, the liability recognised at the date of transition includes the cumulative actuarial losses to the date of transition. Actuarial gains or losses arising from the date of transition are recognised in full in the Statement of Recognised Income and Expense.

A corresponding deferred tax asset has been recognised in respect of the deferred tax benefit associated with the net pension liability recognised on the balance sheet.

(i) Deferred tax – under IFRS, deferred tax is recognised on 'temporary differences' and requires provision to be made for the deferred tax liability associated with the revaluation of investment properties and investments. Under UK GAAP the potential liability on the sale of the properties and investments is disclosed as contingent tax but not provided on the balance sheet unless the liability is expected to crystallise. This liability would only be incurred were the property assets and investments to be sold. A deferred tax asset has also been recognised in respect of the tax benefit associated with the established tax losses and the potential asset on sale of some of the investments at the revalued amount, but this has been offset against deferred tax liabilities, where such netting is permitted, and the net deferred tax liability is shown on the balance sheet.

(j) Inflexion – consolidation of investment Fund II – under IFRS, as the General Partner and also a Limited Partner of Fund II, Inflexion plc is deemed to have the 'power to control' Inflexion Fund II and is therefore required to consolidate the Fund into its financial statements as a subsidiary at the date of transition. Under UK GAAP, the Group's consolidated financial statements include both Inflexion plc's and the Group's Limited Partner investments in Fund II at cost less provision for impairment.

In the period to 31 March 2005, one investment within Inflexion Fund II meets the definition of a subsidiary under IFRS and so has been consolidated into Fund II, which has in turn been consolidated into Inflexion plc. As a result of direct investments held by Inflexion plc in entities in which Fund II also has an interest, Inflexion plc is deemed to have the 'power to control' an additional two investments, which have therefore also been consolidated.

(k) Consolidation of subsidiaries previously held as investments – under IFRS, there are a number of investments that meet the IFRS definition of a subsidiary, which were held as investments under UK GAAP. At the date of transition eight such investments have been consolidated as subsidiaries of the Group. At 31 March 2005 only four such investments have been consolidated as subsidiaries of the Group, as a result of four investments being restructured during the year.

(l) Proposed dividends – under IFRS, proposed dividends are not recognised as liabilities until they have been approved and there is an obligation to make the payment. Therefore the balance sheet, both at the date of transition and at 31 March 2005, has been adjusted to recognise the dividends when approved. This results in an increase in equity shareholders' funds under IFRS compared to UK GAAP and also a net decrease in the dividend for the period. Under IFRS, the dividend is not reflected as part of the income statement but is shown in the Reconciliation of Movement in Equity.

(m) Proposed dividends liability to minority – as noted above, under IFRS proposed dividends are not recognised as liabilities until there is an obligation to make the payment. Therefore dividends payable to minority interests have been reclassified as equity minority interests.

(n) Other: Accounting for joint ventures – joint ventures, which were gross equity accounted for under UK GAAP, have been equity accounted for under IFRS. The main difference under IFRS is that the share of profit after tax is shown on the face of the income statement, compared to the share of turnover and share of operating profit required to be disclosed on the face of the profit and loss account under UK GAAP.

Other: Property, plant and equipment – assets under construction – under IFRS, properties or land acquired with an intention of development as investment property are classified as assets under construction within property, plant and equipment. At the date of transition one development property, Greenwich Reach, has been reclassified within assets under construction. The property will continue to be valued at fair value with gains arising on revaluation taken via the revaluation reserve.

Other: Cash flows – Under IFRS, the consolidated cash flow statement requires reconciliation of the movements in cash and cash equivalents, compared to UK GAAP, under which the movements in cash only have been reconciled. The IFRS consolidated cash flow statement includes the cash flows of the investments, as described above, which under IFRS meet the definition of a subsidiary but which were held as investments under UK GAAP. Any corresponding adjustments to investment cash flows are also reflected.

Company balance sheet

At 31 March 2006	Notes	2006 £000	Restated* 2005 £000
Fixed assets			
Investment properties	b	**2,175**	375
Investments – consolidated subsidiary undertakings	c	**299,381**	387,066
		301,556	387,441
Current assets			
Debtors	d	**760,632**	674,293
Cash at bank		**5**	–
		760,637	674,293
Creditors: amounts falling due within one year	e	**(16,064)**	(8,259)
Net current assets		**744,573**	666,034
Total assets less current liabilities		**1,046,129**	1,053,475
Creditors: amounts falling due after more than one year	f	**(173,158)**	(312,129)
Provisions for liabilities and charges	g	**–**	(56)
Net assets		**872,971**	741,290
Capital and reserves			
Called up share capital		**90,275**	90,256
Share premium account	h	**20,687**	20,575
Capital reduction account	h	**2,868**	2,868
Revaluation reserve	h	**280,166**	224,763
Profit and loss account	h	**478,975**	402,828
Equity Shareholders' funds		**872,971**	741,290

*Comparative figures have been restated following adoption of new accounting standards (see note a).

The Company's loss for the year amounted to £74.4 million (2005: £46.8 million). The accounts on pages 83 to 86 were approved by the Board of Directors on 12 June 2006 and were signed on its behalf by

Robert Rayne Director

Nicholas Friedlos Director

Company reconciliation of movements in shareholders' funds

For the year ended 31 March 2006	2006 £000	Restated* 2005 £000
Loss for the financial year	**(74,388)**	(46,818)
Dividends	**(21,402)**	(17,271)
Retained loss	**(95,790)**	(64,089)
Revaluation of investment property and subsidiary undertakings	**227,111**	88,959
Issue of shares	**131**	1,896
Issue of employee share options	**328**	197
Deferred tax benefit on issue of employee share options	**(99)**	(59)
Movement in Shareholders' funds	**131,681**	26,904
Shareholders' funds at beginning of year (Originally £726.5 million restated for prior year adjustment of £14.8 million)	**741,290**	714,386
Shareholders' funds at end of year	**872,971**	741,290

*Comparative figures have been restated following adoption of new accounting standards (see note a).

Notes

(forming part of the financial statements)

a Accounting policies

The Company financial statements have been prepared under UK GAAP, rather than under IFRS which has been adopted for Group reporting. UK GAAP is converging towards IFRS and a number of new Financial Reporting Standards became applicable for the first time in the year. The accounting policies relevant to the Company are consistent with those set out in the Group accounting policies in note 1.

The new UK accounting standards are:

– FRS 17 'Retirement benefits' (applicable for the first time)
– FRS 20 'Share-based payments'
– FRS 21 'Events after the balance sheet date'
– FRS 23 'The effects of changes in foreign exchange rates'
– FRS 25 'Financial instruments: disclosure and presentation'
– FRS 26 'Financial instruments: measurement'

The Company financial statements have been restated for the year ended 31 March 2005 to reflect the retrospective application of these new standards.

The impact of FRS 20 on the comparative figures is a charge to the profit and loss account of £0.2 million, less associated deferred tax of £0.1 million, with a corresponding increase in equity.

The impact of FRS 21 on the comparative figures is to exclude the proposed final dividend of £14.8 million from the balance sheet and income statement and include the final dividend of £10.7 million relating to the year ended 31 March 2004, resulting in a net increase in Shareholders' funds of £4.1 million.

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements.

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules, except for investment properties and investment in subsidiaries which are stated at their fair value.

Under Section 230(4) of the Companies Act 1985 the Company is exempt from the requirement to present its own profit and loss account. These financial statements present information about the Company as an individual undertaking and not about its Group.

Net rental income

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

Investment properties

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

No depreciation or amortisation is provided in respect of freehold investment properties and leasehold investment properties with over 20 years to run. This treatment, which is in accordance with SSAP 19, may be a departure from the requirements of the Companies Act concerning depreciation of fixed assets. However, these properties are not held for consumption but for investment and the directors consider that systematic annual depreciation would be inappropriate.

The accounting policy adopted is therefore necessary for the financial statements to give a true and fair view. Depreciation or amortisation is only one of many factors reflected in the annual valuation and the amount which might otherwise have been shown cannot be separately identified or quantified.

Taxation

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

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

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

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

a Accounting policies continued

Subsidiary undertakings valuation

The Company's investments in the shares of Group undertakings are stated at directors' valuation on a basis which takes account of the net assets of the undertakings at 31 March 2006 which will include the professional valuation of properties. Surpluses and temporary deficits arising from the directors' valuation are taken to revaluation reserve in the Company balance sheet, permanent diminutions in value are taken to the Company profit and loss account.

Financial guarantees

The Company has not adopted amendments to FRS 26 in relation to financial guarantee contracts which will apply for periods commencing on or after 1 April 2006.

Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within its Group, the Company considers these to be insurance arrangements, and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

The Company does not expect the amendments to have any impact on the financial statements for the period commencing 1 April 2006.

b Tangible fixed assets

	Freehold 2006 £000	Freehold 2005 £000
Investment Properties		
Valuation		
At 1 April	**375**	23,875
Surplus on revaluation	**1,800**	–
Disposal/transfer	**–**	(23,500)
At 31 March	**2,175**	375
Historical cost of revalued assets		
At 31 March 2006 and 31 March 2005	**39**	38

The investment properties have been independently valued by CB Richard Ellis, Chartered Surveyors, of London as at 31 March 2006 on the basis of 'Market Value' in accordance with the Appraisal and Valuation Manual of the Royal Institution of Chartered Surveyors.

c Investments – consolidated subsidiary undertakings

	2006 £000	2005 £000
At 1 April 2005 at valuation	**387,066**	297,601
Additions at cost	**7,000**	506
Surplus on revaluation of subsidiary undertakings	**225,311**	88,959
Disposals	**(319,996)**	–
At 31 March at valuation	**299,381**	387,066

d Debtors

	2006 £000	2005 £000
Rents and service charges receivable	**–**	211
Amounts owed by subsidiary undertakings	**753,889**	664,739
Other debtors	**2,021**	369
Other prepayments and accrued income	**137**	26
Corporation tax	**1,799**	1,662
Deferred tax asset	**2,786**	7,286
	760,632	674,293

e Creditors: amounts falling due within one year

	2006 £000	2005 £000
Bank overdrafts	**24**	93
Rents received in advance	**–**	322
Amounts owed to subsidiary undertakings	**4,393**	4,262
Other taxes and social security	**–**	77
Other creditors	**2,191**	1,660
Accruals	**9,456**	1,845
	16,064	8,259

f Creditors: amounts falling due after more than one year

	2006 £000	2005 £000
6.5% Secured Bond 2026	**173,158**	173,066
£140 million Revolving Bank Loan 2012	**–**	139,063
	173,158	312,129

The Secured Bond of £175 million is secured on all the assets of the Company. The maturity profile of the Company's borrowing is shown below:

	2006 £000	2005 £000
Borrowings		
Repayable after more than five years	**173,158**	312,129
Repayable within four to five years	**–**	–
Repayable within one year	**24**	93
	173,182	312,222

g Provisions for liabilities and charges

	2006 £000	2005 £000
Provision for deferred taxation on accelerated capital allowances and other timing differences		
At 1 April	**56**	55
Movements in provision during the year	**(56)**	1
At 31 March	**–**	56

h Reserves

	Share premium account £000	Capital reduction account £000	Revaluation Reserve £000	Profit and loss account £000	Total £000
At 31 March 2005 as previously stated	20,575	2,868	224,763	387,991	636,197
Prior year adjustment (see note a)	–	–	–	14,837	14,837
At 31 March 2005 restated	20,575	2,868	224,763	402,828	651,034
Issues of shares during the year	112	–	–	–	112
Surplus on revaluation of investment properties	–	–	1,800	–	1,800
Surplus on revaluation of subsidiary undertakings	–		225,311	–	225,311
Realisation of revaluation surpluses of previous years	–	–	(171,708)	171,708	–
Issue of employee share options	–	–	–	328	328
Deferred tax benefit on issue of employee share options	–	–	–	(99)	(99)
Dividends paid during the year	–	–	–	(21,402)	(21,402)
Retained loss for the year	–	–	–	(74,388)	(74,388)
At 31 March 2006	20,687	2,868	280,166	478,975	782,696

Details of the Company's share capital are given in note 25.

Five year summary

	2006[1] £000 (IFRS)	2005[1] £000 (IFRS)	2004 £000 (UK GAAP)	2003 £000 (UK GAAP)	2002 £000 (UK GAAP)
Group balance sheet					
Intangible assets	**33,645**	56,292	(392)	–	–
Investment properties	**1,023,565**	926,013	853,614	821,944	809,153
Property, plant and equipment	**60,064**	45,075	609	547	542
Other investments – Investment Division	**190,381**	181,808	191,885	162,640	170,450
Cash and cash equivalents	**100,440**	42,306	57,475	77,833	107,532
Other net assets/(liabilities)	**(12,556)**	3,359	(13,109)	(10,092)	(20,374)
Borrowings	**(410,050)**	(415,069)	(323,896)	(334,187)	(281,479)
Deferred tax provision	**(91,627)**	(61,437)	(8,213)	(6,622)	(6,893)
Net assets	**893,862**	778,347	757,973	712,063	778,931
Equity minority interests	**(66,940)**	(52,435)	(48,012)	(33,132)	(58,305)
Equity Shareholders' funds	**826,922**	725,912	709,961	678,931	720,626
Represented by					
Called up share capital	**90,275**	90,256	89,886	89,881	89,516
Reserves	**736,647**	635,656	620,075	589,050	631,110
	826,922	725,912	709,961	678,931	720,626
Group income statement					
Net rental income	**52,039**	56,382	53,958	57,088	51,184
Profit/(loss) before taxation and exceptional costs	**186,093**	102,235	17,219	(15,792)	(36,068)
Exceptional costs	**(12,702)**	(48,213)	–	–	–
Profit/(loss) before taxation	**173,391**	54,022	17,219	(15,792)	(36,068)
Profit/(loss) for the year after taxation	**126,597**	46,739	11,809	(25,520)	(46,918)
Earnings/(loss) per Ordinary share	**33.28p**	10.93p	4.85p	(10.47p)	(19.26p)
Dividends per Ordinary share	**6.6p**	6.5p	6.4p	6.3p	6.2p
Shareholders' funds per share	**251p**	221p	217p	207p	221p
Diluted Shareholders' funds per share	**250p**	220p	212p	207p	220p
Return on equity					
LMS overall	**20.5%**	6.1%	6.9%	(3.7%)	(2.4%)
LMS overall (excluding exceptional costs)	**17.1%**	10.5%	6.9%	(3.7%)	(2.4%)
Market price at 31 March					
Ordinary shares	**285.75p**	206p	171.75p	99.5p	157p
Deferred Ordinary shares	**–**	–	166p	89p	140p

1 The figures for 2005 and 2006 above have been prepared under IFRS and are not directly comparable with the UK GAAP figures for 2002 to 2004.

Shareholder information

Registered office

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Facsimile 020 7935 3737
www.lms-plc.com
Email co.secretary@lms-plc.com

Registered in England and Wales

No. 7064

Registrars and transfer office

Capita Registrars Plc
The Registry, 34 Beckenham Road
Beckenham, Kent BR3 4TU
www.capitaregistrars.com

Shareholder enquiries:

Telephone 0870 1623100
Email ssd@capitaregistrars.com

Trustee for 6.5% Secured Bonds 2026

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

Dividend payments directly into bank/building society accounts

Dividends for shareholders are paid through 'BACS' and can be paid directly into a UK bank or building society account with the tax voucher sent direct to the shareholder's registered address. Please contact our Registrar for a dividend mandate form or contact the Company Secretary's department at the Company's Registered Office.

Dividend Reinvestment Plan

A Dividend Reinvestment Plan (DRIP) is available. The DRIP enables shareholders to apply the whole of their cash dividend to buy additional Ordinary shares in the Company in the market at competitive dealing rates. Full details of the DRIP can be obtained from the Registrar or the Company Secretary's department at the Company's Registered Office. Completed application forms for the DRIP to apply to the final dividend, must be returned to the Registrar by 4 July 2006.

Low cost share dealing service

Through Stocktrade we offer our non-US resident shareholders an 'execution only' telephone share dealing service, which provides a way of buying or selling shares in the Company. The basic commission charge for this service is 0.5% of the total value of the sale or purchase amount, with a minimum charge of £15. If you are buying shares there will be an additional 0.5% stamp duty charge, with a PTM levy charge of £1 for single trades in excess of £10,000. To use this service, please telephone 0845 601 0995 between the hours of 8.30 a.m. and 4.30 p.m. quoting the reference Low Co 216. For details of the service available to US resident shareholders, please contact the Company Secretary's department at the Company's Registered Office.

LMS Single Company ISA

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

ShareGift

Shareholders with a small number of shares, the value of which makes it uneconomic to sell them, may wish to consider donating them to charity through ShareGift, a registered charity administered by The Orr Mackintosh Foundation. The relevant share transfer form can be obtained from the Registrar. Further information about ShareGift is available at www.sharegift.org or by writing to: ShareGift, The Orr Mackintosh Foundation, 46 Grosvenor Street, London, W1K 3HN.

Financial Calendar

Ex-dividend date	21 June 2006
Record date	23 June 2006
Final date for receipt of DRIP forms	4 July 2006
Annual General Meeting	27 July 2006
Final dividend payment date	3 August 2006
Interim results	November 2006

Advisers

Auditor
KPMG Audit Plc, London

Banker
Barclays Bank plc

Broker
JPMorgan Cazenove

Solicitors
Clifford Chance
Berwin Leighton Paisner
CMS Cameron McKenna

Valuers
CB Richard Ellis Limited
Smiths Gore
Colliers CRE
Montagu Evans

Glossary of Terms

BREEAM
Building Research Establishment Environmental Assessment Method

CDM
Construction (Design and Management) Regulations 1994

CGI
Computer Generated Image

ERV
Estimated Rental Value

FRS
Financial Reporting Standards

IAS
International Accounting Standards

IFRS
International Financial Reporting Standards

Interest Cover
Net rental income dividend by net interest expense

IPD
Investment Property Databank

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

NYSE
New York Stock Exchange

REIT
Real Estate Investment Trust

SIC
Standards Interpretation Committee

SORIE
Statement of Recognised Income and Expense

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

Total return on equity
Closing adjusted Shareholders' funds plus equity dividends in respect of the year, divided by the opening adjusted Shareholders' funds. Return on equity prior to 2005 was calculated on basic Shareholders' funds under UK GAAP.

Total Shareholder Return
A measure of total returns to Shareholders adding together the movement in the market value of their shares between the beginning and end of the financial year and the value of the dividend. Data sourced from IPD.

UK GAAP
United Kingdom Generally Accepted Accounting Practice

UKLA
United Kingdom Listing Authority

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