The Scottish Mortgage and Trust PLC

Annual Report & Accounts
31 March 2003

Contents

Company Summary

COMPANY DATA AT 31 MARCH 2003

Total assets†	Shareholders' funds	Market capitalisation
£1,052m	£844m	£699m

† before deduction of debentures, long and short term borrowings.

Policy and Objective

Scottish Mortgage is one of the largest investment trust companies in the UK. Its objective is to maximise total return to shareholders at the same time as generating real dividend growth. It invests internationally, mainly in quoted securities. Its portfolio is concentrated in a relatively small number of holdings. These are mainly in strong businesses with good prospects for growth. Its managers are constantly alert for opportunities for major strategic moves.

Benchmark

The portfolio benchmark against which performance is measured is 50% FTSE All-Share Index and 50% FTSE World Ex UK Index (in sterling terms).

Management Details

Baillie Gifford & Co is appointed as investment managers and secretaries to the Company. The management contract can be terminated at twelve months notice.

Capital Structure

At the year end the Company's share capital consisted of 298,005,115 ordinary shares of 25p each which were issued and fully paid. During the year the Company bought back 11,179,573 shares for cancellation.
Long term gearing has been secured by the issue of £146 million (nominal value) of debenture stocks.

Management Fee

Baillie Gifford & Co's annual remuneration is 0.32% of total assets less current liabilities (excluding short term borrowings for investment purposes), calculated on a quarterly basis.

ISA/PEP

ISA and PEP transfer facilities are available (see inside back cover). Up to £7,000 per annum can be invested in a Maxi ISA currently.

AITC

The Company is a member of the Association of Investment Trust Companies, of which it was one of the founder members in 1932.

Year's Summary

	31 March 2003	31 March 2002	% change
Total assets (before deduction of debentures, long and short term borrowings)	£1,051.5m	£1,509.9m	
Loans and Debentures	£207.2m	£206.9m	
Equity shareholders' funds	£844.3m	£1,303.0m	
Net asset value per ordinary share (after deducting prior charges at par)	285.5p	423.6p	(32.6)
Net asset value per ordinary share (after deducting prior charges at market value)	268.0p	409.4p	(34.5)
Share price	234.5p	369.0p	(36.4)
FTSE All-Share Index	1,735.7	2,557.4	(32.1)
FTSE World Ex UK Index (in sterling terms)	191.8	285.0	(32.7)
FTSE World Index (in sterling terms)	194.0	287.8	(32.6)
Benchmark composite index			(32.4)
Dividend per ordinary share	6.60p	6.25p	5.6
Earnings per ordinary share	7.43p	7.56p	(1.7)
Expense ratio	0.49%	0.47%	
Discount (after deducting prior charges at par)	17.9%	12.9%	
Discount (after deducting prior charges at market value)	12.5%	9.9%	

	Year to 31 March 2003		Year to 31 March 2002	
Year's high and low	***High***	***Low***	***High***	***Low***
Price	369.0p	212.3p	417.5p	287.5p
Net asset value	423.6p	263.8p	488.8p	337.3p
Discount	11.7%	21.4%	12.2%	17.5%

	31 March 2003	31 March 2002
Total return per ordinary share		
Revenue	7.43p	7.56p
Capital	(141.69p)	(30.17p)
Total	(134.26p)	(22.61p)

Source: Thomson Financial Datastream.
*Benchmark: 50% FTSE All-Share Index and 50% FTSE World Ex UK Index (in sterling terms).
Dividends are not reinvested.

Five Year Summary

The following charts indicate how an investment in Scottish Mortgage has performed relative to its benchmark (applied retrospectively), its underlying net asset value and the retail price index over the five year period to 31 March 2003:

Source: Thomson Financial Datastream.

Source: Thomson Financial Datastream.

Source: Thomson Financial Datastream.
The discount is the difference between Scottish Mortgage's quoted share price and its underlying net asset value.

Source: Thomson Financial Datastream/Annual Report.

Directors and Management

Directors

Lord Sanderson of Bowden. Russell Sanderson is a former Minister of State at the Scottish Office. He is chairman of the Clydesdale Bank PLC and a director of National Australia Group Europe and of other companies. Lord Sanderson was appointed a Director of The Scottish Mortgage and Trust PLC in 1991 and became Chairman in 1993. He is 70.

GA Ball. Geoffrey Ball is executive chairman of CALA Group Ltd, having led the Management Buy Out in 1999. He is president of the House Builders Federation of England and Wales. He was for thirteen years a director of The Standard Life Assurance Company. He is 59 and was appointed a Director of The Scottish Mortgage and Trust PLC in 1983.

Sir Donald MacKay. Donald MacKay is 66 and was appointed a Director of The Scottish Mortgage and Trust PLC in 1999. He is an economist who was Professor of Political Economy at Aberdeen University and Professor of Economics at Heriot-Watt University. He is currently chairman of The Malcolm Group PLC, a director of Edinburgh Income and Value Trust plc and a former chairman of Scottish Enterprise.

WG McQueen. Gordon McQueen is 56 and was appointed a Director of The Scottish Mortgage and Trust PLC in 2001. He is an executive director of HBOS plc, Bank of Scotland and Halifax plc, where his chief role is Chief Executive, Treasury.

The Earl of Portarlington. George Portarlington is 64 and was appointed a Director of The Scottish Mortgage and Trust PLC in 1997. He is a former director of Queensland Trading and Holding Company Limited of Brisbane and of Cold Storage Holdings Limited of Singapore.

JPHS Scott. John Scott is 50 and was appointed a Director of The Scottish Mortgage and Trust PLC in 2001. He is a former executive director of Lazard Brothers & Co. Limited. During his twenty years with Lazard, he was deeply involved with the merchant bank's Asian activities. He is currently a director of various companies, including Dunedin Income Growth Investment Trust PLC, Martin Currie Pacific Trust plc, Xaar plc, Miller Insurance and Albany Venture Managers.

Lord Sanderson of Bowden
Chairman

Managers and Secretaries

Scottish Mortgage is managed by Baillie Gifford & Co, an investment management firm formed in 1927 out of the legal firm Baillie & Gifford, WS, which had been Managers and Secretaries to the Company since its formation in 1909.

Baillie Gifford is one of the largest investment trust groups in the UK and currently manages six investment trusts. Baillie Gifford also manages unit trusts and Open Ended Investment Companies, together with investment portfolios on behalf of pension funds, charities and other institutional clients, both in the UK and overseas. Funds under the management or advice of Baillie Gifford total over £20 billion. Based in Edinburgh, it is one of the leading privately owned investment management firms in the UK, with 24 partners and a staff of around 400.

The manager of Scottish Mortgage's portfolio is James Anderson, a partner of Baillie Gifford. Stock selection is primarily the responsibility of specialist teams covering all the regions of the world.

The firm of Baillie Gifford & Co is authorised and regulated by the Financial Services Authority.

Chairman's Statement

It has been a difficult year for equity markets. The benchmark index which we use as a guide (50% FTSE All Share and 50% World Ex UK in sterling terms) fell by 32.4%. Our performance was very similar and our net asset value per share fell by 32.6% to 285.5p. Our stock selection was generally good in relative terms, most notably in the core UK market, but overall performance was hindered by the impact of long-term borrowings in declining markets. A detailed analysis can be found in the attribution table on page 8.

The Board is recommending a final dividend of 4.50p per share, making a total proposed dividend for the year of 6.60p. This is an increase of 5.6%, which is well above inflation. This is the 21st consecutive real increase in the Company's dividend. The dividend is comfortably covered by earnings of 7.43p. Earnings exceeded our prior expectations despite the income consequences of a modest shift away from UK equities.

Investment Background

The past year has been one of the most difficult for equity markets in the history of your Company. Coming as it does as the most severe of three consecutive years of decline there has been significant damage to investor confidence. Continuing weakness in the global economy and lingering concerns over questionable corporate results and ethics have weakened the appetite for equities that was such a feature of the 1990's. The growing international tensions culminating in the recent war in Iraq have hindered efforts to rebuild corporate and consumer confidence from gaining momentum.

The American economy has seen the greatest effort to reignite growth. Substantial monetary and fiscal stimulus did indeed revive consumer spirits for much of 2002 but their impact appears to be waning. Both the Federal Reserve and the Administration will be extremely keen to see growth accelerate over the next year but they will have comparatively little scope for further supportive actions. The recent weakness of the dollar recognises the difficulties of this situation and can be expected to continue.

The British economy appeared to be comparatively well-placed twelve months ago. In terms of GDP growth this has proved to be the case as a buoyant housing market has supported consumption sufficiently to offset the apparently endless troubles of the manufacturing sector. We do, however, have several concerns about the medium term outlook. The housing market appears vulnerable to at least a slowdown whilst employment growth has been supported by significant government expenditure which is leading to a sharp rise in the public sector borrowing requirement.

A year ago I observed that we had become increasingly worried by the prospects for the German economy. Sadly our concerns have been justified and have indeed intensified in recent months. The deteriorating health of the German financial system is of particular concern. We see no evidence that this issue is being addressed with the necessary seriousness. Elsewhere in Europe prospects are less malignant but confidence is lacking and current economic data is far from reassuring.

The Japanese economy has endured another year of slow growth and deflation. This comes as little surprise to us or to the investment community as the hopes initially invested in Mr Koizumi's government have long been disappointed. Much of the Japanese corporate sector struggles valiantly to cope with the consequences of such political and financial inertia but the environment remains discouraging for investors.

In pleasing contrast we are delighted to see evidence of continued economic improvements in many emerging economies. The most dramatic progress has been seen in China which has become ever more crucial to global manufacturing industry and even to overall global growth prospects. We would also point to the continuing recovery of Russia and the comparative health of the Indian economy as rare but vital signs of hope in the global economy. The increasing importance of these economies is a theme that we expect to return to in the years ahead.

Investment Activity

Equities

In aggregate we have made net sales of £28m during the year. This has been needed in order to fund share repurchases. Our view of market prospects has improved slightly as the year has passed. This owes little to enthusiasm over current economic prospects but more to valuations gradually becoming more attractive as the markets have fallen. The most significant change in the geographical balance of the portfolio has been the £11m increase in the emerging markets portfolio. Combined with an increase of £10m in the Asia Pacific region this underlines our determination to take advantage of the dynamic economic growth that can be found in these areas. We are delighted that we can find more companies in these markets with appealing individual prospects and better standards of corporate governance than in the past. We now have more of our assets invested in Russia (£23m) than in Germany (£16m), a situation that would have been unthinkable not long ago. Our European portfolio has performed worse than the markets. We will be looking for an improvement here in the year ahead.

We have made net sales of £29m in Britain. As noted above our confidence in the fundamental health of the British economy has faded in the last year but this has been somewhat offset by increasingly attractive equity valuations. Yields on British equities have climbed first towards, and briefly above, those available on gilts.

Fixed interest

We have made an increase in our fixed interest portfolio of £7m. Results have been good over the year in both absolute and relative terms. This is particularly pleasing as the Managers have been encouraged by the Board to improve their resources and skills in this area. For the first time we are including a detailed review of the fixed interest portfolio in this report (page 18).

Repurchase of shares

We have bought back 11.2m shares in the course of the year at a cost of £31m. This has enhanced NAV by 0.8%. We are disappointed that our consistent willingness to consider buybacks is not having a more discernible impact on the discount to NAV. We will, however, be asking shareholders for permission to renew the mandate to repurchase up to a further 15% of the then outstanding shares at the forthcoming AGM.

Balance sheet

In the course of the year we have renewed our short-term yen borrowings of £23m. We still consider this to be an attractive source of funding as we believe that eventually the yen is likely to weaken as a consequence of attempts to resuscitate the Japanese economy.

We have made no changes to our long term debt. As a consequence of the sharp falls in markets these liabilities are now equivalent to 14.5% of total assets. If our debentures are valued at current market rates rather than at par the net asset value would fall to 268.0p against an unadjusted 285.5p. To help to balance the costs of these long-term borrowings we have added to our portfolio of high quality fixed interest bonds and we expect to continue with this approach.

Scottish Mortgage shares and marketing activity

The investment trust industry

Traditional investment trusts suffered unjustifiably bad publicity during the year owing to the severe problems of many split capital trusts. We have encouraged the Managers and the Association of Investment Trust Companies (AITC) to work hard to make it clear that solidly established and properly run general trusts are sound investments that are very different from many structurally flawed split capital trusts. The Board fully supports the efforts of the AITC and the Financial Services Authority to bring the whole industry into line with best practice.

The Board was delighted that our Managers were awarded the AITC sponsored 'Investment Week Investment Trust Group of the Year Award' for 2002.

Marketing initiatives

During the year the Managers carried out a marketing plan which had been agreed and approved by the Board. The ISA, PEP and Share Plan materials were improved with a view to widening their appeal. A targeted advertising campaign and supporting internet initiatives were put in place. A Children's Savings Plan which is low cost, flexible and straight-forward was successfully launched in October. Parents and grandparents can create a nest egg for children either by regular monthly savings or with a lump sum invested in Scottish Mortgage which we believe is an ideal long term destination for such funds. Contact details are given on the inside back cover of this report. The Plan was very well received by the press and is enjoying healthy inflows in its infancy.

Name adjustment

We would like to propose a small alteration in the name from "The Scottish Mortgage and Trust PLC" to "Scottish Mortgage Investment Trust PLC". This change seeks to clarify the nature of the Company for the retail investor market. A resolution to this effect will be moved at the AGM.

The Board and the AGM

It has been a privilege to have been your Chairman over the past 10 years. I shall be retiring at the conclusion of the AGM having reached the age of 70. I would like to thank all my colleagues on the Board for their unfailing help and dedication over the past decade. In recent years the demands placed on Directors have risen considerably and I feel fortunate to have enjoyed such steadfast support from my Board.

The Board would like to propose Sir Donald MacKay as my successor. His experience and expertise has already proved valuable to the Company and I have every confidence in recommending him as your new Chairman.

I would like to extend an invitation to all shareholders to attend the AGM on 3 July in Edinburgh. Details of the AGM can be found on pages 45 and 46 of this report.

Outlook

The last three years have been a harsh period for economies and equities. Despite this we are able to find companies in many parts of the world which are coping admirably with demanding conditions and whose share prices have fallen to historically attractive levels. Yields on equities are close to those on government bonds in many countries including Britain. Whilst we must be aware of the dangers of the current situation we are also encouraged by the attractive opportunities that are available to your Company. In wishing my successor good fortune for the year ahead, I trust we shall see an uplift in the markets from which the Company is well positioned to benefit.

Sanderson of Bowden

7 May 2003

Managers' Overview

It has been a challenging year for equity investors. All major markets have fallen sharply with little apparent differentiation according to economic prospects or stockmarket valuations. We have tried to maintain a balance between exposure to the more defensive areas of the market that have been less badly affected by the harsh conditions of the last three years and an increasing desire to add to our holdings in the segments of world markets that seem to us to have become unduly depressed and that offer more potential gains in the event of improved market conditions. Selected telecommunication and financial stocks fall into the latter category. This task was complicated by the Iraqi crisis with the year-end of the Company falling at a moment of particular global anxiety.

Although we offset a substantial part of our gearing through our successful bond investments the chart below makes it clear that the costs and impact of our long-term borrowings were damaging in the savage equity market conditions of the last year. We retain a belief in the eventual benefits of our gearing but we will continue to examine all our options in a full awareness of the short-term penalties that such a position can exert.

Performance in UK equities continued to be relatively good but we were disappointed that the London market fared no better than its international counterparts. Concern over the deterioration in British economic fundamentals has led us to trim the UK position but we are encouraged by both the prospects of the companies in our portfolio and their depressed valuations.

Our major stock selection problem was in Europe. As noted last year our holdings in this area have a tendency to be more volatile and less defensive than elsewhere in the portfolio. We regard this as a reflection of both the best long-term corporate opportunities available to us in Europe (which tend to be in economically sensitive sectors such as automobiles) and of the excessive volatility of many continental markets. We will be very disappointed if our relative performance in Europe does not improve in any period of better equity returns.

In America our stock selection was good for the year as a whole. This was concentrated in the first half of the year when the solid results and low valuations of our holdings particularly stood out in an anxious market. We are still to be convinced that the recent relative rally of technology shares is justified by either corporate fundamentals or valuation levels.

As noted elsewhere we are committed to increasing our exposure to emerging markets. This already made a modest net contribution to our performance last year but we would regard this as an area where the opportunities for the Company are substantial in the years ahead.

PERFORMANCE ATTRIBUTION FOR THE YEAR TO 31 MARCH 2003

Computed relative to the benchmark (50% FTSE All-Share Index and 50% FTSE World Ex UK Index (in sterling terms)) with net income reinvested.

PERFORMANCE ATTRIBUTION (in sterling terms)

	Benchmark asset allocation		Scottish Mortgage asset allocation		Performance*		Contribution to relative return	Contribution attributable to:	
	01.04.02	31.03.03	01.04.02	31.03.03	SM	Benchmark		Stock selection	Asset allocation
Portfolio breakdown	%	%	%	%	%	%	%	%	%
UK	50.0	50.0	52.6	54.9	(26.2)	(29.8)	2.7	2.8	(0.1)
Europe ex. UK	10.0	9.5	14.5	10.8	(44.3)	(34.2)	(2.2)	(1.9)	(0.3)
North America	32.9	32.5	27.7	29.4	(30.0)	(31.8)	0.9	0.8	0.1
Japan	4.2	4.3	5.1	5.5	(27.7)	(25.5)	(0.2)	(0.2)	–
Asia Pacific ex. Japan	2.2	3.0	4.7	6.2	(28.4)	(26.4)	–	(0.1)	0.1
Other Emerging Markets	0.7	0.7	2.9	4.7	(23.3)	(33.9)	0.4	–	0.4
Bonds	–	–	5.8	11.0	20.1	–	4.4	–	4.4
Cash	–	–	1.9	0.9	4.0	–	1.4	–	1.4
Debentures and loans	–	–	(15.2)	(23.4)	–	–	(8.0)	–	(8.0)
Total	100.0	100.0	100.0	100.0	(31.4)	(30.6)	(1.1)	1.3	(2.4)

Source: HSBC

*The above returns are calculated on a total return basis with net income reinvested. Dividends and interest are reinvested on a cash basis, unlike the NAV calculation where income is recognised on an accruals basis, relative performance may differ as a result. Scottish Mortgage's figures represent the returns on the Company's portfolio and the benchmark figures for each geographical area represent the return on the appropriate FTSE index.

Contributions cannot be added together as they are geometric; for example to calculate how a return of (31.4%), against a benchmark return of (30.6%) translates into a relative return of (1.1%), divide the portfolio return of 68.6 by the benchmark return of 69.4 and subtract one.

The chart below compares Scottish Mortgage's performance in each of the geographical regions in which it invests with the relevant local index.

Source: HSBC/Thomson Financial Datastream
* The above figures are calculated on a total return basis with income reinvested.

INVESTMENT CHANGES (£'000)

	Valuation at 31 March 2002	Net acquisitions (disposals)	Appreciation (depreciation)	Valuation at 31 March 2003
Equities*:				
UK	693,135	(29,194)	(193,382)	470,559
Continental Europe	191,045	(17,714)	(80,581)	92,750
North America	364,961	(3,943)	(108,601)	252,417
Japan	67,226	2,030	(21,748)	47,508
Asia Pacific	61,755	9,538	(18,301)	52,992
Other Emerging Markets	38,978	10,931	(9,785)	40,124
	1,417,100	(28,352)	(432,398)	956,350
UK corporate bonds	42,377	17,771	5,649	65,797
Euro bonds	33,564	(13,913)	5,597	25,248
US dollar bonds	–	3,264	89	3,353
Total investments	1,493,041	(21,230)	(421,063)	1,050,748
Net liquid assets	16,846	(15,726)	(323)	797
Total assets	1,509,887	(36,956)	(421,386)	1,051,545

The figures above for total assets are made up of total net assets before deduction of debentures, long and short term borrowings.
* Equities includes convertibles, warrants, limited partnerships and OEICs.

Classification	UK %	Continental Europe %	North America %	Japan %	Asia Pacific %	Other Emerging Markets %	2003 Total %	2002 Total %
Equities:*								
Resources	4.7	0.4	1.1	–	0.4	2.5	9.1	9.1
Mining	0.9	–	–	–	0.4	0.5	1.8	0.3
Oil and gas	3.8	0.4	1.1	–	–	2.0	7.3	8.8
Industrials	2.6	1.1	–	0.9	1.7	–	6.3	5.9
Chemicals	–	–	–	0.5	–	–	0.5	0.6
Construction and building materials	2.6	0.4	–	0.2	–	–	3.2	2.2
Diversified industrials	–	–	–	–	0.6	–	0.6	0.6
Electronic and electrical equipment	–	–	–	0.2	1.1	–	1.3	2.2
Engineering and machinery	–	0.7	–	–	–	–	0.7	0.3
Consumer Goods	11.7	2.2	6.9	0.9	0.5	0.3	22.5	23.6
Automobiles	–	0.8	–	0.2	0.2	–	1.2	0.9
Household goods and textiles	–	–	–	–	–	–	–	0.3
Beverages	2.8	–	–	–	0.3	–	3.1	4.1
Food producers and processors	–	–	1.2	–	–	–	1.2	1.1
Healthcare and pharmaceuticals	5.4	1.0	4.6	0.7	–	0.3	12.0	12.0
Personal care and household products	–	0.4	–	–	–	–	0.4	0.3
Tobacco	3.5	–	1.1	–	–	–	4.6	4.9
Services and Utilities	10.9	2.1	4.3	1.3	0.5	–	19.1	19.1
Retailers	0.3	0.3	2.8	0.3	–	–	3.7	3.6
Leisure and hotels	0.7	–	0.4	–	–	–	1.1	1.9
Media and entertainment	2.5	0.5	1.1	0.2	0.1	–	4.4	6.1
Support services	2.1	0.2	–	–	–	–	2.3	2.3
Transport	0.1	–	–	0.3	–	–	0.4	0.4
Telecommunication services	4.5	1.1	–	0.5	0.4	–	6.5	4.3
Electricity	0.7	–	–	–	–	–	0.7	0.5
Financials	14.5	1.1	8.2	1.0	0.9	1.0	26.7	27.9
Banks	9.8	–	1.1	0.2	0.6	–	11.7	12.5
Insurance	0.2	0.4	1.2	–	–	–	1.8	2.4
Life assurance	1.9	–	–	–	–	–	1.9	1.8
Investment companies	0.8	0.7	–	–	–	1.0	2.5	2.7
Real estate	0.5	–	–	–	–	–	0.5	0.4
Other financial	1.3	–	5.9	0.8	0.3	–	8.3	8.1
Information Technology	0.4	1.9	3.5	0.4	1.0	–	7.2	8.3
Information technology hardware	–	1.1	1.2	0.4	0.3	–	3.0	4.1
Software and computer services	0.4	0.8	2.3	–	0.7	–	4.2	4.2
Total Equities*	44.8	8.8	24.0	4.5	5.0	3.8	90.9	
Total Equities* – 2002	45.9	12.7	24.2	4.4	4.1	2.6		93.9
Bonds	6.3	2.4	0.3	–	–	–	9.0	5.0
Net Liquid Assets	(0.7)	0.6	–	–	–	0.2	0.1	1.1
Total Assets (before deduction of debentures, and short term borrowings)	50.4	11.8	24.3	4.5	5.0	4.0	100.0	
Total Assets – 2002	48.8	15.4	24.7	4.4	4.1	2.6		100.0
Debentures and Short Term Borrowings	(14.5)	–	–	(5.2)	–	–	(19.7)	(13.7)
Equity Shareholders' Funds	35.9	11.8	24.3	(0.7)	5.0	4.0	80.3	
Equity Shareholders' Funds – 2002	38.7	15.4	24.7	0.8	4.1	2.6		86.3
Number of equity investments*	*48*	*18*	*24*	*17*	*15*	*7*	*129*	*136*

* Including convertibles, warrants, limited partnerships and OEICs.

THIRTY LARGEST EQUITY HOLDINGS

Name	Business	Market value £'000	% of total assets
†Vodafone Group	Mobile telecommunications services	47,355	4.5
GlaxoSmithKline	Pharmaceuticals	39,862	3.8
Royal Bank of Scotland	Banking	28,472	2.7
Golden West Financial	Savings and loans	26,848	2.5
HSBC Holdings	Banking	25,103	2.4
BP	Integrated oil	23,441	2.2
Barclays	Banking	22,716	2.2
Wellpoint	Managed care	18,208	1.7
Freddie Mac	Mortgages	18,049	1.7
Diageo	Branded spirits	17,653	1.7
Pfizer	Pharmaceuticals	16,204	1.5
British American Tobacco	Tobacco	13,865	1.3
Aviva	Life assurance	13,460	1.3
HBOS	Banking	12,769	1.2
Marsh & McLennan	Insurance and fund management	12,675	1.2
William Wrigley	Chewing gum	12,510	1.2
Omnicom	Advertising agency	11,926	1.1
Allied Domecq	Branded spirits	11,737	1.1
Imperial Tobacco	Tobacco	11,718	1.1
M&T Bank	Banking	11,633	1.1
Wolseley	Builders' merchant	11,520	1.1
Yukos	Oil company	11,499	1.1
Suncor Energy	Oil company	11,290	1.1
Gallaher Group	Tobacco	11,273	1.1
Altria	Tobacco and food	11,240	1.1
Shell Transport & Trading	Integrated oil	10,656	1.0
Reed Elsevier	Professional information publisher	10,590	1.0
Baillie Gifford Latin American Fund	Investment fund	10,372	1.0
Nokia	Mobile telecommunications equipment	10,247	1.0
Walgreen	Pharmacy chain	10,183	1.0
		505,074	48.0

† includes holding partly in convertible loan stock

United Kingdom

North America

Other Emerging Markets

Continental Europe

United Kingdom

The year to 31 March was a miserable one for investors in the UK equity market. Over this period, the FTSE All-Share Index fell 32.1%. The Company's UK equity investments did less badly than the broad market but still recorded a very substantial decline. The UK economy grew at a modest rate through the period with employment holding firm at a high level and household incomes rising. Whilst perhaps not the best combination for profit margins, this economic backdrop does not explain such a dramatic loss of investor confidence.

The sharp fall in share prices may be a reappraisal by investors of what the appropriate valuation range is for equities. However, some specific factors can be identified. The most important of these was forced selling by life assurance companies to meet regulatory capital requirements. This forced selling of equities caused further falls in share prices which led to additional pressure on solvency and yet more equity selling.

A second negative factor has been provided by UK corporate pension schemes. For some years now, they have been shifting their asset allocation away from UK equities and into either bonds or overseas equities. This has led to the absence from the market of a major historic source of demand for UK equities.

The Company's UK portfolio has had a defensive slant for the last two years and perseverance with this policy allowed the worst of the declines to be avoided. However, the sell-off was very broadly based and most of the Company's investments declined in value during the year. There were exceptions to this. Once again, the large positions in tobacco companies proved beneficial with the share prices of Gallaher and Imperial Tobacco both posting gains for the year on the back of decent earnings growth and a re-rating. Two of the house-building companies, Bovis Homes and Bellway, also saw their share prices rise. However, these instances are few and far between.

We avoided some of the more precipitous share price declines. The holding in Royal Sun Alliance was sold before it warned over profits and capital strength. We again found no attraction in such diverse companies as Abbey National, BT Group, BAE and Reuters and the absence of their shares from the portfolio was helpful.

One change of view worth highlighting concerns Vodafone, the mobile phone group, which has during the course of the year become the Company's largest single investment. Its profits are growing rapidly as robust sales growth combine with operational and financial leverage, high levels of cash generation permit continued investment in infrastructure and its sheer scale bring benefits in marketing and procurement. It does not however, signal a change of view on the entire UK telecoms industry. Vodafone remains our only holding in this sector.

Of the other large sectors in the UK market, pharmaceutical, bank and oil stocks all performed broadly in line with the market. We are happy to continue with a large holding in GlaxoSmithKline on the strengths of its modest rating and early stage research portfolio but have been reducing the holding in AstraZeneca where the share price appears too highly rated given uncertainty over new drug launches. Amongst the banks, Royal Bank of Scotland, HSBC and HBOS did relatively well, offset by a poor performance from Lloyds. We have reduced the holding in Lloyds. The largest transactions have been in the oil stocks. For much of the period, the prospect of war in Iraq kept the oil price high and we were reluctant to make any significant sales despite an increasing awareness that, for the largest companies such as Shell and BP, long term growth prospects were very poor. However, some sales were made to fund purchases of other oil companies with better prospects, notably those operating in emerging markets. A swift prosecution of the Iraq war has now removed any reluctance to sell and further reductions have been made in recent weeks.

Whether an end to military operations in Iraq sparks sustained optimism amongst UK companies and investors remains to be seen. However, compared to overnight interest rates currently set at 3.75% and UK government bonds offering yields between 4 and 4½%, the prospect of buying into a growing income stream that already offers a yield of nearly 4% is something we find fundamentally appealing. We claim no insight into precisely when the bear market will end. We also recognise how difficult it is to maintain conviction in the benefits of long term equity investment after such a depressing period. However, common sense suggests enthusiasm for the market is better rewarded when stocks are bought on low valuations. We believe UK equity valuations are currently cheap.

1 *Marketing campaigns such as this advertisement for Smirnoff Ice are bolstering Diageo's leading position in the global spirits industry.*

2 *Educational titles are just one part of Reed Elsevier's strong portfolio of publishing activities.*

Continental Europe

It has been a dismal year for European markets. In local currency terms the FTSE Europe (ex UK) index fell by 42.8%. The rally in the previously weak euro cut this to a decline of 35.7% in sterling terms but this still exceeded the losses in the UK, US and Japanese markets. Our own portfolio performed worse than this after a bad first half of the year although results for the second half were in line with the index.

The main anxieties contributing to this market collapse have been weak economic growth and strains in the European financial system. Germany has been at the centre of both of these concerns. German consumption has remained weak as unemployment has grown and disposable income has remained under pressure from low wage growth, high tax demands and deteriorating demographics. At the same time the perennial problem of inadequate profitability in the German banking industry and the high equity exposure of insurance companies has undermined the solidity of the financial system. These issues will require more vigorous responses than they have yet received if they are not to fester in the years ahead.

Our exposure to the German market is now modest. In the course of the period under review we sold Deutsche Bank and belatedly, MLP, our only holdings in the financial sector. Our largest holding in Germany is the business software giant SAP which appears to have coped with a demanding environment in exemplary fashion. This company and our two holdings in the automotive industry, BMW and Porsche, are reminders that Germany still offers companies of considerable attraction despite the gloomy economic situation.

The French economy has slowed in the last year but it has avoided the stagnation that is prevalent in Germany. We retain considerable confidence in several of our long-term holdings in the Paris market. Sanofi-Synthelabo (pharmaceuticals), L'Oreal (cosmetics) and the luxury goods company Hermes all fall into this category. The only new purchases this year have been in the telecommunications industry as we think that France Telecom has finally confronted its balance sheet problems and that its Orange mobile subsidiary has an extremely strong position in the domestic market.

1 *BMW's new Z4.*

2 *Atlas Copco tunnelling machine at work. Picture courtesy of Atlas Copco.*

The telecommunications industry remains critical to European market trends. This is as true of the Scandinavian equipment suppliers as it is for the operating companies. Whilst equipment demand remains subdued Nokia's dominance of the global handset market continues to grow and profitability has remained strikingly high despite the difficult environment. We have added to our holding in the course of the year. We are less happy with our position in Ericsson where volumes and profitability have been disappointing. We have maintained our holding as we still believe that we have been premature rather than wrong in our belief that improvement will occur.

We have made net sales of £175m of European equities in the last three years. We now have 8.8% of total assets invested in the region and we would be surprised to see this exposure fall significantly further. We can now find many equities with sustainable business franchises selling at low ratings by historical standards, by international comparisons and relative to their local bond markets. The timing of any market rally is uncertain but valuation levels are already supportive. We hope to be able to report better absolute and relative performance in the year ahead.

North America

The US economy grew modestly last year as private consumption, by far its largest component, was boosted by tax cuts and lower interest rates. Meanwhile corporate capital expenditure remained weak in the face of lingering excess capacity and shows few signs of revival. We believe the outlook for the economy remains one of subdued growth as, following the consumer spending spree of recent years, there is little pent-up demand and the scope for further stimulus is limited by the growing Federal budget deficit and the already low level of interest rates.

The US stockmarket fell by nearly a third in sterling terms during the Company's year. This fall was concentrated in the first four months and in this period the Company's defensive portfolio outperformed sharply. Relative performance was weaker in the second half of the year as more cyclical stocks came into favour and as litigation fears resurfaced at Altria, formerly known as Philip Morris. Nevertheless the Company's North American investments outperformed their benchmark for the year as a whole.

For the last three years the Company's portfolio has been dominated by high quality business franchises with clean accounting and defensive growth prospects. While we remain unconvinced that a strong economic recovery is likely, we have slowly increased the cyclicality of the portfolio as we have found opportunities to invest in companies with strong longer term prospects at valuations depressed by difficult recent trading. Among these are two retailers with rather different customer bases: Tiffany, the jeweller, and TJX, the largest American seller of discounted branded clothing. Both have strong management teams and formidable competitive advantages – Tiffany in its carefully nurtured brand and TJX in its scale and buying expertise.

We bought Wyeth, a pharmaceutical company formerly known as American Home Products, after a run of disappointing news, which we think is now ended. The purchase of Wendy's, one of the strongest operators in the fast food sector, was rather less well timed as it was almost immediately caught up in one of the periodic price wars between its rivals McDonald's and Burger King. Other purchases included Microchip, the only large, focused manufacturer of microcontrollers, and Suncor, a Canadian oil company with very substantial reserves and an unusually attractive production profile.

The accounting issues discussed in last year's report have attracted still further attention and a raft of legislative and regulatory initiatives. These reforms are welcome and moderately useful, but the key discipline imposed on companies has come from the markets – falling share prices have been more effective in changing behaviour than regulation. Nonetheless we continue to feel that two important accounting issues have not been fully absorbed by the market – the impact of options grants on technology companies and pension fund problems at companies, largely in the telecoms and industrial sectors, with defined benefit schemes.

These issues heavily influenced our sales during the year, which largely involved further reductions to our positions in technology and telecoms. We now have no money invested in North American telecoms companies and very little in technology companies. While revenues have begun to stabilise in many areas of technology, there seems to us little prospect of a strong rebound, given the economic outlook and overcapacity, yet valuations remain high, in both absolute and relative terms, especially when options grants are expensed.

While valuations at the aggregate market level do not yet appear cheap, they are at least more reasonable. Reports such as these inevitably focus on what has changed over the course of the year, but it is important to note that the bulk of the portfolio is unchanged from a year ago. In particular we continue to find our largest holdings, Golden West, Freddie Mac and Wellpoint highly attractive as strong, well managed franchises trading at below average valuations.

1 *A Tiffany & Co's magazine advertisement. Copyright Tiffany & Co., reprinted with permission.*

2 *Golden West's World Savings branch in Sebastian, Florida.*

Japan

The Tokyo equity market declined again in the 12 months under review, falling by 25.7% in local currency and 25.2% in sterling terms. Although the TOPIX fell to levels last seen in 1984, the market's performance against its global counterparts over the year was relatively resilient. With net investment of £2.0m the Japanese weighting inched up to 4.5% of assets over the period.

Our relative performance has been slightly disappointing this year owing mainly to poor stock picking among financials. We invested in the city bank UFJ on the grounds that its valuation against core earnings looked attractive, but the share price declined sharply as the equity market focused on balance sheet risk. Consumer lender Promise underperformed as news on non-performing loans continued to deteriorate. We have retained holdings in both, believing that current valuations more than discount asset quality concerns. Elsewhere, Nintendo's share price was very weak as the new Gamecube made little impact on Sony's dominance of the games console market so we sold the holding.

The Japanese economy has enjoyed a mild recovery over the last year. Initial impetus came from a rebound in exports, which encouraged a revival of industrial capital investment, while consumption trends have remained steady despite rising unemployment. Fiscal year 2002 GDP growth seems likely to be reported at around 1.5%, significantly above consensus expectations a year ago of negative growth. Importantly, there is also some evidence that deflationary pressures are easing, with recent consumer and wholesale price data showing lower year on year declines. Japan's growth dynamics remain export-dependent, so the outlook for 2003 is cloudy given question marks over global economic activity, but we expect China to continue its emergence as a major stimulant to Japanese growth.

Attention has again been dominated by the travails of the city banks. The appointment of the reform-minded Heizo Takenaka as head of the Financial Services Agency sparked hope that genuine reform of major banks and their problem borrowers was becoming more likely, leading to severe share price weakness for both as perceived bankruptcy risk rose. Although Takenaka's policies in practice have not proved as radical as initially expected, there has been limited progress in improving the condition of the banks. A new body called the Industrial Revitalisation Corporation has been created to remove problem loans from balance sheets, and the Bank of Japan has started buying banks' equity cross-holdings. Meanwhile the banks themselves have become more proactive in raising new tier 1 capital and cutting costs. Still, it is fair to say that Japan's malfunctioning financial system remains one of the major factors in the country's economic problems, and a final solution is some way off.

We continue to be more impressed by the actions of industrial Japan to improve its margins, balance sheet efficiency and shareholder returns. Despite meagre economic growth, corporate operating profits have bounced back strongly in fiscal year 2002, and share buy backs have accelerated markedly. We are seeing merger and acquisition activity becoming a key element of several important industries, such as semiconductors and steel, as companies at last address problems of overcapacity and lack of focus. We invested in Konica following the announcement of its merger with Minolta; management expects earnings to more than double over the next few years given the potential for synergies and cost cutting in the core office automation and imaging businesses.

With Japanese valuations now on the whole reasonable compared to international counterparts and corporate behaviour improving the equity market has some attractions but the technical situation is currently difficult owing to forced selling by corporate pension funds being returned to the government. Evidence of a greater commitment to political and banking reform would encourage us to increase our weighting.

1 A high-end Tostem Inax bathroom.

2 Yamada Denki's scale allows it to reap purchasing economies on high volume electronics lines.

Asia Pacific and Other Emerging Markets

During the year to 31 March we have made a net investment of £10m into the markets of the developed Asia Pacific region and £11m into the emerging markets. These both reflect two broad themes, the increasing relative attraction of stocks in these markets on a case-by-case basis, and the emergence of secular trends which appear to benefit these markets disproportionately. Foremost of these is the rising economic influence of China and India, which is causing deflationary cost pressures globally while simultaneously raising demand for a number of basic materials. The investment implications include increasing demand for outsourced goods and services, while volumes and prices for certain commodity-producing companies may be on an improving trend. These provide favourable industry backgrounds for a number of companies in the Asia Pacific and emerging markets. The purchases made during the year have substantially increased our holdings in energy and primary commodities, notably Yukos and Norilsk Nickel in Russia and BHP in Australia.

Asia

The Australian market has suffered less badly than most developed markets during the year. The improving background for commodities has lent strong support to the Australian dollar, which has seen significant appreciation over the year. As well as increasing our holding in BHP, we have made substantial changes to our other holdings. Both Brambles and Coles Myer continued to produce disappointing operating performances, and we made complete sales. We bought a new holding in the successful beer and wines company Foster's Group. We also sold our holding in Commonwealth Bank of Australia as we grew concerned that its wealth management business was vulnerable to market conditions, and replaced it with the more conservative ANZ Bank. These changes have been helpful to performance.

In Hong Kong our portfolio is virtually unchanged. Companies like supply chain manager Li & Fung and PC producer Legend have coped satisfactorily with difficult market conditions, and we have made small additions here, but we have been disappointed with the performance of Hutchison Whampoa, whose European telecoms businesses have been slow to make headway. We made a change in Singapore, where we sold Singapore Press, whose growth prospects appear to have been disabled by a persistently feeble local economy, and bought Singapore Exchange, a high-yielding stock with more opportunity to increase its earnings.

We have maintained our relatively large position in Samsung Electronics, although we have some concerns about cyclicality of demand for some of its products. Elsewhere in Korea we sold Kookmin Bank before the development of a serious consumer credit crisis, and took a new position in SK Telecom, one of the most technically sophisticated and well-positioned telecoms operators anywhere in the world. In India we increased the size of our holding in software developer Infosys, as the momentum of outsourcing appeared to be improving. After the year-end, however, Infosys reported a worrying loss of pricing power, prompting us to sell out even after a steep fall in the price. We took a new holding in Hero Honda, a producer of motorcycles which benefits particularly from the increase in middle class purchasing power.

Other emerging markets

During the year we made a sizeable increase in our exposure to Russia, where we feel that corporate governance continues to improve dramatically and valuations still look very modest. We were rewarded by a rise in the market in contrast to so much of the investment world. We raised our stake in the rapidly growing integrated oil company, Yukos, and bought positions in Norilsk Nickel, Lukoil and Gazprom, three other commodity producers. We also purchased a holding in Teva, an Israeli company that is one of the leading generic pharmaceutical companies in the world. We think that this industry will continue to benefit from major patent expiries from the proprietary pharmaceutical companies.

Latin America was disappointing last year, with the MSCI Latin American Index falling by 37.4% in sterling terms. Although our holding in the Baillie Gifford Latin American Fund outperformed its benchmark by a significant margin, it still suffered a substantial loss. Within this, Mexico was impacted by the weakness in the US economy and Brazil was hit by concerns about the new left-of-centre government. We reduced our exposure to the region during the year but remain positive about the medium term outlook, especially given the current low valuations.

We continue to believe that emerging markets offer the most appealing investment opportunities available to us. Economic and corporate prospects are strong whilst ratings remain reasonable. It is probable that we will make further net purchases in the coming year.

1 *Norilsk Nickel's Nadezda smelting facility in Siberia.*
Picture courtesy of Norilsk Nickel.

2 *Samsung Electronics is one of the leading global brands in cellular devices.*
Picture courtesy of Samsung Electronics.

Fixed Interest

As of 31 March 2003 the Company held 29 fixed interest securities and one bond fund with an aggregate value of £94.4m. The average redemption yield on the portfolio is 7.0% and its average expected maturity is 9.8 years. The portfolio is composed exclusively of corporate bonds with a range of credit ratings from AAA to B. The average credit rating using the Moody's credit rating agency's methodology, is BBB-. Over the year the bond portfolio has increased by 24% by market value and the number of holdings by eight. The return on the portfolio over the review period was 20.1%. This was a highly satisfactory result. The income earned on the portfolio is relatively high – its running yield is in excess of 6%.

At the beginning of the review period the Company had significant exposure to bonds issued by European banks. This approach has prospered: as the sophistication of financial markets has grown and regulatory oversight tightened, well-run banks have better managed exposure to corporate credit risk than in previous cycles. We have now taken profits on much of this position. We subsequently bought a position in investment grade telecom companies through France Telecom. The company laid out a clear plan for reducing its indebtedness and has the advantage, for now, of unusually high profitability in mobile telephony. France Telecom has executed its recovery plan well so far and the risk premium on the bonds has fallen sharply. We also benefited from a strong rally in the Bank of Scotland SAMS bond which has been pulled up by the housing boom.

The outlook for interest rates is unclear. The world economy is pulling out of recession more slowly than we were expecting a year ago but real interest rates are already at abnormally low levels and would be likely to move sharply higher if trend growth is re-established. The outlook for corporate bonds is similarly balanced. There are high expectations of corporate deleveraging allowing over-indebted companies to improve their credit standings. While we see some good examples of this (as in the case of France Telecom), many other companies are struggling to improve operating cash flow and are falling prey to the consequences of past strategic errors. Within such an ambiguous market environment, successful credit selection and monitoring will be vital.

1 *Barry Callebaut is the world's largest independent chocolate maker.*

2 *Popular demand for new services such as picture messaging translates into rapid growth for Vodafone.*

Classification	Name	Business	Market value £'000	%
UNITED KINGDOM				
Mining	Xstrata	Diversified mining	9,278	0.9
Oil and gas	BG Group	Integrated gas	6,006	
	BP	Integrated oil	23,441	
	Shell Transport & Trading	Integrated oil	10,656	
			40,103	3.8
Construction and building materials	Bellway	House builder	4,326	
	Bovis Homes	House builder	4,398	
	Redrow	House builder	5,240	
	Travis Perkins	Builders' merchant	2,273	
	Wolseley	Builders' merchant	11,520	
			27,757	2.6
Beverages	Allied Domecq	Branded spirits	11,737	
	Diageo	Branded spirits	17,653	
			29,390	2.8
Healthcare and pharmaceuticals	Alliance UniChem	Wholesale distributor of pharmaceutical products	8,539	
	AstraZeneca	Pharmaceuticals	4,961	
	Cambridge Antibody Tech	Pharmaceuticals	442	
	GlaxoSmithKline	Pharmaceuticals	39,862	
	Shire Pharmaceuticals	Pharmaceuticals	2,352	
			56,156	5.4
Tobacco	British American Tobacco	Tobacco	13,865	
	Gallaher Group	Tobacco	11,273	
	Imperial Tobacco	Tobacco	11,718	
			36,856	3.5
Retailers	Dixons Group	Electrical retailer	3,256	0.3
Leisure and hotels	P & O Princess Cruises	Global cruise company	7,562	0.7
Media and entertainment	*Aegis Group*	*Media services*	2,861	
	British Sky Broadcasting	Pay TV	5,306	
	Reed Elsevier	Professional information publisher	10,590	
	Trinity Mirror	Newspaper publisher	7,270	
			26,027	2.5
Support services	Bunzl	Distributor of consumable products	7,281	
	Capita Group	Support services	4,494	
	Compass Group	*Contract catering*	8,762	
	Premier Farnell	Distributor of electronic components	1,572	
			22,109	2.1
Transport	easyJet	Airline	1,371	0.1
Telecommunication services	† Vodafone Group	Mobile telecommunications services	47,355	4.5
Electricity	Scottish & Southern Energy	Electricity utility	7,384	0.7
Banks	Barclays	Banking	22,716	
	HBOS	Banking	12,769	
	HSBC Holdings	Banking	25,103	
	Lloyds TSB Group	*Banking*	8,765	
	Royal Bank of Scotland	Banking	28,472	
	Standard Chartered	Banking	5,260	
			103,085	9.8
Insurance	Jardine Lloyd Thompson Group	Insurance broker	2,319	0.2
Life assurance	Aviva	Life assurance	13,460	
	Prudential	Life assurance	6,202	
			19,662	1.9
Investment companies	UK Balanced Property Trust	Property investment trust	8,330	0.8
Real estate	Hammerson	Property	3,079	
	Shaftesbury	Property	2,261	
			5,340	0.5

† denotes holding partly in convertible loan stock

Classification	Name	Business	Market value £'000	%
Other financial	Cattles	Consumer credit	471	
	Intermediate Capital Group	Mezzanine finance provider	4,626	
	Man Group	Hedge fund manager	7,947	
			13,044	1.3
Software and computer services	Sage	Business software	4,175	0.4
	TOTAL UNITED KINGDOM EQUITIES		470,559	44.8
CONTINENTAL EUROPE				
Oil and gas	ENI	Oil and gas – Italy	4,681	0.4
Construction and building materials	CRH	Building materials – Ireland	4,115	0.4
Engineering and machinery	Atlas Copco	Engineering – Sweden	7,424	0.7
Automobiles	BMW	Automobiles – Germany	4,127	
	Porsche	Automobiles – Germany	4,395	
			8,522	0.8
Healthcare and pharmaceuticals	Novartis	Pharmaceuticals – Switzerland	4,614	
	Sanofi-Synthelabo	Pharmaceuticals – France	5,468	
			10,082	1.0
Personal care and household products	L'Oreal	Personal care – France	3,908	0.4
Retailers	Hermes	Luxury goods – France	2,760	0.3
Media and entertainment	VNU	Publishing and media research – Netherlands	5,744	0.5
Support services	Adecco	Recruitment agency – Switzerland	2,320	0.2
Telecommunication services	# France Telecom	Telecommunications – France	7,126	
	Orange	Mobile telecommunications – France	4,248	
			11,374	1.1
Insurance	Swiss Re	Reinsurance – Switzerland	4,388	0.4
Investment companies	Baillie Gifford European Smaller Companies Fund	Small company fund	7,423	0.7
Information technology hardware	Ericsson	Telecommunications equipment – Sweden	1,817	
	Nokia	Mobile telecommunications equipment – Finland	10,247	
			12,064	1.1
Software and computer services	SAP	Business software – Germany	7,945	0.8
	TOTAL EUROPEAN EQUITIES		92,750	8.8

# denotes holding partly in warrants

Classification	Name	Business	Market value £'000	%
NORTH AMERICA				
Oil and gas	Suncor Energy	Oil company – Canada	11,290	1.1
Food producers and processors	William Wrigley	Chewing gum	12,510	1.2
Healthcare and pharmaceuticals	Eli Lilly	Pharmaceuticals	7,592	
	Pfizer	Pharmaceuticals	16,204	
	Wellpoint	Managed care	18,208	
	Wyeth	Pharmaceuticals	6,221	
			48,225	4.6
Tobacco	Altria	Tobacco and food	11,240	1.1
Retailers	Costco Wholesale	Warehouse clubs	9,233	
	Tiffany	Jeweller	5,524	
	TJX	Off-price clothing	4,676	
	Walgreen	Pharmacy chain	10,183	
			29,616	2.8
Leisure and hotels	Wendy's	Restaurants	4,786	0.4
Media and entertainment	Omnicom	Advertising agency	11,926	1.1
Banks	M&T Bank	Banking	11,633	1.1
Insurance	Marsh & McLennan	Insurance and fund management	12,675	1.2
Other financial	Freddie Mac	Mortgages	18,049	
	Golden West Financial	Savings and loans	26,848	
	Moody's	Bond rating agency	9,622	
	State Street	Custodian bank	7,864	
			62,383	5.9
Information technology hardware	Analog Devices	Semiconductors	8,229	
	Microchip Technology	Semiconductors	4,092	
			12,321	1.2
Software and computer services	Automatic Data Processing	Payroll processing	6,818	
	DST Systems	Mutual fund processing	7,348	
	First Data	Transaction processing	9,646	
			23,812	2.3
	TOTAL NORTH AMERICAN EQUITIES		252,417	24.0
JAPAN				
Chemicals	Konica	Office equipment and imaging	2,485	
	Sumitomo Chemical	Diversified chemicals	2,781	
			5,266	0.5
Construction and building materials	Tostem Inax Holdings	Building materials	2,519	0.2
Electronic and electrical equipment	Canon	Printers and copiers	2,341	0.2
Automobiles	Toyota Motor	Car manufacturer	2,355	0.2
Healthcare and pharmaceuticals	Kao	Household goods	3,297	
	Takeda Chemical Industries	Pharmaceuticals	3,900	
			7,197	0.7
Retailers	Yamada Denki	Consumer electronics retailer	2,689	0.3
Media and entertainment	Fuji Photo Film	Photographic imagery	1,806	0.2
Transport	East Japan Railway	Railway operator	3,104	0.3

Classification	Name	Business	Market value £'000	%
Telecommunication services	NTT	Telecommunications	1,754	
	NTT DoCoMo	Mobile telecommunications	3,696	
			5,450	0.5
Banks	UFJ Holdings	Bank	1,824	0.2
Other financial	*MAC Japan Active Shareholder Fund Limited Partnership	Shareholder activist fund	4,917	
	Promise	Consumer finance	3,416	
			8,333	0.8
Information technology hardware	Hitachi	Electronics conglomerate	1,937	
	Rohm	Specialist semiconductors	2,687	
			4,624	0.4
	TOTAL JAPANESE EQUITIES		47,508	4.5
ASIA PACIFIC				
Mining	BHP Billiton	Diversified resource – Australia	4,257	0.4
Diversified industrials	Hutchison Whampoa	Industrial conglomerate – Hong Kong	3,103	
	Li & Fung	Supply chain management – Hong Kong	3,326	
			6,429	0.6
Electronic and electrical equipment	Hon Hai Precision	Electronics manufacturer – Taiwan	2,621	
	Johnson Electric	Micromotor manufacturer – Hong Kong	2,081	
	Samsung Electronics	Electronics manufacturer – Korea	7,161	
			11,863	1.1
Automobiles	Hero Honda Motors	Motorcycle and scooter manufacturer – India	2,511	0.2
Beverages	Foster's Group	Brewing and wine – Australia	3,387	0.3
Media and entertainment	Tom.Com	Media – Hong Kong	1,129	0.1
Telecommunication services	SK Telecom	Wireless telecommunications provider – Korea	4,429	0.4
Banks	Australia and New Zealand Banking	Banking – Australia	4,627	
	Hang Seng Bank	Banking – Hong Kong	1,935	
			6,562	0.6
Other financial	Singapore Exchange	Securities exchange owner/operator – Singapore	3,136	0.3
Information technology hardware	Legend Holdings	PC manufacturer – Hong Kong	2,557	0.3
Software and computer services	Infosys Technologies	Software developer – India	6,732	0.7
	TOTAL ASIA PACIFIC EQUITIES		52,992	5.0
EMERGING MARKETS				
Mining	Norilsk Nickel	Mining company – Russia	4,958	0.5
Oil and gas	Gazprom	Gas producer – Russia	2,353	
	Lukoil	Oil company – Russia	4,206	
	Petrobras	Oil company – Brazil	3,047	
	Yukos	Oil company – Russia	11,499	
			21,105	2.0
Healthcare and pharmaceuticals	Teva Pharmaceuticals	Generic drugs manufacturer – Israel	3,689	0.3
Investment companies	Baillie Gifford Latin American Fund	Investment fund – Latin America	10,372	1.0
	TOTAL EMERGING MARKETS EQUITIES		40,124	3.8

* denotes unlisted security

Classification	Name		Market value £'000	%
	Value of equity stocks and OEICs	950,473		
	Convertible loan stock having an element of equity	4,726		
	Warrant having an element of equity	1,151		
TOTAL EQUITY INVESTMENTS			956,350	90.9
FIXED INTEREST				
Sterling denominated	Bank of Scotland (SAMS) 2072	23,203		
	BG Energy Capital 6.375% 2008	3,433		
	Big Food Group 9.75% 2012	795		
	British Gas 8.875% 2008	4,137		
	Cairngorm F/R 2016	2,970		
	Castle Transmission 9% 2007	1,470		
	France Telecom 7.25% 2020	3,495		
	France Telecom 8% 2017	3,356		
	Gallaher Group 6.625% 2009	3,441		
	GUS Plc 5.625% 2013	300		
	Innogy 8.375% 2006	6,923		
	Pemex Project 7.5% 2013	1,973		
	RHM Finance 8.8% 2017	3,135		
	Scottish Mutual Assurance 7.25% Perpetual	1,615		
	Unique Pub Finance 6.464% 2032	2,554		
	Vodafone 5.9% 2032	2,997		
		65,797		
Euro denominated	ACM European Enhanced Income Fund	2,800		
	Barry Callebaut 9.25% 2010	363		
	BSCH Issuances 5.125% 2009	3,530		
	Eco-Bat Finance 10.125% 2013	1,386		
	Kamps 8.5% 2009	2,206		
	Kronos 8.875% 2009	1,374		
	Messer Griesheim 10.375% 2011	2,982		
	Norsk Hydro 6.25% 2010	3,818		
	Nymphenburg FRN 2025	2,734		
	PTC International Finance II 11.25% 2009	1,526		
	Sanitec International 9% 2012	968		
	TRW Automotive 10.125% 2013	1,561		
		25,248		
US$ denominated	British Sky Broadcasting 8.2% 2009	1,417		
	Smurfit Capital 6.75% 2005	1,936		
		3,353		
TOTAL FIXED INTEREST			94,398	9.0
NET LIQUID ASSETS			797	0.1
TOTAL ASSETS AT MARKET VALUE (before deduction of debentures and short term borrowings)			1,051,545	100.0

CAPITAL

At 31 March	Total assets £'000	Debenture stocks, long and short term borrowings £'000	Equity shareholders' funds £'000	Equity shareholders' funds per share p	Net asset value per share* p	Share price p	Discount † %
1993	1,029,800	239,710	790,090	219.0	220.3	184.5	16.3
1994	1,047,750	123,542	924,208	256.2	257.4	219.0	14.9
1995	1,072,822	195,505	877,317	243.2	244.4	217.0	11.2
1996	1,323,010	209,871	1,113,139	308.6	309.8	268.7	13.3
1997	1,472,300	256,229	1,216,071	337.1	338.4	290.5	14.2
1998	1,877,159	303,063	1,574,096	436.4	437.4	384.0	12.2
1999	1,868,328	222,427	1,645,901	456.3	457.3	375.5	17.9
2000	2,206,594	279,010	1,927,584	569.1	570.2	493.5	13.5
2001	1,660,182	195,893	1,464,289	445.4	447.5	377.0	15.8
2002	1,509,887	206,899	1,302,988	421.4	423.6	369.0	12.9
2003	**1,051,545**	**207,225**	**844,320**	**283.3**	**285.5**	**234.5**	**17.9**

* Net asset value per ordinary share has been calculated after deducting prior charges at par value (see note 18, page 43).
† Discount is the difference between Scottish Mortgage's quoted share price and its underlying net asset value.

REVENUE / GEARING RATIOS

Year to 31 March	Gross revenue £'000	Available for ordinary shareholders £'000	Earnings per ordinary share ‡ p	Dividend per ordinary share net p	Expense ratio § %	Actual gearing ¶	Potential gearing ‖
1993	37,442	13,818	3.83	4.00	0.31	107	130
1994	35,751	14,847	4.12	4.10	0.34	106	113
1995	42,504	19,390	5.37	4.40	0.24	105	122
1996	48,114	21,394	5.93	4.65	0.29	101	119
1997	50,571	24,604	6.82	5.15	0.27	104	121
1998	52,184	21,685	6.01	5.35	0.37	107	119
1999	44,894	20,263	5.62	5.50	0.38	107	114
2000	44,100	27,807**	7.82**	5.65	0.50	105	114
2001	44,075	25,212	7.57	6.00	0.51	104	113
2002	36,377	24,213	7.56	6.25	0.47	109	116
2003	**33,909**	**22,597**	**7.43**	**6.60**	**0.49**	**113**	**125**

‡ The calculation of earnings per ordinary share is based on the revenue from ordinary activities after taxation and the weighted *average number of ordinary shares in issue (see note 8, page 38).*
§ Ratio of total operating costs to average shareholders' funds.
¶ Total assets (including all debt used for investment purposes) less all cash and fixed interest securities (ex convertibles) divided by shareholders' funds.
‖ Total assets (including all debt used for investment purposes) divided by shareholders' funds.
** Restated for change in accounting policy to charge expenses 50:50 between revenue and capital.

CUMULATIVE PERFORMANCE

At 31 March	Net asset value per share	Net asset value total return ††	Share price	Share price total return ††	Benchmark	Benchmark total return‡‡	Earnings per ordinary share	Dividend per ordinary share net	Retail price index
1993	100	100	100	100	100	100	100	100	100
1994	117	118	119	121	112	115	108	103	102
1995	111	115	118	122	109	116	140	110	106
1996	141	148	146	154	134	147	155	116	109
1997	154	164	157	170	142	161	178	129	112
1998	199	215	208	228	183	213	157	134	115
1999	208	229	204	228	200	237	147	138	118
2000	259	287	267	302	231	278	204	141	121
2001	203	227	204	233	198	243	198	150	124
2002	192	218	200	232	188	235	197	156	125
2003	**130**	**150**	**127**	**151**	**127**	**163**	**194**	**165**	**129**
Compound Annual Returns									
5 year	(8.2%)	(7.0%)	(9.4%)	(8.0%)	(7.1%)	(5.2%)	4.3%	4.3%	2.3%
10 year	2.6%	4.1%	2.4%	4.2%	2.4%	5.0%	6.9%	5.1%	2.6%

†† *Source: AITC.*
‡‡ Source: Thomson Financial Datastream.

Directors' Report

The Directors have pleasure in submitting their Annual Report together with the results of the Company for the year to 31 March 2003.

Review of Activities

During the year under review the Company has followed the normal activities of an investment trust company. A review of the main features of the year is contained in the Chairman's Statement and in the Managers' Portfolio Review on the preceding pages.

Dividends

The Board recommends a final dividend of 4.50p per ordinary share which, together with the interim already paid, makes a total of 6.60p for the year compared with 6.25p for the previous year.

If approved, the recommended final dividend on the ordinary shares will be paid on 9 July 2003 to shareholders on the register at the close of business on 13 June 2003.

After payment of the dividend the accumulated revenue balance is increased by £2,867,000 to £50,889,000.

Status

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

The Company carries on business as an investment trust. It was approved by the Inland Revenue as an investment trust under section 842 of the Income and Corporation Taxes Act 1988 for the year ended 31 March 2002, subject to any matters that may arise from any subsequent enquiry by the Inland Revenue into the Company's tax return. In the opinion of the Directors the Company has subsequently conducted its affairs so as to enable it to continue to obtain such approval and will continue to seek approval under section 842 of the Income and Corporation Taxes Act 1988 each year.

Corporate Governance

The Board has considered the principles set out in the Combined Code and believes that the Company's current practice, given the special circumstances of an investment trust company is, in all material respects, consistent with the principles of the Combined Code.

The Principles of Good Governance

The Board

The Board's regular meetings take place every two months. It has a number of matters reserved for its approval including investment policy, borrowings, treasury matters and dividend policy. The Board also reviews the financial statements, investment transactions, revenue budgets and performance.

The Board currently comprises six Directors all of whom are non-executive and independent of the Company's Managers. The executive responsibilities for investment management have been delegated to the Company's Managers and Secretaries, Baillie Gifford & Co, and in the context of a Board comprised entirely of non-executive Directors, there is no chief executive officer. Lord Sanderson was appointed Chairman in 1993 and is also the senior independent member. The Directors all have appropriate business and financial experience with which to conduct the business of the Board. Information about them can be found on page 4.

Given the non-executive nature of the Board a separate nomination committee has not been established. It is the view of the Board that the appointment of new Directors should be a matter for consideration by the Board as a whole. Upon appointment each Director is provided with a summary of the responsibilities and duties of directors, together with relevant background information on the Company. Consistent with the recommendation of the Code of Best Practice, the Board will arrange appropriate training for new Directors where necessary.

Under the provisions of the Company's Articles, a Director appointed during the year is required to retire and seek election by shareholders at the next Annual General Meeting. The Articles also require that one third of the Directors retire by rotation and submit themselves for re-election. In order to ensure compliance with the spirit of this provision, the Board has resolved further that no Director shall serve for a period of greater than three consecutive years without submitting himself for re-election.

There is an agreed procedure for Directors to seek independent professional advice if necessary and at the Company's expense.

Remuneration

Since all Directors are non-executive, the Company is not required to comply with principles B.1 to B.3 of the Combined Code in respect of executive Directors' remuneration. The Company's policy on remuneration is set out in the Directors' Remuneration Report on pages 29 and 30.

Internal Controls and Risk Management

The practical measures to ensure compliance with regulation and company law, and to provide effective and efficient operations and investment management, have been delegated to the Managers and Secretaries, Baillie Gifford & Co, under the terms of the Management Agreement. The Board acknowledges its responsibilities to supervise and control the discharge by the Managers and Secretaries of their obligations.

Baillie Gifford & Co is responsible for the design, implementation and maintenance of control policies and procedures to safeguard the assets of the Company and to manage its affairs properly. This responsibility also extends to maintaining effective operational and compliance controls and risk management.

The Company's investments are segregated from those of Baillie Gifford & Co and its other clients through the appointment of The Bank of New York and Mizuho Corporate Bank, Limited as independent custodians of the Company's investments.

Baillie Gifford & Co has an established compliance function in accordance with Financial Services Authority regulations. The compliance function provides the Board with a report on monitoring procedures at least annually. Baillie Gifford & Co conducts an annual review of its system of internal controls which is documented within an internal controls report. This report is independently reviewed by Baillie Gifford & Co's auditors. A copy of the internal controls report is submitted to the Board. The Baillie Gifford & Co partner in charge of internal audit and compliance provides the Board with regular reports on its monitoring programmes.

The Directors acknowledge their responsibility for the Company's system of internal controls and for reviewing its effectiveness. The system of internal controls is designed to manage rather than eliminate risk and can only provide reasonable but not absolute assurance against material misstatement or loss. The Directors confirm that they have reviewed the effectiveness of the system and they have procedures in place to review its effectiveness on a regular basis.

The Board has undertaken a full review of all aspects of the published guidance "Internal Control: Guidance for Directors on the Combined Code" (the Turnbull guidance) and has established an ongoing process for identifying, evaluating and managing the significant risks faced by the Company, in accordance with the Turnbull recommendations. To ensure that risk management and internal controls are considered on a regular basis and that a full risk and control assessment is undertaken on an annual basis, the following processes have been established in compliance with the guidance:

- internal controls strategy has been formalised following the production of a detailed risk map whereby significant risks are identified and the key controls to manage these risks are confirmed as in place and operating effectively;
- reporting procedures for the internal audit department, in respect of its risk framework monitoring and audit programme, and the compliance department, in respect of its regulatory monitoring programme, are defined and formalised within a service level agreement; and
- regular reports on internal controls are prepared by the Managers and submitted for Board review.

These procedures ensure that consideration is given regularly to the nature and extent of the risks facing the Company and that they are being actively monitored. Where changes in risk have been identified during the year they also provide a mechanism to assess whether further action is required to manage the risks identified. The Board confirms that these procedures have been in place throughout the Company's financial year, are operating effectively and continue to be in place up to the date of approval of this Report.

Accountability and Audit

The respective responsibilities of the Directors and the auditors in connection with the Financial Statements are set out on pages 30 and 31.

The accounts have been prepared on the going concern basis as it is the Directors' opinion that the Company will continue in operational existence for the foreseeable future.

An audit committee has been established in compliance with the Combined Code consisting of all independent non-executive Directors (the entire Board). Its authority and duties are clearly defined within its written terms of reference. The Chairman of the Board has been appointed Chairman of the Audit Committee. The committee meets periodically to review the Company's interim and annual financial statements. It meets at least annually with the external auditors and approves the level of fees for audit and non-audit services.

An Investment Management Agreement between the Company and Baillie Gifford & Co sets out the matters over which the Managers have authority in accordance with the policies and directions of, and subject to restrictions imposed by, the Board. The Management Agreement is terminable on not less than 12 months' notice and the Audit Committee regularly reviews the terms of the Management Agreement.

Relations with Shareholders

The Company's Managers meet regularly with shareholders and their representatives and report to the Board. The Company's Annual General Meeting provides a forum for communication with shareholders and the Board announces the level of proxies lodged. The notice period for the Annual General Meeting is at least twenty working days.

The Company has given discretionary voting powers to the investment managers, Baillie Gifford & Co. The Managers vote against resolutions they consider may damage shareholders' rights or economic interests. Baillie Gifford & Co give due weight to what they consider to be socially responsible investment when making investment decisions, but their overriding objective is to produce good investment returns for shareholders.

Compliance

The Board considers that throughout the year the Company has been in compliance with the Combined Code provisions set out in Section 1 of the Combined Code on Corporate Governance issued by the UK Listing Authority of the Financial Services Authority. There is no nomination committee, the absence of which has been explained above. As previously stated, internal control procedures have been in place throughout the Company's financial year which accord with the guidance for directors on compliance with the Combined Code.

Directors

The Directors at the year end, and their interests in the Company, were as follows:

Name	**Nature of interest**	**Ordinary 25p shares held at** *31 March 2003*	*31 March 2002*
Lord Sanderson of Bowden	Beneficial	66,177	65,606
	Non-beneficial	2,000	29,500
GA Ball	Beneficial	10,000	10,000
Sir Donald MacKay	Beneficial	2,469	2,469
WG McQueen	Beneficial	1,500	1,500
	Non-beneficial	3,000	3,000
The Earl of Portarlington	Beneficial	936,000	936,000
JPHS Scott	Beneficial	2,129	2,088

Mr GA Ball retires by rotation and, being eligible, is recommended by the Board for re-election.

Lord Sanderson of Bowden will retire from the Board at the conclusion of the Annual General Meeting.

Mr FPM Johnston retired from the Board on 4 July 2002.

There have been no changes intimated in the Directors' interests up to 6 May 2003.

Substantial Holdings

The following information has been intimated to the Company as at 6 May 2003 in compliance with section 198 of the Companies Act 1985:

Name	Number of ordinary 25p shares held	% of issue
DC Thomson and Co Ltd	15,000,000	5.0
Prudential plc	10,938,100	3.7
Legal & General Investment Management	9,092,051	3.1

Repurchase of Shares

At the Annual General Meeting held on 4 July 2002 the Company renewed its authority to purchase shares in the market, in respect of up to 46,065,722 ordinary shares (equivalent to 14.99% of its then issued share capital), such authority to expire at the conclusion of the Annual General Meeting of the Company to be held in 2003 or 3 January 2004, whichever is earlier, unless previously varied, revoked or renewed.

During the year to 31 March 2003 the Company bought back 11,179,573 ordinary shares (nominal value £2,795,000), *on the London Stock Exchange for cancellation. The total consideration for these shares was* £30,599,000. Between 1 April 2003 and the date of this report the Company has bought back a further 700,000 *shares for cancellation at a cost of £1,778,000.*

The principal reasons for such share buy-backs are:

(i) to enhance net asset value for continuing shareholders by purchasing shares at a discount to the prevailing net asset value;

(ii) to address any imbalance between the supply of and the demand for Scottish Mortgage's shares that results in a discount of the quoted market price to the published net asset value per share.

The shares in question were purchased at a price (after allowing for costs) below the net asset value and subsequently cancelled, thereby reducing the issued share capital (see note 15 on page 42). As a result of such purchases the net asset value of the Company has increased by approximately 0.8%.

The Directors are seeking shareholders' approval at the Annual General Meeting to renew the authority to purchase up to 14.99% of the Company's ordinary shares in issue at the date of the passing of the resolution, such authority to expire at the Annual General Meeting of the Company to be held in 2004 or 2 January 2005. Under the Listing Rules of the UK Listing Authority of the Financial Services Authority, the maximum price that may be paid on the exercise of the authority must not exceed 105% of the average of the middle market quotations for the shares over the five business days immediately preceding the date of purchase. The minimum price that may be paid will be 25p per share. Purchases of shares will be made within guidelines established, from time to time, by the Board. Your attention is drawn to Special Business, Resolution No. 7, in the Notice of Annual General Meeting.

Change of Name

An amendment to the Company's name from 'The Scottish Mortgage and Trust PLC' to 'Scottish Mortgage Investment Trust PLC' is being proposed in Resolution No. 8, in the Notice of Annual General Meeting. The proposed amendment seeks to clarify the nature of the Company for the retail investor market and will become effective from such date as the Directors shall determine, not being later than 31 August 2003, thereby providing sufficient time to amend all shareholder communications and retail literature.

Creditor Payment Policy

It is the Company's payment policy for the forthcoming financial year to obtain the best terms for all business. In general, the Company agrees with its suppliers the terms on which business will take place and it is its policy to abide by these terms. The Company had no trade creditors at 31 March 2003.

Auditors

The auditors, KPMG Audit Plc, are willing to continue in office and in accordance with section 385 and section 390A of the Companies Act 1985 resolutions concerning their reappointment and remuneration will be submitted to the Annual General Meeting.

By order of the Board

BAILLIE GIFFORD & Co
Managers and Secretaries
7 May 2003

Baillie Gifford & Co

Directors' Remuneration Report

The Board has prepared this report, in accordance with the requirements of Schedule 7A to the Companies Act 1985, which applies for the first time this financial year. An ordinary resolution for the approval of this report will be put to the members at the forthcoming Annual General Meeting.

The law requires the Company's auditors to audit certain of the disclosures provided. Where disclosures have been audited, they are indicated as such. The auditors' opinion is included in their report on page 31.

Remuneration Committee

The Company has six Directors all of whom are non-executive. There is no separate remuneration committee and the Board as a whole considers changes to Directors' fees from time to time. Baillie Gifford & Co, who have been appointed by the Board as Managers and Secretaries, provide advice when the Board considers the level of Directors' fees.

Policy on Directors' fees

The Board's policy is that the remuneration of Directors should be set at a reasonable level that is commensurate with the duties and responsibilities of the role and consistent with the requirement to attract and retain Directors of the appropriate quality and experience. It should also reflect the experience of the Board as a whole, be fair and should take account of the level of fees paid by comparable investment trusts. It is intended that this policy will continue for the year ended 31 March 2004 and subsequent years.

The fees for the non-executive Directors are determined within the limits set out in the Company's Articles of Association. These state that the fees paid to the Chairman shall not exceed £30,000 per annum and those paid to a Director shall not exceed £20,000 per annum. Non-executive Directors are not eligible for bonuses, pension benefits, share options, long-term incentive schemes or other benefits.

The Board carried out a review of the level of Directors' fees during the year, and concluded that the fees should be increased from £21,000 to £22,000 for the Chairman and from £15,000 to £16,000 per Director. The increase was effective from 1 April 2002.

Directors' and officers' liability insurance cover is held by the Company in respect of the Directors.

Directors' service contracts

It is the Board's policy that none of the Directors has a service contract. All of the Directors were provided with appointment letters during the course of the year. The terms of their appointment provide that a Director shall retire and be subject to re-election at the first Annual General Meeting after their appointment. Thereafter they are obliged to retire by rotation, and, if they wish, to offer themselves for re-election, at least every three years after that. There is no notice period and no provision for compensation upon early termination of appointment.

Company performance

The graph below compares the total return (assuming all dividends are reinvested) to ordinary shareholders compared to the total shareholder return on a notional investment made up of shares in the component parts of the FTSE All-Share Index. This index was chosen for comparison purposes, as it is a widely used measure of performance for UK listed companies. (Benchmark provided for information purposes only.)

Source: Thomson Financial Datastream.

*All figures are total return (assuming all dividends are reinvested).

**Benchmark: 50% FTSE All-Share Index and 50% FTSE World Ex UK Index (in sterling terms).

Directors emoluments for the year (audited)

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

	Fees 2003 £	Fees 2002 £
Lord Sanderson of Bowden (Chairman)	22,000	21,000
GA Ball	16,000	15,000
FPM Johnston (retired 4 July 2002)	4,164	15,000
Sir Donald MacKay	16,000	15,000
WG McQueen	16,000	15,000
The Earl of Portarlington	16,000	15,000
JPHS Scott (appointed 31 October 2001)	16,000	6,205
Sir John Shaw (retired 5 July 2001)	-	3,945
	106,164	106,150

Approval

The Directors' Remuneration Report on pages 29 and 30 was approved by the Board of Directors on 24 April 2003 and signed on its behalf by

Chairman

Sanderson of Bowden

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

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

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

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

Independent Auditors' Report

TO THE MEMBERS OF THE SCOTTISH MORTGAGE AND TRUST PLC ('the Company')

We have audited the financial statements on pages 32 to 44. 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 auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditors

The Directors are responsible for preparing the Annual Report and the Directors' Remuneration Report. As described on page 30, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

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

We review whether the statement on pages 25 to 27 reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

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

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the 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 financial statements give a true and fair view of the state of affairs of the Company as at 31 March 2003 and of its total return for the year then ended; and
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Edinburgh
7 May 2003

KPMG Audit Plc

STATEMENT OF TOTAL RETURN
(incorporating the revenue account*)

		for the year ended 31 March 2003			for the year ended 31 March 2002		
	Notes	**Revenue £'000**	**Capital £'000**	**Total £'000**	**Revenue £'000**	**Capital £'000**	**Total £'000**
Losses on investments	9	–	(421,063)	(421,063)	–	(89,951)	(89,951)
Currency (losses)/gains	16	–	(701)	(701)	–	3,447	3,447
Income	2	33,909	–	33,909	36,377	–	36,377
Investment management fee	3	(2,053)	(2,053)	(4,106)	(2,695)	(2,695)	(5,390)
Other administrative expenses	4	(1,185)	–	(1,185)	(1,103)	–	(1,103)
NET RETURN BEFORE FINANCE COSTS AND TAXATION		30,671	(423,817)	(393,146)	32,579	(89,199)	(56,620)
Finance costs of borrowings	5	(7,119)	(7,119)	(14,238)	(7,396)	(7,393)	(14,789)
RETURN ON ORDINARY ACTIVITIES BEFORE TAXATION		23,552	(430,936)	(407,384)	25,183	(96,592)	(71,409)
Tax on ordinary activities	6	(955)	–	(955)	(970)	–	(970)
RETURN ON ORDINARY ACTIVITIES AFTER TAXATION *for the financial year attributable to equity shareholders*		22,597	(430,936)	(408,339)	24,213	(96,592)	(72,379)
Dividends in respect of equity shares	7	(19,730)	–	(19,730)	(19,453)	–	(19,453)
TRANSFER TO/(FROM) RESERVES		2,867	(430,936)	(428,069)	4,760	(96,592)	(91,832)
RETURN PER ORDINARY SHARE	8	7.43p	(141.69p)	(134.26p)	7.56p	(30.17p)	(22.61p)

* The revenue column of this statement is the profit and loss account of the Company.
All revenue and capital items in this statement derive from continuing operations.
The accompanying notes on pages 35 to 44 are an integral part of this statement.

	Notes	at 31 March 2003 £'000	at 31 March 2003 £'000	at 31 March 2002 £'000	at 31 March 2002 £'000
FIXED ASSETS					
Investments	9		1,050,748		1,493,041
CURRENT ASSETS					
Debtors	11	22,360		16,874	
Cash at bank and in hand	10	3,915		18,279	
		26,275		35,153	
CREDITORS					
Amounts falling due within one year	12	(48,953)		(41,621)	
NET CURRENT LIABILITIES			(22,678)		(6,468)
TOTAL ASSETS LESS CURRENT LIABILITIES			1,028,070		1,486,573
CREDITORS					
Amounts falling due after more than one year	13		(183,750)		(183,585)
			844,320		1,302,988
CAPITAL AND RESERVES					
Called-up share capital	15		74,501		77,296
Capital redemption reserve	16		15,679		12,884
Capital reserve – realised	16		798,814		939,610
Capital reserve – unrealised	16		(95,563)		225,176
Revenue reserve	16		50,889		48,022
EQUITY SHAREHOLDERS' FUNDS	17		844,320		1,302,988
NET ASSET VALUE PER ORDINARY SHARE	18		285.5p		423.6p

The Accounts were approved by the Board and signed on their behalf on 7 May 2003.

Chairman

The accompanying notes on pages 35 to 44 are an integral part of this statement.

CASH FLOW STATEMENT

	Notes	for the year ended 31 March 2003 £'000	for the year ended 31 March 2003 £'000	for the year ended 31 March 2002 £'000	for the year ended 31 March 2002 £'000
NET CASH INFLOW FROM OPERATING ACTIVITIES	20		27,837		29,925
SERVICING OF FINANCE					
Interest paid		(14,287)		(15,012)	
NET CASH OUTFLOW FROM SERVICING OF FINANCE			(14,287)		(15,012)
TAXATION					
Income tax paid		(48)		(34)	
Overseas tax suffered		(961)		(998)	
TOTAL TAX PAID			(1,009)		(1,032)
FINANCIAL INVESTMENT					
Acquisitions of investments		(347,442)		(495,639)	
Disposals of investments		371,734		539,802	
Realised currency loss		(323)		(552)	
NET CASH INFLOW FROM FINANCIAL INVESTMENT			23,969		43,611
EQUITY DIVIDENDS PAID			(19,460)		(19,791)
NET CASH INFLOW BEFORE FINANCING			17,050		37,701
FINANCING					
Shares purchased for cancellation		(31,414)		(67,249)	
Loans repaid		–		(79,350)	
Loans drawn down		–		94,423	
Realised currency loss on multi-currency loans		–		(26)	
NET CASH OUTFLOW FROM FINANCING			(31,414)		(52,202)
DECREASE IN CASH	21		(14,364)		(14,501)
RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT	21				
Decrease in cash in the period			(14,364)		(14,501)
Increase in bank loans			–		(15,047)
Exchange movement			(378)		3,999
Other non-cash changes			52		42
MOVEMENT IN NET DEBT IN THE YEAR			(14,690)		(25,507)
NET DEBT AT 1 APRIL			(188,620)		(163,113)
NET DEBT AT 31 MARCH			(203,310)		(188,620)

The accompanying notes on pages 35 to 44 are an integral part of this statement.

1 PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies is set out in paragraphs (a) to (h) below. All have been applied consistently throughout the current and preceding year.

(a) BASIS OF ACCOUNTING

The accounts are prepared under the historical cost convention, modified to include the revaluation of fixed asset investments, and on the assumption that approval as an investment trust will continue to be granted.

The accounts have been prepared in accordance with applicable UK accounting standards and with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies'.

(b) INVESTMENTS

Listed investments are shown at middle market value, or in the case of FTSE 100 constituents, at last traded prices issued by the London Stock Exchange.

Listed investments include Open Ended Investment Companies ('OEICs') authorised in the UK; these are valued at mid price and are classified for valuation purposes according to the principal geographical area of the underlying holdings.

Unlisted investments are shown at a valuation determined by the Directors based upon latest dealing prices, stockbroker valuations, net asset values and other information, as appropriate.

(c) INCOME

(i) Income from equity investments is brought into account on the date on which the investments are quoted ex-dividend or, where no ex-dividend date is quoted, when the Company's right to receive payment is established.

(ii) Interest from fixed interest securities is recognised on an accruals basis. Fixed interest securities issued at a significant discount or premium are accounted for on an effective yield basis.

(iii) Franked income is stated net of tax credits.

(iv) Unfranked investment income includes the taxes deducted at source.

(v) Interest receivable on deposits is recognised on an accruals basis.

(vi) If scrip is taken in lieu of dividends in cash, the net amount of the cash dividend declared is credited to the revenue account.

(d) EXPENSES

All expenses are accounted for on an accruals basis. Expenses are charged through the revenue account except as follows: where they relate directly to the acquisition or disposal of an investment, in which case they are added to the cost of the investment or deducted from the sale proceeds and where they are connected with the maintenance or enhancement of the value of investments, in which case they are charged 50:50 to the revenue account and realised capital reserve.

(e) LONG TERM BORROWINGS AND FINANCE COSTS

Long term borrowings are carried in the balance sheet at the cumulative amount of net proceeds after issue, plus accrued finance costs. The finance costs of such borrowings are allocated 50:50 to the revenue account and realised capital reserve at a constant rate on the carrying amount. Issue costs are written off at a constant rate over the life of the borrowings.

(f) TAXATION

Deferred taxation is provided on all timing differences, calculated at the current tax rate relevant to the benefit or liability. Deferred tax assets are recognised only to the extent that it will be more likely than not that there will be taxable profits from which underlying timing differences can be deducted.

(g) FOREIGN CURRENCIES

Transactions involving foreign currencies are converted at the rate ruling at the time of the transaction. Assets and liabilities in foreign currencies are translated at the closing rates of exchange at the balance sheet date. Any gain or loss arising from a change in exchange rate subsequent to the date of the transaction is included as an exchange gain or loss in capital reserve or revenue reserve as appropriate.

(h) CAPITAL RESERVES

Realised: Gains and losses on realisation of investments and realised exchange differences of a capital nature are dealt with in this reserve. Purchases of the Company's own shares for cancellation are also funded from this reserve. 50% of management fees, including related VAT, and finance costs are allocated to the realised capital reserve in accordance with the Company's objective of combining capital and income growth.

Unrealised: Unrealised appreciation represents the amount by which the market value of assets and liabilities differs from their book value and is dealt with in this reserve.

	2003	2002
	£'000	**£'000**
2 INCOME		
INCOME FROM INVESTMENTS		
Franked investment income	19,072	18,063
UK unfranked investment income†	3,411	3,418
Overseas dividends	7,825	8,597
Overseas interest	2,341	4,806
	32,649	34,884
OTHER INCOME		
Deposit interest	1,078	1,484
Underwriting commission	182	9
	1,260	1,493
TOTAL INCOME	33,909	36,377
TOTAL INCOME COMPRISES		
Dividends	27,778	27,743
Interest from investments	4,871	7,141
Other	1,260	1,493
	33,909	36,377
INCOME FROM INVESTMENTS		
Listed UK	23,136	21,391
Listed overseas	9,513	13,493
	32,649	34,884

† Includes income from OEICs.

3 INVESTMENT MANAGEMENT FEE	2003			2002		
	Revenue £'000	**Capital £'000**	**Total £'000**	**Revenue £'000**	**Capital £'000**	**Total £'000**
Investment management fee	1,834	1,834	3,668	2,418	2,418	4,836
Irrecoverable VAT thereon	219	219	438	277	277	554
	2,053	2,053	4,106	2,695	2,695	5,390

Baillie Gifford & Co is employed by the Company as Managers and Secretaries under a management agreement which is terminable on not less than 12 months notice, or on shorter notice in certain circumstances. The fee in respect of each quarter is 0.08% of total assets less current liabilities (excluding short term borrowings for investment purposes) and is subject to VAT at the appropriate rate. The management fee is levied on all assets, including holdings in collective investment schemes (OEICs) managed by Baillie Gifford & Co; however the OEICs' share class held by the Company does not attract a management fee.

4 OTHER ADMINISTRATIVE EXPENSES – *all charged to revenue*	**2003**	**2002**
	£'000	***£'000***
General administrative expenses	1,065	983
Directors' fees (see Directors' Remuneration Report on pages 29 and 30)	106	106
Auditors' remuneration for audit services	14	14
	1,185	1,103

General administrative expenses include the Company's contribution to the AITC's campaign of £128,000 for the year ended 31 March 2002. There were no contributions made in the year to 31 March 2003.

	2003			2002		
	Revenue £'000	**Capital £'000**	**Total £'000**	**Revenue £'000**	**Capital £'000**	**Total £'000**
5 *FINANCE COSTS OF BORROWINGS*						
Bank loans and overdrafts repayable within five years	151	151	302	424	421	845
Debentures repayable wholly or partly in more than five years	6,968	6,968	13,936	6,972	6,972	13,944
	7,119	7,119	14,238	7,396	7,393	14,789
6 TAX ON ORDINARY ACTIVITIES						
Overseas taxation	955	–	955	970	–	970

	2003 £'000	**2002 £'000**
The tax charge for the year is lower than the standard rate of corporation tax in the UK (30%) The differences are explained below:		
Revenue return on ordinary activities before taxation	23,552	25,183
Revenue return on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2002 – 30%)	7,066	7,555
Income not taxable (franked investment income)	(5,722)	(5,419)
Expenses not deductible for tax purposes	–	38
Overseas withholding tax claimed as a deduction	(287)	(291)
Overseas withholding tax written off	955	970
Capitalised expenses	(2,752)	(3,026)
Excess expenses in period not provided for as an asset	1,695	1,143
Current tax charge for the year	955	970

Capital returns are not included in the above analysis; as an Investment Trust, the Company's capital gains are not taxable.

There is no corporation tax charge at 31 March 2003 or 31 March 2002 as the Company has unrelieved management expenses which are available to be carried forward. The tax charge for 31 March 2003 and 2002 comprises overseas withholding taxes written off.

At 31 March 2003 the Company had surplus management expenses of £24 million (2002 – £18 million) which have not been recognised as a deferred tax asset. This is because the Company is not expected to generate taxable income in a future period in excess of the deductible expenses of that future period and, accordingly, it is unlikely that the Company will be able to reduce future tax liabilities through the use of existing surplus expenses.

7 ORDINARY DIVIDENDS	**2003**	**2002**	**2003 £'000**	**2002 £'000**
Adjustment to provision for final dividend	–	–	(49)	(52)
Interim dividend per ordinary share (paid 29 November 2002)	2.10p	2.00p	6,369	6,365
Proposed final dividend per ordinary share (payable 9 July 2003)	4.50p	4.25p	13,410	13,140
	6.60p	6.25p	19,730	19,453

	2003			2002		
	Revenue	Capital	Total	Revenue	Capital	Total
8 *RETURN PER ORDINARY SHARE*	*7.43p*	*(141.69p)*	*(134.26p)*	*7.56p*	*(30.17p)*	*(22.61p)*

Revenue return per ordinary share is based on the net revenue on ordinary activities after taxation of £22,597,000 (2002 – £24,213,000), and on 304,134,148 (2002 – 320,181,479) ordinary shares, being the weighted average number of ordinary shares in issue during the year.

Capital return per ordinary share is based on the net capital loss for the financial year of £430,936,000 (2002 – net capital loss of £96,592,000), and on 304,134,148 (2002 – 320,181,479) ordinary shares, being the weighted average number of ordinary shares in issue during the year.

9 FIXED ASSETS – INVESTMENTS	2003 £'000	2002 £'000
Listed at market value – UK	532,041	749,247
– overseas	513,790	738,462
Unlisted	4,917	5,332
	1,050,748	1,493,041

	Listed in UK £'000	Listed overseas £'000	Unlisted £'000	Total £'000
Cost of investments held at 1 April 2002	564,187	702,626	5,967	1,272,780
Unrealised appreciation/(depreciation) at 1 April 2002	185,060	35,836	(635)	220,261
Value of investments held at 1 April 2002	749,247	738,462	5,332	1,493,041
Movements in year:				
Purchases at cost	168,059	186,987	–	355,046
Sales – proceeds	(201,152)	(175,124)	–	(376,276)
– realised profits/(losses) on sales	28,517	(117,851)	–	(89,334)
Book cost of investments written off	(11,368)	–	–	(11,368)
Decrease in unrealised appreciation	(201,262)	(118,684)	(415)	(320,361)
Value of investments held at 31 March 2003	532,041	513,790	4,917	1,050,748
Cost of investments held at 31 March 2003	548,243	596,638	5,967	1,150,848
Unrealised depreciation at 31 March 2003	(16,202)	(82,848)	(1,050)	(100,100)
Value of investments held at 31 March 2003	532,041	513,790	4,917	1,050,748

(LOSSES)/GAINS ON INVESTMENTS	2003 £'000	2002 £'000
Realised losses on sales	(89,334)	(113,529)
Book cost of investments written off	(11,368)	–
(Decrease)/increase in unrealised appreciation	(320,361)	23,578
	(421,063)	(89,951)

During the year the Company had holdings in Open Ended Investment Companies ('OEICs') managed by Baillie Gifford & Co, the Company's investment manager. The share class held in these OEICs does not attract a management fee. At 31 March the Company held:

	2003		2002	
	C income shares held	% value of share class held	C income shares held	% value of share class held
Baillie Gifford European Smaller Companies Fund	7,910,800	94.9	7,910,800	21.1
Baillie Gifford Latin American Fund	12,000,000	80.0	15,000,000	83.3

10 FINANCIAL ASSETS

A full list of the Company's investments is given on pages 19 to 23. In addition a geographical analysis of the portfolio, an analysis of the investment portfolio by broad industrial or commercial sector, and a list of the 30 largest equity investments by their aggregate market value are contained in the Managers' Review Section.

Exposure to currency risk through asset allocation is indicated below.

	2003 £'000	2002 £'000
Portfolio (currency of listing):		
Sterling	556,951	770,269
US dollar	288,945	392,540
Euro	87,212	164,294
Swedish kroner	9,241	9,673
Swiss franc	11,322	30,843
Japanese yen	47,508	67,226
Hong Kong dollar	14,131	19,111
Korean won	10,788	17,134
Australian dollar	12,271	14,044
Other Asia Pacific currencies	12,379	7,907
	1,050,748	1,493,041
Cash:		
UK deposits	3,907	5,148
Foreign deposits – euro	–	6,135
– US dollar	–	6,954
– Japanese yen	8	42
	3,915	18,279

The cash deposits generally comprise call or short term money market deposits of less than one month.
Short term debtors and creditors have been excluded from the disclosure of financial instruments.

Included within the analysis provided on pages 19 to 23 is the Company's holding in warrants which confer the right to convert into equity shares. An analysis of the currency exposure and maturity profile of these warrants at 31 March is provided below.

	2003		2002	
	Market value £'000	Weighted average period until maturity	Market value £'000	Weighted average period until maturity
Warrants:				
Euro	1,151	12 months	–	–

The interest rate risk profile of the Company's financial assets at 31 March was:

	2003			2002		
	Market value £'000	Weighted average interest rate	Weighted average period until maturity	Market value £'000	Weighted average interest rate	Weighted average period until maturity
Fixed rate:						
UK bonds	39,624	7.6%	12 years	19,631	8.8%	6 years
UK convertible loan stock	4,726	7.3%	2 years	–	–	–
European bonds	19,714	8.3%	7 years	26,621	7.1%	8 years
US bonds	3,353	7.3%	4 years	–	–	–
Floating rate:						
UK bonds (interest rate linked to sterling LIBOR)	26,173	3.0%	62 years	22,746	3.4%	63 years
European bonds (interest rate linked to euro LIBOR)	2,734	8.3%	2 years	4,793	7.8%	14 years

			2003	2002
			£'000	£'000
11 DEBTORS				
Due within one year:				
Income accrued			9,911	9,039
Sales for subsequent settlement			11,043	6,501
Taxation recoverable			130	82
Other debtors and prepayments			1,276	1,252
			22,360	16,874
12 CREDITORS				
Amounts falling due within one year:				
ING Bank N.V. yen loan			23,475	23,314
Purchases for subsequent settlement			7,604	–
Proposed final dividend			13,410	13,140
Other creditors and accruals			4,464	5,167
			48,953	41,621

Included in other creditors is £91,000 (2002 – £208,000) in respect of the investment management fee.

Borrowing facilities

A £100 million short term multi-currency loan facility has been arranged with The Royal Bank of Scotland Plc, expiring within 12 months.
A £35 million multi-currency loan facility has been arranged with National Australia Bank Limited.
A ¥4,400 million loan facility has been arranged with ING Bank N.V.
At 31 March 2003 drawings were as follows:

National Australia Bank Limited	¥5,900 million at an interest rate of 0.65% per annum (see note 13).
ING Bank N.V.	¥4,400 million at an interest rate of 0.40% per annum.

13 CREDITORS				
Amounts falling due after more than one year:				
Debenture stocks:	Nominal rate	Effective rate		
£20 million 8–14% stepped interest debenture stock 2020	14.0%	12.3%	22,419	22,459
£75 million 6.875% debenture stock 2023	6.875%	6.9%	74,265	74,229
£50 million 6–12% stepped interest debenture stock 2026	12.0%	10.8%	54,913	54,961
4½% irredeemable debenture stock			675	675
National Australia Bank Limited multi-currency loan (see note 12)			31,478	31,261
			183,750	183,585

Debenture stocks

The debenture stocks are stated in accordance with the requirements of FRS4; the cumulative effect is to increase the carrying amount of borrowings by £6.6 million (2002 – £6.6 million).

The debenture stocks are secured by a floating charge over the assets of the Company.

	2003	2002
	£'000	£'000
14 FINANCIAL LIABILITIES		
The interest rate risk profile of the Company's financial liabilities at 31 March was:		
Floating rate – Yen denominated	54,953	54,575
Fixed rate – Sterling denominated	152,272	152,324
	207,225	206,899
The maturity profile of the Company's financial liabilities at 31 March was:		
In one year or less, or on demand	23,475	23,314
In more than one year, but less than five years	31,478	31,261
In more than five years (weighted average period fixed 21 years)	151,597	151,649
No fixed date for repayment	675	675
	207,225	206,899

Fair value of financial liabilities

The debenture stock issues are included in the accounts in accordance with FRS4. A comparison with the closing mid market value is as follows:

	2003			2002		
	Nominal £'000	Book £'000	Market £'000	Nominal £'000	Book £'000	Market £'000
8–14% stepped interest debenture stock 2020	20,000	22,419	35,576	20,000	22,459	34,318
6.875% debenture stock 2023	75,000	74,265	79,485	75,000	74,229	74,175
6–12% stepped interest debenture stock 2026	50,000	54,913	82,300	50,000	54,961	80,375
4½% irredeemable debenture stock	675	675	575	675	675	530
	145,675	152,272	197,936	145,675	152,324	189,398

All short term borrowings are stated at market value.

Deducting prior charges at market value would have the effect of reducing net asset value per share from 285.5p to 268.0p. Taking the market price of the ordinary shares at 31 March 2003 of 234.5p, this would have given a discount to net asset value of 12.5% as against 17.9% on a traditional basis. At 31 March 2002 the effect would be to reduce net asset value from 423.6p to 409.4p. Taking the market price of the ordinary shares at 31 March 2002 of 369.0p, this would have given a discount to net asset value of 9.9% as against 12.9%.

Short term debtors and creditors have been excluded from the disclosure of financial instruments.

Gains and losses on hedges

At 31 March 2003 there were no unrecognised gains/losses on hedges. Realised currency gains/losses are taken to the capital reserve and are not reflected in the revenue account unless they are of a revenue nature.

	2003		2002	
	Number	£'000	Number	£'000
15 CALLED-UP SHARE CAPITAL				
Authorised ordinary shares of 25p each	360,720,000	90,180	360,720,000	90,180
Allotted, called-up and fully paid ordinary shares of 25p each	298,005,115	74,501	309,184,688	77,296

At the Annual General Meeting on 4 July 2002 the Company renewed its authority to purchase shares in the market, in respect of 46,065,722 ordinary shares (equivalent to 14.99% of its issued share capital at that date). In the year to 31 March 2003 a total of 11,179,573 (2002 – 19,533,200) ordinary shares with a nominal value of £2,795,000 were bought back at a total cost of £30,599,000 (2002 – £69,469,000). At 31 March 2003 the Company had authority to buy back a further 36,761,149 ordinary shares.

Under the provisions of the Company's Articles the share buy-backs were funded from the realised capital reserve. The nominal value of the share capital is maintained through a transfer to the capital redemption reserve.

16 RESERVES

At 1 April 2002	12,884	939,610	225,176	48,022
Net loss on realisation of investments	–	(89,334)	–	–
Book cost of investments written off	–	(11,368)	–	–
Decrease in unrealised appreciation	–	–	(320,361)	–
Exchange differences	–	(323)	–	–
Exchange differences on multi-currency loans	–	–	(378)	–
Shares purchased for cancellation	2,795	(30,599)	–	–
Investment management fee	–	(2,053)	–	–
Finance costs of borrowings	–	(7,119)	–	–
Retained net revenue for the year	–	–	–	2,867
At 31 March 2003	15,679	798,814	(95,563)	50,889

17 TOTAL SHAREHOLDERS' FUNDS	2003	2002
	£'000	£'000
Total shareholders' funds are attributable as follows:		
Equity shares	844,320	1,302,988

Total shareholders' funds have been calculated in accordance with the provisions of Financial Reporting Standard 4 'Capital Instruments'. However, the net asset value per share figures in note 18 have been calculated on the basis of shareholders' rights to reserves as *specified in the Articles of Association of the Company. A reconciliation of the two figures is as follows:*

Shareholders' funds attributable to ordinary shares (as above)	£844,320,000
Number of ordinary shares in issue at the year end	298,005,115
Shareholders' funds per ordinary share (pence)	283.3p
Additions/(deductions)	
– expenses of debenture issue	(0.8p)
– allocation of interest on borrowings	3.0p
Net asset value per ordinary share	285.5p

18 NET ASSET VALUE PER ORDINARY SHARE

The net asset value per ordinary share and the net asset value attributable to the ordinary shareholders at the year end calculated in accordance with the Articles of Association were as follows:

	2003	2002	2003 £'000	2002 £'000
Ordinary shares	285.5p	423.6p	850,921	1,309,641

The movements during the year of the assets attributable to the ordinary shares were as follows:

	2003 £'000	2002 £'000
Total net assets at 1 April	1,309,641	1,470,984
Total recognised gains and (losses) for the year	(408,339)	(72,379)
Dividends appropriated in the year	(19,730)	(19,453)
Adjustment to debentures	(52)	(42)
Shares purchased for cancellation	(30,599)	(69,469)
Total net assets at 31 March	850,921	1,309,641

Net asset value per ordinary share is based on net assets (adjusted to reflect the deduction of the debentures at par) and on 298,005,115 (2002 – 309,184,688) ordinary shares, being the number of ordinary shares in issue at the year end. Shareholders' funds as reported on the face of the balance sheet has been computed in accordance with the provisions of Financial Reporting Standard 4 'Capital Instruments'. A reconciliation of the two sets of figures under these two conventions is given in note 17.

19 RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	2003 £'000	2002 £'000
Shareholders' funds at 1 April	1,302,988	1,464,289
Total recognised (losses) and gains for the year (after dividend payments)	(428,069)	(91,832)
Shares purchased for cancellation	(30,599)	(69,469)
Shareholders' funds at 31 March	844,320	1,302,988

20 RECONCILIATION OF NET REVENUE BEFORE FINANCE COSTS AND TAXATION TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	2003 £'000	2002 £'000
Net revenue on ordinary activities before finance costs and taxation	30,671	32,579
Investment management fees charged to capital	(2,053)	(2,695)
(Increase) in accrued income	(868)	(291)
(Increase)/decrease in debtors	(24)	464
Increase/(decrease) in creditors	111	(132)
	27,837	29,925

21 ANALYSIS OF CHANGE IN NET DEBT

	At 1 April 2002 £'000	Cash flows £'000	Other non-cash changes £'000	Exchange movement £'000	At 31 March 2003 £'000
Cash at bank and in hand	18,279	(14,364)	–	–	3,915
Loans due within one year	(23,314)	–	–	(161)	(23,475)
Loans due in more than one year	(31,261)	–	–	(217)	(31,478)
Debenture stocks	(152,324)	–	52	–	(152,272)
	(188,620)	(14,364)	52	(378)	(203,310)

22 DIRECTORS' INTERESTS IN CONTRACTS

No Director has a contract of service with the Company.

During the year no Director was interested in any contract or other matter requiring disclosure under section 232 of the Companies Act 1985.

23 CONTINGENCIES, GUARANTEES AND FINANCIAL COMMITMENTS

At the year end the Company had a contingent liability amounting to £14 million (2002 – £14 million) under a subscription agreement relating to participating loan notes. The obligation will expire on 31 December 2005.

24 SUMMARY OF MAIN INVESTMENT RESTRICTIONS

(as incorporated within the investment management agreement between the Company and Baillie Gifford & Co)

Holding size

At the time of investment, a maximum of 8% of total assets may be invested in any one holding. This restriction does not apply to investment in collective investment schemes, issues by way of rights or certain government bonds.

A maximum of 40% of total assets may be invested in holdings exceeding 3% of the value of the Company's total assets. Again, this restriction does not apply to collective investment schemes, issues by way of rights or certain government bonds.

Categories of investment

No investment shall be made on which there is unlimited liability.

The Managers must seek permission of the Board to invest in collective investment schemes managed by Baillie Gifford & Co.

Transactions in futures and options must be consistent with Inland Revenue guidelines so as to ensure maintenance of the Company's Investment Trust status.

25 DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

The Company operates as an investment trust company in accordance with S842 of the Income and Corporation Taxes Act 1988. The international nature of the Company's investment activities provides opportunities for both market appreciation and currency gains, but leaves it exposed to the risk of market volatility and currency fluctuations.

In the case of an investment trust, capital profits from investing activities and currency gains are not recognised in the revenue account, but are credited directly to a separate capital reserve which the Company is prohibited from distributing in the form of dividends.

The Company makes use of gearing (long and short term borrowings) to achieve improved performance in rising markets.

The Company's revenue account may be affected by fluctuations in short term interest rates; income from overseas investment can be affected by currency fluctuations.

The Company's financial instruments, which provide finance for investment activities, comprise its debenture stocks, its long and short term borrowings, and its cash and liquid resources. In addition to the equity portfolio, the Company maintains investments in UK and overseas corporate bonds as part of its investment strategy.

The Company may, from time to time, enter into derivative transactions to hedge specific currency or interest rate risk. No such transactions were undertaken in the period under review.

The Company has precisely defined guidelines to govern the purchase or writing of options on individual shares. No options were purchased or written in the year under review.

Trading in financial instruments is not within the normal activities of an investment trust, nor is it the Company's policy to trade in such instruments. Transactions in financial instruments generally arise as a result of strategic investment decisions.

The Company's Managers may not enter into derivative transactions without the prior approval of the Board, and all borrowing facilities require Board authorisation. The Board agrees policies for managing risk with the Company's Managers. The main risks arising from the Company's financial instruments are market risk (as noted above), interest rate risk, credit risk, liquidity risk and foreign currency risk.

Interest Rate Risk

The Company finances its operations by means of realised capital profits, retained revenue reserves, bank borrowings and the issue of debenture stocks. The value of the Company's bond portfolio is subject to interest rate risk. It is not the Company's policy to hedge this risk.

The Company has negotiated short term multi-currency borrowing facilities at interest rates linked to LIBOR and may draw down funds for a period of up to 12 months.

The Company has issued a mix of stepped and fixed interest debenture stocks. The stepped interest debenture stocks have reached their final step and are deemed to be fixed.

Credit Risk

In addition to interest rate risk, the Company's investments in bonds are also subject to credit risk. Credit risk reflects the possibility that a borrower will not be able to meet its obligation to make payments of interest or principal when they fall due. The Managers analyse the credit risk of the Company's bond investments prior to purchase and continue to monitor developments in credit quality subsequently.

Liquidity Risk

The Company's policy with regard to liquidity is to ensure continuity of funding. Short term flexibility is achieved by overdraft facilities.

Foreign Currency Risk

The international nature of the Company's investment activities gives rise to a currency risk which is inherent in the performance of its overseas investments. It is not the Company's policy to hedge this risk on a continuing basis, but the Company may from time to time match specific overseas investment with foreign currency borrowings.

The revenue account is subject to currency fluctuation arising on overseas income. The Company does not hedge this currency risk.

NOTICE IS HEREBY GIVEN that the ninety-fourth Annual General Meeting of The Scottish Mortgage and Trust PLC will be held within the Registered Office of the Company, 1 Rutland Court, Edinburgh EH3 8EY, on Thursday, 3 July 2003, at 11.00 am for the following purposes:

Ordinary Business

1. To approve the Accounts of the Company for the year to 31 March 2003 with the Reports of the Directors and of the Auditors thereon.
2. To approve the Directors' Remuneration Report.
3. To declare a dividend.
4. To re-elect Mr GA Ball as a Director.
5. To reappoint KPMG Audit Plc as Auditors.
6. To authorise the Directors to determine the remuneration of the Auditors.

Special Business

To consider and, if thought fit, to pass the following resolutions as Special Resolutions:

7. That, in substitution for any existing authority, the Company be authorised, in accordance with section 166 of the Companies Act 1985 (the 'Act'), to make market purchases (within the meaning of section 163(3) of the Act) of ordinary shares of 25p each in the capital of the Company ('Shares'), provided that:
   (a) the maximum number of Shares hereby authorised to be purchased shall be 14.99% of the issued share capital on the date on which this resolution is passed;
   (b) the minimum price which may be paid for a Share shall be 25p;
   (c) the maximum price (exclusive of expenses) which may be paid for a Share shall be 105% of the average of the middle market quotations (as derived from the Daily Official List of the London Stock Exchange) for the Shares for the five business days immediately preceding the date of purchase; and
   (d) unless previously varied, revoked or renewed, the authority hereby conferred shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2004 or 2 January 2005, whichever is the earlier, save that the Company may, prior to such expiry, enter into a contract to purchase Shares under such authority which will or might be executed wholly or partly after the expiration of such authority and may make a purchase of Shares pursuant to any such contract.
8. That, the name of the Company be changed to "Scottish Mortgage Investment Trust PLC" with effect from such date as the Directors shall determine, not being later than 31 August 2003.

By order of the Board

BAILLIE GIFFORD & Co
Managers and Secretaries
23 May 2003

Baillie Gifford & Co.

Notes

1 A member entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, vote on his/her behalf. A proxy need not be a member of the Company. A Form of Proxy for the use of members is enclosed.

2 An ordinary shareholder entered on the Register of Members 48 hours before the meeting is entitled to attend and vote at the meeting pursuant to Regulation 34 of the Uncertificated Securities Regulations 1995. Any changes to the Register of Members after such time and date shall be disregarded in determining the rights of any shareholder to attend and/or vote at the meeting.

3 Shareholders participating in the Baillie Gifford Investment Trust Share Plan, Children's Savings Plan or the Baillie Gifford Investment Trust ISA/PEP who wish to vote and/or attend the meeting must complete and return the enclosed reply-paid Form of Direction.

4 No Director has a contract of service with the Company.

The Annual General Meeting of the Company will be held at the offices of Baillie Gifford & Co at 1 Rutland Court, Edinburgh EH3 8EY on Thursday, 3 July 2003 at 11.00 am.

If you have any queries as to how to vote or how to attend the meeting, please call us on 0800 027 0133.

ANALYSIS OF SHAREHOLDERS

ANALYSIS OF SHAREHOLDERS

	At 31 March 2003		At 31 March 2002	
	Number	%	Number	%
Institutions	121,357,526	40.7	133,000,000	43.0
Intermediaries	83,871,746	28.2	80,400,944	26.0
Individuals	70,707,032	23.7	75,400,000	24.4
Baillie Gifford Share Plan/PEP/ISA	19,553,382	6.6	19,199,056	6.2
Marketmakers	2,515,429	0.8	1,184,688	0.4
	298,005,115	100.0	309,184,688	100.0

- **How to Invest** The Company's shares are traded on the London Stock Exchange. They can be bought through a stockbroker, by asking a professional adviser to do so, or through the Baillie Gifford Investment Trust Share Plan – see inside back cover for details.
- **Sources of Further Information on the Company** The price of shares is quoted daily in the *Financial Times* and can also be found on the Baillie Gifford website at **www.bailliegifford.com**, Trustnet at www.trustnet.co.uk and on other financial websites. Company factsheets are also available from Baillie Gifford on request and are updated monthly on the Baillie Gifford website.
- **Key Dates** Ordinary shareholders normally receive two dividends in respect of each financial year. An interim dividend is paid at the end of November and a final dividend is paid early July. The AGM is normally held in early July.
- **CGT** For Capital Gains Tax indexation purposes, the market value (adjusted for the bonus issue of 4 for 1) of an ordinary share in the Company as at 31 March 1982 was 30.6p.
- **Share Register Enquiries** Computershare Investor Services PLC maintains the share register. In the event of queries regarding shares registered in your own name, please contact the Registrars on 0870 702 0010. You can check *your holding on the Registrars' web site: www.cshare.co.uk by quoting the reference number on your share* certificate.
- **Telephone Share Dealing Service** A telephone share dealing service has been established by Computershare Investor Services PLC, which provides a simple way of buying or selling The Scottish Mortgage and Trust PLC ordinary shares on the London Stock Exchange. The commission is 1%, subject to a minimum charge of £15. In addition stamp duty, currently 0.5% is payable on purchases. There are no forms to complete and the share price at which you deal will generally be confirmed to you whilst you are still on the telephone. The service is available *from 8.00 am to 4.30 pm Monday to Friday, excluding bank holidays, on telephone number 0870 703 0084.* Please ensure you have your Shareholder Reference Number (SRN) ready when making the call. The SRN appears on your share certificate. Detailed terms and conditions are available on request, please phone 0870 702 0000.

  This is not a recommendation to buy, sell or hold shares in Scottish Mortgage. If you are unsure of what action to take contact a financial adviser authorised under the Financial Services and Markets Act 2000. Please note that share values may go down as well as up, which may result in you receiving less than what you originally invested.

  In so far as this statement constitutes a financial promotion for the share dealing service provided by Computershare Investor Services PLC, it has been approved by Computershare Investor Services PLC for the purpose of Section 21(2)(b) of the Financial Services and Markets Act 2000 only. Computershare Investor Services PLC is authorised and regulated by the Financial Services Authority.

  Where this has been received in a country where the provision of such a service would be contrary to local laws or regulations, this should be treated as information only.

Scottish Mortgage is an investment trust. Investment trusts offer investors the following advantages:

- Participation in a diversified portfolio of shares.
- Constant supervision at low cost by experienced professional managers.
- Freedom from capital gains tax on capital profits realised within the portfolio.
- The opportunity to achieve improved performance for shareholders' funds in rising markets by the borrowing of additional money.

Shares in Scottish Mortgage are also available within an ISA or PEP Transfer wrapper or through Baillie Gifford's Investment Trust Share Plan or Children's Savings Plan as detailed on the inside back cover. These products can also be used to invest in the five other investment trusts managed by Baillie Gifford:

- Baillie Gifford Shin Nippon PLC
- Mid Wynd International Investment Trust PLC
- Pacific Horizon Investment Trust PLC
- The Baillie Gifford Japan Trust PLC
- The Monks Investment Trust PLC.

These accounts have been approved by the Directors of The Scottish Mortgage and Trust PLC. The information about the ISA, PEP, Share Plan and Children's Savings Plan has been approved by Baillie Gifford Savings Management Limited. Baillie Gifford Savings Management Limited is the ISA Manager of the Baillie Gifford Investment Trust ISA, the PEP Manager of the Baillie Gifford Investment Trust PEP and the Manager of the Baillie Gifford Investment Trust Share Plan and Children's Savings Plan. Baillie Gifford Savings Management Limited is wholly owned by Baillie Gifford & Co. Both are authorised and regulated by the Financial Services Authority. Baillie Gifford only provides information about its products and does not provide investment advice. The staff of Baillie Gifford may have positions in investment trusts managed by Baillie Gifford and may buy, sell or offer to make a purchase or sale of such securities from time to time. The value of ISA and PEP tax advantages will depend on personal circumstances. Past performance is not necessarily a guide to future performance. The capital value of and income distributed by an investment trust can go down as well as up and an investor may not get back the amount originally invested. The price of an investment trust share will fluctuate in accordance with supply and demand and may not reflect the underlying net asset value.

Baillie Gifford's Investment Trust Share Plan

You can invest from £250 or from £30 per month in any of the six investment trusts managed by Baillie Gifford through the Baillie Gifford Investment Trust Share Plan. The plan is designed to be a flexible and low cost way of saving on a regular or lump sum basis for the long term.

Baillie Gifford's Investment Trust ISA

You can invest in any of our trusts in a tax efficient way by investing from £2,000 or £250 per month or by transferring an ISA from your existing manager.

Baillie Gifford's Children's Savings Plan

An easy to use plan tailored especially to meet the requirements to save for children whether it be for educational purposes or inheritance planning. The plan is flexible and inexpensive.

Baillie Gifford's Investment Trust PEP Transfer

You can transfer an existing PEP to access different markets through our investment trusts or to change your investment manager.

Further Information

Retail Investments Department
Baillie Gifford Savings Management Limited
1 Rutland Court
EDINBURGH EH3 8EY

Tel: 0800 027 0133
We may record your call

e-mail: its@bailliegifford.com
website: www.bailliegifford.com

Fax: 0131 474 3248

Pillans & Waddies, Edinburgh. 72263

DIRECTORS

Chairman
Lord Sanderson of Bowden

GA Ball
Sir Donald MacKay
WG McQueen
The Earl of Portarlington
JPHS Scott

MANAGERS, SECRETARIES AND REGISTERED OFFICE

Baillie Gifford & Co
1 Rutland Court
Edinburgh EH3 8EY
Telephone: 0131 222 4000
Website: www.bailliegifford.com

REGISTRARS

Computershare Investor Services PLC
Owen House
8 Bankhead Crossway North
Edinburgh EH11 4BR
Telephone: 0870 702 0010

BANKERS

The Bank of New York
Mizuho Corporate Bank, Limited

AUDITORS

KPMG Audit Plc
Saltire Court
20 Castle Terrace
Edinburgh EH1 2EG

Company Registration No. 7058