Scottish Mortgage Investment Trust PLC

Your low cost choice for global investment

Annual Report and Accounts 31 March 2006

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Scottish Mortgage Investment Trust PLC is a low cost investment trust that aims to maximise total returns from a focused and actively managed portfolio of equities. It invests globally, with a core exposure to the UK, looking for strong businesses with above-average returns.

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).

Notes

None of the views expressed in this document should be construed as advice to buy or sell a particular investment.

Investment trusts are UK public listed companies and as such comply with requirements of the UK Listing Authority. They are not authorised or regulated by the Financial Services Authority.

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt as to the action you should take you should consult your stockbroker, bank manager, solicitor, accountant or other independent financial advisor authorised under the Financial Services and Markets Act 2000 immediately.

If you have sold or otherwise transferred all of your ordinary shares in Scottish Mortgage Investment Trust PLC, please forward this document and the accompanying form of proxy as soon as possible to the purchaser or transferee or to the stockbroker, bank or other agent through whom the sale or transfer was or is being effected for delivery to the purchaser or transferee.

Message from the Chairman

Three years ago your Board, along with the Managers, reviewed investment strategy. The result of this scrutiny was to reduce the number of holdings and to take a more global approach which, above all, focused upon companies rather than geographic asset allocation. I am happy to say that this approach has borne fruit, as demonstrated this year by a 46% increase in net asset value, a 57% increase in the share price and a 15.6% increase in the dividend.

Financial Highlights

Share Price +56.6%

NAV +46.5%

Benchmark* +26.3%

Past performance is no guarantee of future performance.

One Year Summary

	31 March 2006	31 March 2005	% change
Total assets (before deduction of debentures, long and short term borrowings)	£1,985.2m	£1,455.7m†	
Loans and debentures	£231.8m	£213.1m	
Equity shareholders' funds	£1,753.4m	£1,242.6m†	
Net asset value per ordinary share (after deducting debentures at market value)	584.1p	398.8p†	46.5
Net asset value per ordinary share (after deducting debentures at par)	610.9p	422.6p†	44.6
Share price‡	521.5p	333.0p	56.6
Benchmark			26.3
FTSE All-Share Index	3,048.0	2,457.7	24.0
FTSE World Ex UK Index (in sterling terms)	319.3	248.2	28.7
Dividends paid and proposed per ordinary share	8.50p	7.35p	15.6
Earnings per ordinary share	8.82p	7.37p	19.7
Total expense ratio	0.52%	0.52%	
Discount (after deducting debentures at market value)	10.7%	16.5%	

	Year to 31 March 2006		Year to 31 March 2005	
Year's high and low	High	Low	High	Low
Share price	521.5p	321.3p	351.0p	280.5p
Net asset value per share (after deducting debentures at market value)	584.1p	376.2p	406.4p	330.2p
Net asset value per share (after deducting debentures at par)	610.9p	401.0p	429.9p	348.0p
Discount (after deducting debentures at market value)	8.6%	16.5%	11.6%	17.1%
Average sector discount (AITC Global Growth Sector)	7.4%	11.7%	10.5%	15.3%

	31 March 2006	31 March 2005
Total return per ordinary share		
Revenue	8.82p	7.37p
Capital	185.58p	36.58p†
Total	**194.40p**	**43.95p†**

† Restated, see notes 1 and 2 on pages 38 and 39.

‡ Mid market price.

Past performance is no guarantee of future performance.

Five Year Summary

The following charts indicate how Scottish Mortgage has performed relative to its benchmark, its underlying net asset value and the retail price index over the five year period to 31 March 2006.

Past performance is no guarantee of future performance.

Chairman's Statement

Scottish Mortgage has returned outstanding results this year. The share price rose by 57% ending the year at an all time high while net asset value per share rose by 46%. By comparison, the benchmark index (50% FTSE All-Share Index and 50% FTSE World Ex UK in sterling terms) rose by 26%. These results reflect the continuing success of the truly global stock selection approach embraced enthusiastically by the Managers three years ago.

Market Background

Stock markets were strong during the year largely on the back of good results from a broad range of companies. The rises in market values should be seen in the context of a continuation of the recovery period: it is only now that old peaks are being reached in many markets. While interest rates have risen in some countries, they are generally still relatively low. Rising inflation does not appear to be an issue of major concern at the moment and economic growth at present is partly fuelled by the increase in wealth and activity in large countries, such as China and India, whose economies are growing rapidly.

Investment Approach

A benign global economic background will help the Managers to achieve the shareholders' requirement for growth. However, deliberations about the progress of economies will not create value for shareholders, this depends on the Managers' ability to choose companies which will flourish over the longer term.

It was with this view in mind that our investment approach has evolved over the past three years. To reiterate, we have encouraged the Managers to:

1. **Take a global view.** The country where a company is listed on a stock exchange is of secondary importance compared with where it actually carries out its business. Customers and businesses are becoming more and more global in their reach. It is important not to limit investment thinking and decisions by allocating funds to countries and not to companies.
2. **Have the courage of their convictions.** The choice and size of the investments should mirror the Managers' view of the companies' prospects not their position in any index. Scottish Mortgage is an active fund and not a passive index tracker. The portfolio has progressively become more concentrated and there are now 86 equity holdings as opposed to 129 three years ago. The floor is likely to be around 70 to 80 companies.
3. **Think long term.** The Board expects holdings to be bought and held and not to be traded frenetically. An aspiration is to have a typical holding period of at least five years but preferably even longer.

Three Year Performance

The three year record is worthy of examination as it is over this period that the global approach has been honed. The table below shows the performance of Scottish Mortgage shares against its Benchmark and the average of other global funds over one and three years.

	Total Return* to 31 March 2006 1 year	3 years
Scottish Mortgage share price	60%	138%
Benchmark	30%	85%
AITC Global Growth Average†	41%	110%
IMA Global Growth Average‡	32%	85%

Past performance is no guarantee of future performance.

However, in its regular assessments, the Board is now focusing to a greater extent on the three to five year performance record. This is in line with the long term investment horizon adopted.

Dividend and Earnings

Earnings per share were stronger than anticipated, rising to a figure of 8.82p per share (2004/2005 – 7.37p). The Company has benefited from substantial dividend growth from overseas equities, particularly from those investments in the emerging markets. As a result, a final dividend of 4.65p has been recommended which, if approved, will make for a total of 8.50p, an increase of 15.6% compared to the previous year. During the year the inflation rate was 2.4% as measured by the Retail Price Index. It is the Board's intention to continue to increase the dividend at a rate in excess of inflation. Revenue reserves stand at around 20p per share and, if required, these will be used to smooth the rate of growth should there be an earnings shortfall in future years.

* Total return includes both capital growth and income reinvested.

† AITC is the Association of Investment Trust Companies and shown here is the average of other investment trusts in the same AITC sector as Scottish Mortgage.

‡ IMA is the Association of Investment Managers and these figures shown are for open ended funds (unit trusts and Open Ended Investment Companies (OEICs)) in a similar sector.

Discount, Buyback Policy and Treasury Shares

The discount narrowed from 16.5% to 10.7% . The Board is very conscious of the fact that it is the share price performance that is of primary interest to investors and we have outlined our approach to the discount policy in the Business Review on page 22.

The Board believes that performance is the key driver of discounts over the long term. The Directors realise that discount volatility is not in the interests of most shareholders and that the threat of such volatility could be a deterrent to attracting new shareholders. While a discount target is not being set, as has been done by other large trusts, the consideration of future buybacks will be made with reference to Scottish Mortgage's discount relative to those of its peer group. The Directors also believe that the superior performance and distinctive approach justifies a narrower discount than at present.

During the year, a total of 7,530,000 shares were bought back at a total cost of £30.26m which increased net asset value per share by 0.44%. It is a source of some frustration that during this period of good performance greater demand for the Company's shares has not been encountered, thus necessitating the need to buy back shares. The Managers are aware of this frustration and are devoting considerable thought and resources to the marketing of Scottish Mortgage. Details of various marketing initiatives are shown on the inside back cover.

The Board is seeking powers at the AGM to be able to take into treasury any shares that have been bought back for subsequent reissue but only at a premium to net asset value. This ensures that the interests of existing shareholders will not be diluted.

Balance Sheet

During the year borrowings have been deployed to good effect as markets have risen. The Company has short term borrowings of ¥5.9bn (£ equivalent £29m) and €73m (£ equivalent £51m) in place. The latter replaces a $60m facility that has been repaid. Details of the debentures are given on pages 43 and 48. The level of gearing into equity markets at 112% or 12% of shareholders' funds* is not excessive and will be adjusted as circumstances dictate.

Costs

I am happy to report that the Total Expense Ratio (TER) remains at 0.52%. An advantage of funds of the size of Scottish Mortgage is the dilution of costs and our low TER (in comparison to other investment trusts and open ended funds) is a further considerable attraction for shareholders and potential investors. The beneficial effect of lower costs on compounded returns over long periods of time can be considerable.

* With the debentures valued at their market price.

Board and AGM

The AGM will be held on Wednesday 28 June 2006 in Edinburgh. Details are given on pages 51 and 52 of this document. I do hope you will come and meet the Board. The Managers will make a short presentation and there will be an opportunity for questions.

Outlook

The Managers give a very lucid view of the outlook on pages 8 to 13 which the Board shares and which I recommend to you. I am happy to report that they are finding no shortage of suitable investment opportunities at the moment which is a positive indicator.

The Board is very pleased with the Managers' exceptional performance over the past three years which is the result of a combination of hard work and sound thinking. Achieving sustainable long term growth through direct investment in equities on a global basis, remains our highest priority. I consider that Scottish Mortgage is very well placed to deliver these returns to shareholders over time.

Donald MacKay

Sir Donald MacKay
10 May 2006

Directors and Managers

Members of the Board come from a broad variety of backgrounds. The Board can draw on a very extensive pool of knowledge and experience. Baillie Gifford & Co, a leading UK investment management firm, who act as Managers and Secretaries to the Company have done so since its formation in 1909.

Directors

1 Sir Donald MacKay

Sir Donald MacKay, the Chairman, is an economist with an extensive record in advising governments, organisations and companies. Sir Donald is 69 and was appointed a Director in 1999 and became Chairman in 2003. He is also Chairman of the Nomination Committee. He was Professor of Political Economy at Aberdeen University and Professor of Economics at Heriot-Watt University. He is a former chairman of The Malcolm Group PLC and Scottish Enterprise and is currently a director of Edinburgh New Income Trust plc.

2 GA Ball

Geoffrey Ball, the senior independent director, is a long-standing director who also has considerable industrial experience in the house building sector. Geoffrey is 62 and was appointed a Director in 1983. He is executive chairman of Cala Group Ltd, having led the management buy out in 1999. He was president of the House Builders Federation of England and Wales from 2001 to 2003 and he was a director of The Standard Life Assurance Company for 13 years until 2001.

3 MM Gray

Michael Gray, 58, joined the Board in 2004 after a successful career in printing and technology industries where he gained valuable global business experience. As chairman and chief executive he led the growth of McQueen International over a 17 year period as it evolved from being a printing company into a global enterprise providing a range of support services to technology companies. On McQueen's acquisition, he became senior vice president of Sykes Enterprises Inc., a global NASDAQ quoted outsourcing services company. He retired from Sykes in 1999 and currently has many business, community, charity and sporting interests and responsibilities including being a member of the Advisory Board of the Scottish Institute of Sport Foundation. He is a former director of Scottish Enterprise and the Scottish Community Foundation.

4 WG McQueen

Gordon McQueen, the Chairman of the Audit Committee, brings to the Board first class financial and banking expertise. Gordon is 59 and was appointed a Director in 2001. He was an executive director of HBOS plc, Bank of Scotland and Halifax plc, where his main role was chief executive, Treasury. He is a director of The Alliance Trust PLC, The Second Alliance Trust PLC, JP Morgan Mid Cap Investment Trust plc and Shaftesbury PLC.

5 JPHS Scott

John Scott is a former international investment banker who maintains a number of interests in the investment trust sector. John is 53 and was appointed a Director in 2001. He is a former executive director of Lazard Brothers & Co., Limited. During his twenty years with Lazard, he was involved with the merchant bank's corporate advisory activities and its Asian businesses. He is currently a director of various companies, including Martin Currie Pacific Trust plc, JP Morgan Fleming Claverhouse Investment Trust plc, Xaar plc, Miller Insurance Services and Schroder Japan Growth Fund plc. In addition, he is chairman of Dunedin Income Growth Investment Trust PLC and Endace Limited.

6 Lord Strathclyde

Thomas Strathclyde, currently Leader of the Opposition in the House of Lords, has considerable political experience. Tom is 46 and was appointed a Director in 2004. His parliamentary career to date includes extensive ministerial experience at the Departments of Employment, the Environment, Trade and Industry and the Scottish Office. Prior to entering politics in 1988 as a Government Whip, Lord Strathclyde worked in the City for the insurance brokers, Bain Dawes. Lord Strathclyde is also chairman of London based hedge fund manager Trafalgar Capital Management and a director of Galena Capital Management Limited and Marketform Limited. He is also the president of the Quoted Companies Alliance.

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 & Co are one of the largest investment trust managers in the UK and currently manage eight investment trusts. Baillie Gifford also manage 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 £47 billion. Based in Edinburgh, it is one of the leading privately owned investment management firms in the UK, with 29 partners and a staff of around 450.

The manager of Scottish Mortgage's portfolio is James Anderson, a partner of Baillie Gifford where he is Chief Investment Officer and Head of the Global Team. He is ultimately responsible for stock selection and works closely with the other Heads of the Investment Departments.

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

Management Details

Baillie Gifford & Co are appointed as investment managers and secretaries to the Company. The management contract can be terminated at 12 months' notice.

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 and payable on a quarterly basis.

Managers' Review

The Year in Review

Returns have been strong in the last year. Global equity markets have risen steadily. Our own performance has been good. As proposed last year we have ceased to provide geographical details of our performance. We provide overall figures for the trust and individual stock results for our top 30 holdings. We have nothing to hide but we are ever more convinced that providing short term regional performance data is damaging to the application of common sense and intelligence in fund management. The tendency to be held in thrall by index weights and the daily noise of volatility interferes with both the commitment to searching out stocks that offer superior long-term returns and the ability to be courageous in purchasing stocks when they are out of favour. Three years is the absolute minimum over which skill rather than randomness can be assessed and we try very hard to apply this standard of judgement to our own efforts. Since we started articulating this philosophy three years ago the results have been encouraging but we reiterate that this is the bare minimum for any serious judgement of our abilities. We will endeavour to remember that over confidence is a besetting sin of fund managers.

There has been another substantial fall in the number of equity holdings from 101 to 86. We would be surprised if this process of concentration goes much further although there may still be scope for a small shrinkage in the number of UK listed stocks in order to express our stock preference with more conviction but little extra risk. We now have just five Japanese holdings as opposed to 12 a year ago. Some readers may find it provocative that this has happened at a moment when the Japanese economy had finally shown signs of vitality and when many managers are optimistic about prospects for the Tokyo market. We are confident that the economy had revived at least temporarily but we are sceptical whether this translates into a stock market offering many companies with clear and powerful competitive advantages. Of those that did offer such attractions the number of bargains in a global context has sharply diminished. We would cite our sale of the long-held and still admirable retailer Yamada Denki as falling into this category.

As long-term investors we believe that the possibilities open to us have seldom been greater. We have little ability to predict the direction of markets over the next year and find some amusement in the confidence with which others offer such forecasts. Yet precisely by trying to put aside some of the habits of fund management as commonly practiced today we have the scope to add significant value for our shareholders over lengthy periods of time. More and more managers, aided and abetted by the rise of hedge funds, the influence of the investment banks, and the unintended consequences of ill-considered regulation have abandoned the effort to invest in individual companies and instead speculate as to the direction of markets, countries, sectors and stocks over the next three months. This leaves those less obsessed by the volatility of indices with ever greater opportunities.

We invest globally. We think this is the most rational approach in a world in which the impact of globalisation is a truism. We find it puzzling that so many investors still think in terms of national or regional stock allocations when both companies and countries are so inextricably bound in a multinational web. We are sceptical of the theoretical or practical rationales for thinking in terms of national market multiples or risk premiums. Our sole concession is that we take our commitment to real dividend growth seriously. This means that our UK exposure (though declining) is greater than it would otherwise be but here too we do our best to incorporate the global context in assessing opportunities.

Although we consider all forecasts with caution we think the path of least resistance in the next decade leads to ever greater globalisation and the associated rise of what are conveniently, if questionably, known as 'emerging markets.' The impact of the profound changes being seen in China, India, Eastern Europe and Latin America is likely to become the dominant backdrop to investment decisions. This does not mean that the economies of these markets will continually prosper and still less that their stock markets will always flourish but it does mean that we should consider how each of our stocks fits into this global transformation. Equally, historic relationships and assumed correlations will frequently break down throughout the world as this takes place. The risk models that many rely too heavily upon will probably be a hindrance rather than a help.

We are growth stock investors. This has been unpopular for the last five years. Whilst this has been frustrating it has meant that we are now in the pleasant position of being able to find many companies with strong secular growth opportunities trading at ratings that are undemanding relative to both the broader market and their own history. It may require patience to benefit from this situation but that is precisely what our investment trust ought to be able to offer.

The Portfolio

In this section twelve months ago we discussed the rise of emerging markets, their commodity and industrial impacts, the attractions of disciplined technology investing, the virtues of selected US financials and consumer staples and the undervaluation of growth. All these themes remain central to our thinking about equity opportunities for the years ahead.

How We Think about Investment in Emerging Markets

Whilst we have already touched on the rise of the emerging economies some more specific words may be of interest. We apply the same investment standards to companies headquartered in emerging markets as we do to those in developed markets. We do not purchase them simply because they are based in emerging markets but because they have the competitive positions, growth opportunities and valuation attractions that would appeal to us anywhere in the world. That these characteristics can frequently be found in emerging markets stocks hardly seems surprising to us given the human capital, educational progress, technological prowess and resource endowment that many of these countries offer. That valuations have been so attractive shows to our mind just how far the memory of past economic crises, investor adherence to index weights and unwarranted scepticism about the importance of profitable growth has become. If the long-predicted downturn in the global economy triggered by inadequate US savings and consequent indebtedness does occur then naturally emerging markets will tremble but the real risk and damage will be done in America (and other mature economies) as their problems extend beyond losses in profitability to serious balance sheet quandaries. At a time of crisis it is balance sheets that dominate investor mentalities. From General Motors to the US government the debtors are predominately in America – not emerging markets. In short from both a risk and an opportunity stand-point we think emerging markets are better placed than the developed world. To us when we can find individual stocks that meet our criteria the natural response is still to be prepared to add to our exposure. We are puzzled at the limited exposure so many investors maintain. We would very much like to understand where else they think the growth opportunities in the global markets are going to come from in the next twenty years.

None of this means that there will not be setbacks inspired either by economic and political setbacks or stock overvaluation. The country that we worry most about at present is Poland where the combination of populist politics and economic imbalances seems the worst attempt to re-invent the toxic mixtures that led to the emerging market crises of the past. We have no exposure to this economy. From a valuation perspective we regret that the two Indian stocks that we have owned, Hero Honda and HDFC, have risen to ratings that are now more demanding than we would prefer. Given that valuation is at best an inexact science we have cut back rather than sold our holdings but this represents the first time that we have found this necessary in companies for which we still retain much admiration.

Commodities

Many of our most profitable investments over the last year have been in natural resources. We did not start with a particularly notable exposure to this subsequently fashionable area but we were fortunate enough to have owned a selection of companies that have been powerful beneficiaries of rising commodity prices. In fact we are quite surprised just how much we have benefited from our preference for resource rich rather than index heavy stocks. Most notably Petrobras and Gazprom have risen to be our two largest holdings. Whilst we would be surprised if their performance of the last twelve months can be replicated in the year ahead we remain comfortable with the size of the holdings. Petrobras is able to expand production and reserves in a manner that is the envy of the traditional majors at a still undemanding rating. Gazprom continues to be a controversial but successful investment. Over the last year it has ever more clearly demonstrated the awesome power of its resource base and pipeline infrastructure whilst making surprisingly significant efforts to see that shareholders are the beneficiaries of this dominance. We still have no desire to own the shares of the British, American or European oil majors. We think the last year has only emphasised the paucity of their reserves and the difficulties they face in rebuilding them. We are somewhat agnostic about the likely course of oil prices but we would be surprised if crude fell below the approximately $40 level which would start to undermine the long-term case for our holdings.

Broader commodity prices have also been driven higher by the combination of persistent Chinese demand and improved OECD economic activity. Whilst this has been of benefit to our portfolio we are becoming concerned that even a modest slowing of global growth could affect pricing as supply gradually increases. We are therefore redoubling our search for companies that have a sufficiently secure competitive position to ride out a potential downturn. We are more confident that this is most evidently so amongst the focused emerging market quoted stocks rather than the diversified giants. We particularly admire the strong market position and iron ore reserve base of CVRD and have been building up this holding at the expense of the BHP Billiton position. We have been rewarded for last year's patience with Anglo American Platinum by a return to market favour of this metal and, latterly, by takeover speculation that has prompted us to reduce our holding.

Industrials

One of the challenges for us as growth investors is trying to move towards companies and sectors that have outstanding prospects for the future rather than to become unduly attracted by what has grown in the past. This has been critical in thinking about the broad industrial field. The scope for profitable growth has been transformed by opportunities in emerging markets. This is becoming a generally accepted orthodoxy now but was an unusual hypothesis only two years ago. We continue to think that there are appealing investments to be made but the greater recognition of the virtues of many of the stocks in our portfolio makes us determined to be ever more selective. We have remained enthusiastic supporters of the Swedish engineering duo Atlas Copco and Sandvik. In both cases the last year has seen their mining equipment divisions come into better focus and it is typical of the disciplined and patient capital allocation of these two companies that such activities were supported and expanded in times when many less resilient managements would have despaired of seeing adequate returns. We have, however, sold ABB as we felt that the rise in the share price was sufficient to make our questions over their sustainable competitive advantages more relevant. Thus far this has proven a premature decision.

We are still owners of three automobile stocks. Porsche, BMW and Nissan all appear to be amongst the few winners in this tough industry. The two German companies continue to exploit their brand strength and the global appetite for luxury product, whilst Nissan's low cost manufacturing, product strength and tough management have produced a model turnaround. If we have a concern over any of these companies it is probably at Porsche where we are yet to be entirely persuaded of the virtues of building a stake in Volkswagen but we are wary of second guessing a management with such a formidable record.

Technology

Last year we commented on the generally subdued share performance of our technology investments. This year there has been some improvement in prices but we still feel that the excellent business performance of many dominant companies is only being grudgingly acknowledged by markets. Some of this scepticism is just the general reluctance to embrace growth stocks that we have already commented on but there also seems to be a specific set of anxieties over technology that probably owes much to a reaction against the long-gone but emotionally draining days of the internet bubble. We have therefore added to our existing holdings and made new investments which excite us for the future despite the downbeat market mood.

We have increased our holdings in Samsung Electronics, SAP and Canon. These three stocks have little in common by geography or technology but all of them possess dominant global leadership and demonstrate an admirable willingness to reinvest in their core businesses and an associated refusal to pander to short-term earnings guidance obsession of the markets. We would be disappointed not to own these stocks for years to come.

We have bought holdings in eBay and Amazon.com. These purchases are the key reason that our US exposure has risen in the course of the year. Neither has helped our performance as yet but we continue to view share price weakness as an opportunity to add to our holdings. We are particularly attracted by the outstanding network driven competitive advantages and returns that eBay enjoys. We regard both continued investment in its global footprint and the purchase of Skype as sensible despite their dampening impact on short-term earnings.

Financial, Consumer Staples and now Housing in America

US equities have continued to under-perform global indices over the last year. Despite this the US stocks that we own have once again added value for our shareholders. We think that the discipline of simply picking equities that we believe to be intrinsically and individually attractive rather than making a decision to allocate a set percentage of assets to North America has helped us to invest sensibly. We must again pay tribute to the calibre of advice and decisions in our US department which has long refused to behave as index sensitive traders in favour of remaining dedicated stock pickers with particular skills in assessing consumer staples and financials. A notable example of this has been our successful holding in Moody's, the credit rating agency, with a franchise that we cannot find elsewhere in the world and a simplicity of business model that is unusual in the complex world of unwieldy financial conglomerates. Only valuation has made us trim our holding in recent months.

We have added to our holding of Hershey. Whilst we consider it implausible that its chocolate will interest global appetites it is clear that it remains a brand with powerful mind-share in its American heartland with strong profitability and consistent growth prospects. We sold our successful investment in Wendy's as the value of its ownership of Tim Horton's had become more apparent to the market. We replaced it with a stake in Brown-Forman, the maker of Jack Daniels and Southern Comfort, as the power of its focused marketing expertise continues to drive pleasing sales growth.

We are intrigued by how many people throughout the world appear to be worried about the stability of the US housing market. Whilst these anxieties may have some economic basis what seems much clearer is that US house-building equities already discount a great deal of bad news. Given the demographic tailwinds, prime property scarcity, increasing scale advantages, solid balance sheets and near book value ratings we think that this is becoming an area of considerable interest. Returns are higher and valuations substantially lower than for UK builders. At present we have purchased Ryland, which appears to us to be one of the best run and more conservative companies and we may increase our exposure in the year ahead.

The UK Market

The UK market returned 28.0% in the year to 31 March, the third successive year of double digit positive returns. Although domestic growth was subdued, the market offers significant exposure to the strong global economy which allowed profits and dividends to continue to rise at a healthy rate, while the abundance of cheap credit contributed to a boom in takeovers and corporate restructuring which pushed share valuations higher.

Our UK portfolio modestly beat the FT All-Share Index despite a relatively low exposure to the resource industries, where we find the most appealing investment opportunities outside the UK stock market. We added to our position in Rio Tinto, attracted by the combination of low cost long life reserves with a consistent and long-term management approach but we have continued to shun the UK listed oil majors BP and Royal Dutch Shell, both of which were poor performers over the period. Underperformance and a steady rise in expectations for future oil prices and profits have combined to reduce the prospective valuations on both companies but for the time being we continue to identify better investment opportunities in overseas markets. Towards the end of the period we also sold our preferred UK energy company BG, following a surge in the share price and valuation, in part fuelled by takeover speculation.

Elsewhere we benefited from a strong recovery in the share price of the hedge fund manager Man Group and also from Standard Chartered and Northern Rock, all of which had seen substantial purchases in the previous year, although our continued confidence in the investment appeal of Royal Bank of Scotland has yet to be repaid. The UK property sector has also been a highly profitable area for the fund over recent years, with a recovery in rents and falling yields translating into very strong share price performance thanks to high financial gearing and the narrowing of discounts. Most of these drivers now look to be slowing and with future returns likely to be much more modest we have begun to reduce exposure. Disappointments included Vodafone, where we made significant reductions in the face of deteriorating prospects, mainly driven by falling prices. We remain hopeful that the UK consumer's appetite for DIY will recover and are retaining our so far unsuccessful investments in Kingfisher (owner of B&Q) and Travis Perkins (owner of Wickes), while we have taken advantage of weakness in Royal Bank of Scotland, Reed Elsevier and Carnival to add to our already significant positions.

Portfolio activity was higher than usual, with net sales of approaching £60m, leading to a fall in the number of UK investments and a further decline in the proportion of assets invested domestically. The two largest sales were BG and the reduction of Vodafone but others included Allied Domecq and BOC, both of which received bids from European companies; the media companies BSkyB and Trinity Mirror, which are both experiencing increased competition enabled by new technologies; and the life insurers Aviva and Friends Provident. We continue to focus our portfolio on companies where we have a high degree of confidence in sustainable longer term growth and rising profitability and we bought new holdings in Yell, Schroders and Inchcape, all of which have made a positive contribution to date.

UK economic growth was sluggish in 2005 and we expect more of the same going forward, with high levels of consumer and public debt dampening domestic demand. While the stock market offers exposure to much more than just the domestic economy, some of our recent favourites have seen a significant rerating and now look less appealing. Unless we can identify a range of new buying ideas, the UK stake may continue to shrink simply because we are able to find a broader range of potential investments elsewhere in the world.

Fixed Interest

Scottish Mortgage's bond portfolio earned a return of 9.6% in the year to 31 March. World economic growth has generally been higher than expected, the United States economy has grown only slightly less than in 2004 while Europe and Japan are showing signs of sustainable economic recovery. Importantly for bond markets, consumer price inflation has remained very subdued despite higher oil prices. In many respects the most disappointing economic performance has been that of the United Kingdom where growth has been lower than expected and inflation higher.

The response of both the United States and European central banks has been to raise short-term interest rates from their unusually low levels. The Fed raised rates eight times to reach a level of 4.75% while the ECB raised rates from 2% to 2.5% in two steps. Against the global trend, the Bank of England cut its base borrowing rate to 4.5% in August in the face of weakening consumer spending.

US ten year government bond yields rose by 0.4% and euro government bonds by 0.2%. As a result returns were meagre in both markets – 1.9% and 2.7% respectively. Gilts did much better, ten year bonds returning 6.9% as yields fell by 0.3%. As well as the weaker economy, sterling bonds benefited from strong buying by pension funds owing to regulatory changes. Scottish Mortgage's bond portfolio benefited from strengthening currencies – the US dollar appreciated by 8.9% and the euro by 1.4%.

The Trust's fixed interest portfolio consists of bonds issued by various companies in sterling, euros and US dollars. It has shrunk in size from £75 million to £66 million over the past twelve months due to shifts in the Trust's asset allocation. The biggest change in the portfolio was the sale of our long-standing investment in Bank of Scotland Shared Appreciation Mortgage bonds which had done well from past growth in house prices. Some of the proceeds have been reinvested in a range of corporate bonds, particularly higher yielding securities.

With little anticipation of falling government bond yields, the focus is firmly finding company's whose bonds will benefit from improved creditworthiness. While strong corporate earnings are aiding this quest, there has been a clear trend towards companies taking a more 'shareholder friendly' approach. In concrete terms this means higher dividend payments, large share buy-backs and more debt-financed investment; each of these factors can lead to a company's bonds performing poorly. So while corporate bonds performed slightly better than government bonds in aggregate, this masked a highly variable pattern of returns at stock level.

We have found an unusual number of opportunities recently in the insurance industry. The increased oversight of financial regulators has considerably reduced the risks of malfeasance or poor balance sheet discipline and, in particular, UK life insurance companies now bear considerably less exposure to the equity market. 2005's extraordinarily high losses following the Caribbean hurricane season illustrated the strength of Lloyd's and the major reinsurance companies' reserves. We have, therefore, bought bonds issued by Lloyd's of London and Talanx, the owner of Hannover Re.

The economic environment and generally improved investor sentiment have been beneficial for the high yield bond market. The default rate for highly-indebted companies remained extremely low for the third year in succession. The European high yield market returned 6.6% in 2005, easily eclipsing returns on government bonds and investment grade bonds. 48% of the Trust's bond portfolio is high yield, up from 29% in 2005, and high yield was a major contributor to performance this year.

The outlook is for moderate returns from investment grade bonds. In the absence of an economic slowdown, high yield bonds will probably do rather better. In all cases, with corporate activity an increasingly volatile factor, we expect our stock-picking abilities to need to be at the fore.

Portfolio Outlook

Whilst three years of steady recovery in equities may have made investors somewhat complacent we still find scope for cautious optimism. Fundamentally we are still finding too many companies with high quality earnings streams and appealing growth prospects selling at reasonable valuations to want to raise cash or even reduce our modest gearing. A setback is always possible and there are sufficient political and economic anxieties to provide the rationalisation for any such correction but at present we would see such a development as likely to provide opportunities for new purchases and additions rather than as a cause for long-term concern. Demonstrating our ability to identify these opportunities will be the decisive task in the years ahead.

Thirty Largest Equity Holdings and Equity Performance as at 31 March 2006

Name	Business	Market value £'000	Market value 31 March 2005 £'000	% of total assets	Performance† Absolute %	Performance† Relative %
Petrobras	Oil company	69,950	31,127	3.5	136.08	81.99
Gazprom	Gas producer	65,338	19,412	3.3	198.56	130.14
Royal Bank of Scotland	Banking	52,444	42,555	2.6	15.73	(10.79)
Samsung Electronics	Electronics manufacturer	52,063	31,119	2.6	43.85	10.89
SAP	Business software	48,269	24,030	2.4	46.87	13.22
Barclays	Banking	45,701	36,737	2.3	29.87	0.11
Atlas Copco	Engineering	44,919	23,581	2.3	108.34	60.60
British American Tobacco	Tobacco	44,259	29,607	2.2	54.76	19.29
eBay	Internet trading company	41,058	–	2.1	(1.35)*	(16.12)*
GlaxoSmithKline	Pharmaceuticals	40,635	32,751	2.0	28.02	(1.32)
Omnicom	Advertising agency	38,395	20,411	1.9	3.41	(20.28)
Man Group	Hedge fund manager and asset gatherer	36,975	20,580	1.9	84.08	41.89
EOG Resources	Gas and oil exploration and production	36,693	22,783	1.8	61.28	24.32
Rio Tinto	Diversified mining	35,064	13,664	1.8	77.45	36.79
Wolseley	Builders' merchant	34,619	16,886	1.7	29.32	(0.32)
Canon	Printers, copiers and cameras	33,876	10,962	1.7	35.70	4.61
CVRD	Iron ore mining	32,085	14,895	1.6	83.14	41.17
Golden West Financial	Savings and loans	31,306	25,588	1.6	22.71	(5.41)
Northern Rock	Mortgage banking	30,784	20,631	1.6	54.42	19.03
Sandvik	Engineering	30,268	16,557	1.5	57.23	21.20
Carnival	Cruise ship operator	28,945	15,138	1.5	(1.43)*	(24.02)*
The Hershey Company	Confectionery	28,427	15,609	1.4	(5.00)	(26.77)
Teva Pharmaceuticals	Generic drugs manufacturer	28,301	19,554	1.4	45.67	12.29
Moody's	Bond rating agency	27,351	20,819	1.4	93.76	49.36
Standard Chartered	Banking	26,506	17,612	1.3	54.56	19.14
Reed Elsevier	Publisher	25,975	–	1.3	10.83*	(16.86)*
ConocoPhillips	Integrated oil company	25,480	19,962	1.3	30.02	0.22
Vodafone	Mobile telecommunication services	25,252	66,486	1.3	(11.28)	(31.61)
Porsche	Automobiles	25,139	12,808	1.3	43.60	10.69
Microsoft	Software products	25,117	10,165	1.3	23.81	(4.56)
		1,111,194	652,029	**55.9**		

† Absolute and relative performance has been calculated over the period 1 April 2005 to 31 March 2006. Absolute performance is in sterling terms; relative performance is against the benchmark: 50% FTSE All-Share Index and 50% FTSE World Ex UK Index (in sterling terms).

* Figures relate to part-period returns relating to the holding period of the relevant stock.

Source: Baillie Gifford & Co/StatPro.

Past performance is no guarantee of future performance.

Investment Changes (£'000)

	Valuation at 31 March 2005 Restated†	Net acquisitions (disposals)	Appreciation (depreciation)	Valuation at 31 March 2006
Equities*:				
United Kingdom	607,623	(58,253)	146,052	695,422
Continental Europe	141,227	(5,027)	72,122	208,322
North America	312,804	82,626	90,620	486,050
Japan	69,349	(20,429)	29,038	77,958
Asia Pacific	130,474	(29,806)	73,174	173,842
Emerging Markets	112,034	(4,294)	141,233	248,973
Total equities	1,373,511	(35,183)	552,239	1,890,567
Bonds:				
Sterling bonds	56,660	(22,840)	523	34,343
Euro bonds	13,694	5,869	938	20,501
US dollar bonds	4,487	6,356	326	11,169
Total bonds	74,841	(10,615)	1,787	66,013
Total investments	1,448,352	(45,798)	554,026	1,956,580
Net liquid assets	7,352	21,263	(33)	28,582
Total assets	**1,455,704**	**(24,535)**	**553,993**	**1,985,162**

The figures above for total assets are made up of total net assets before deduction of debentures, long and short term borrowings.

* Equities include OEICs, unit trusts and limited partnerships.
† See notes 1 and 2 on pages 38 and 39.

Classification of Investments

Classification Equities*:	UK %	Continental Europe %	North America %	Japan %	Asia Pacific %	Emerging Markets %	2006 Total %	2005 Total† %
Oil and Gas	**–**	**–**	**3.1**	**–**	**0.5**	**7.9**	**11.5**	**11.1**
Oil and gas producers	–	–	3.1	–	0.5	7.9	11.5	11.1
Basic Materials	**1.8**	**–**	**0.9**	**–**	**0.9**	**3.3**	**6.9**	**6.6**
Chemicals	–	–	0.9	–	–	–	0.9	1.8
Mining	1.8	–	–	–	0.9	3.3	6.0	4.8
Industrials	**3.3**	**3.8**	**0.9**	**2.2**	**3.2**	**–**	**13.4**	**12.9**
Construction and materials	–	–	–	–	–	–	–	0.4
Electronic and electrical equipment	–	–	0.9	1.7	2.6	–	5.2	4.1
Industrial engineering	–	3.8	–	–	–	–	3.8	4.2
Industrial transportation	–	–	–	0.5	0.6	–	1.1	0.8
Support services	3.3	–	–	–	–	–	3.3	3.4
Consumer Goods	**4.9**	**2.3**	**5.3**	**0.6**	**0.8**	**–**	**13.9**	**15.9**
Automobiles and parts	–	2.3	–	0.6	0.8	–	3.7	3.2
Beverages	1.2	–	0.9	–	–	–	2.1	2.3
Food producers	–	–	1.9	–	–	–	1.9	2.5
Household goods	1.0	–	1.6	–	–	–	2.6	2.2
Personal goods	–	–	–	–	–	–	–	0.6
Tobacco	2.7	–	0.9	–	–	–	3.6	5.1
Health Care	**2.3**	**–**	**1.0**	**–**	**–**	**1.4**	**4.7**	**4.9**
Health care equipment and services	–	–	1.0	–	–	–	1.0	1.0
Pharmaceuticals and biotechnology	2.3	–	–	–	–	1.4	3.7	3.9
Consumer Services	**7.4**	**0.5**	**7.0**	**–**	**–**	**–**	**14.9**	**10.4**
Food and drug retailers	1.0	–	1.8	–	–	–	2.8	2.2
General retailers	0.9	0.5	3.3	–	–	–	4.7	1.6
Media	2.7	–	1.9	–	–	–	4.6	3.3
Travel and leisure	2.8	–	–	–	–	–	2.8	3.3
Telecommunications	**1.3**	**–**	**–**	**–**	**–**	**–**	**1.3**	**4.6**
Mobile telecommunications	1.3	–	–	–	–	–	1.3	4.6
Financials	**13.5**	**1.0**	**4.4**	**1.1**	**3.4**	**–**	**23.4**	**23.9**
Banks	7.8	–	–	–	1.1	–	8.9	9.1
Non-life insurance	–	–	0.7	0.6	–	–	1.3	0.3
Life assurance	–	–	–	–	–	–	–	2.4
Real estate	1.9	–	–	–	0.6	–	2.5	2.3
General financial	3.1	–	3.7	0.5	1.7	–	9.0	7.4
Investment companies	0.7	1.0	–	–	–	–	1.7	2.4
Technology	**0.5**	**2.9**	**1.9**	**–**	**–**	**–**	**5.3**	**4.1**
Software and computer services	0.5	2.4	1.3	–	–	–	4.2	3.0
Technology hardware and equipment	–	0.5	0.6	–	–	–	1.1	1.1
Total Equities*	**35.0**	**10.5**	**24.5**	**3.9**	**8.8**	**12.6**	**95.3**	
Total Equities* – 2005	41.7	9.7	21.5	4.8	9.0	7.7		**94.4**
Bonds	1.7	1.0	0.6	–	–	–	3.3	5.1
Net Liquid Assets	0.9	0.1	0.4	–	–	–	1.4	0.5
Total Assets (before deduction of debentures, long and short term borrowings)	**37.6**	**11.6**	**25.5**	**3.9**	**8.8**	**12.6**	**100.0**	
Total Assets – 2005	46.1	10.6	21.8	4.8	9.0	7.7		**100.0**
Debentures, Long and Short Term Borrowings	(7.7)	(2.6)	–	–	(1.4)	–	(11.7)	(14.6)
Equity Shareholders' Funds	**29.9**	**9.0**	**25.5**	**3.9**	**7.4**	**12.6**	**88.3**	
Equity Shareholders' Funds – 2005	35.7	10.6	19.6	4.8	7.0	7.7		**85.4**
Number of equity investments*	**33**	**9**	**22**	**5**	**9**	**8**	**86**	**101**

* Including OEICs, unit trusts and limited partnerships.
† Restated, see notes 1 and 2 on pages 38 and 39, also FTSE sectors reclassified January 2006.

Classification	Name	Business	Market value £'000	% of total assets
United Kingdom				
Mining	Rio Tinto	Diversified mining	35,064	1.8
Support services	Capita	Support services	8,731	
	Hays	Personnel and recruitment services	10,546	
	Travis Perkins	Builders' merchant	12,763	
	Wolseley	Builders' merchant	34,619	
			66,659	3.3
Beverages	Diageo	Branded spirits	24,643	1.2
Household goods	Wimpey	House builder	19,582	1.0
Tobacco	British American Tobacco	Tobacco	44,259	
	Imperial Tobacco	Tobacco	8,530	
			52,789	2.7
Pharmaceuticals and biotechnology	GlaxoSmithKline	Pharmaceuticals	40,635	
	Shire Pharmaceuticals	Pharmaceuticals	5,383	
			46,018	2.3
Food and drug retailers	Alliance UniChem	Pharmaceutical distributor and pharmacy operator	19,712	1.0
General retailers	Inchcape	Motor distributor	8,473	
	Kingfisher	DIY retailer	10,288	
			18,761	0.9
Media	Aegis	Media services	5,733	
	Reed Elsevier	Publisher	25,975	
	Yell Group	Directories	21,236	
			52,944	2.7
Travel and leisure	Carnival	Cruise ship operator	28,945	
	Ladbrokes	Licensed betting operator	19,450	
	William Hill	Licensed betting operator	7,806	
			56,201	2.8
Mobile telecommunications	Vodafone	Mobile telecommunication services	25,252	1.3
Banks	Barclays	Banking	45,701	
	Northern Rock	Mortgage banking	30,784	
	Royal Bank of Scotland	Banking	52,444	
	Standard Chartered	Banking	26,506	
			155,435	7.8
Real estate	British Land	Property	13,651	
	Hammerson	Property	16,620	
	Shaftesbury	Property	7,364	
			37,635	1.9
General financial	Intermediate Capital Group	Mezzanine finance provider	9,056	
	Man Group	Hedge fund manager and asset gatherer	36,975	
	Schroders	General financial	15,444	
			61,475	3.1
Investment companies	UK Balanced Property Trust	Property investment trust	13,260	0.7
Software and computer services	Sage	Small business software	9,992	0.5
Total United Kingdom Equities			**695,422**	**35.0**

Classification	Name	Business	Market value £'000	% of total assets
Continental Europe				
Industrial engineering	Atlas Copco	Engineering – Sweden	44,919	
	Sandvik	Engineering – Sweden	30,268	
			75,187	3.8
Automobiles and parts	BMW	Automobiles – Germany	21,365	
	Porsche	Automobiles – Germany	25,139	
			46,504	2.3
General retailers	Hermes	Luxury goods – France	9,120	0.5
Investment companies	Baillie Gifford European Smaller Companies Fund	Small company fund	16,281	
	Black Sea Property Fund	Bulgarian property trust	2,525	
			18,806	1.0
Software and computer services	SAP	Business software – Germany	48,269	2.4
Technology hardware and equipment	Ericsson	Telecommunications equipment – Sweden	10,436	0.5
Total Continental European Equities			**208,322**	**10.5**
North America				
Oil and gas producers	ConocoPhillips	Integrated oil company	25,480	
	EOG Resources	Gas and oil exploration and production	36,693	
			62,173	3.1
Chemicals	Monsanto	Seed and agricultural chemicals	18,075	0.9
Electronic and electrical equipment	Rockwell Automation	Industrial automation providers	18,653	0.9
Beverages	Brown-Forman	Wines and spirits producer	16,860	0.9
Food producers	The Hershey Company	Confectionery	28,427	
	William Wrigley	Chewing gum	8,302	
			36,729	1.9
Household goods	Mohawk Industries	Carpets	12,160	
	Ryland	House builder	19,993	
			32,153	1.6
Tobacco	Altria	Tobacco and food	18,378	0.9
Healthcare equipment and services	Wellpoint	Managed care	18,743	1.0
Food and drug retailers	Shoppers Drug Mart	Drug store – Canada	21,962	
	Walgreen	Pharmacy chain	13,573	
			35,535	1.8
General retailers	Amazon.com	Online retailer	23,971	
	eBay	Internet trading company	41,058	
			65,029	3.3
Media	Omnicom	Advertising agency	38,395	1.9
Non-life insurance	Progressive Ohio	Property and casualty insurance	14,395	0.7
General financial	Golden West Financial	Savings and loans	31,306	
	Moody's	Bond rating agency	27,351	
	T Rowe Price	Fund management	15,024	
			73,681	3.7
Software and computer services	Microsoft	Software products	25,117	1.3
Technology hardware and equipment	Linear Tech	Linear integrated circuits	12,134	0.6
Total North American Equities			**486,050**	**24.5**

Classification	Name	Business	Market value £'000	% of total assets
Japan				
Electronic and electrical equipment	Canon	Printers, copiers and cameras	33,876	1.7
Industrial transportation	Mitsui OSK Lines	Shipping	9,844	0.5
Automobiles and parts	Nissan Motor	Car manufacturer	11,988	0.6
Non-life insurance	Mitsui Sumitomo Insurance	Non-life insurer	11,461	0.6
General financial	*Mac Japan 2 Unit Trust	Unit trust fund	10,789	0.5
Total Japanese Equities			**77,958**	**3.9**
Asia Pacific				
Oil and gas producers	CNOOC	Oil and gas production – China	10,816	0.5
Mining	BHP Billiton	Diversified resources – Australia	17,760	0.9
Electronic and electrical equipment	Samsung Electronics	Electronics manufacturer – Korea	52,063	2.6
Industrial transportation	Zhejiang Expressway	Transport – China	11,532	0.6
Automobiles and parts	Hero Honda Motors	Motorcycle and scooter manufacturer – India	15,169	0.8
Banks	Australia and New Zealand Banking	Banking – Australia	22,243	1.1
Real estate	Shanghai Forte Land	Residential property – China	11,079	0.6
General financial	Hansung Development Finance Corporation	Mortgage bank – India	17,552	
	Singapore Exchange	Securities exchange owner/operator – Singapore	15,628	
			33,180	1.7
Total Asia Pacific Equities			**173,842**	**8.8**
Emerging Markets				
Oil and gas producers	Gazprom	Gas producer – Russia	65,338	
	Lukoil	Oil company – Russia	20,455	
	Petrobras	Oil company – Brazil	69,950	
			155,743	7.9
Mining	Anglo American Platinum	Platinum mining – South Africa	12,142	
	Norilsk Nickel	Mining company – Russia	14,943	
	*Polyus Gold	Mining company – Russia	5,759	
	CVRD	Iron ore mining – Brazil	32,085	
			64,929	3.3
Pharmaceuticals and biotechnology	Teva Pharmaceuticals	Generic drugs manufacturer – Israel	28,301	1.4
Total Emerging Markets Equities			**248,973**	**12.6**
Total Equity Investments			**1,890,567**	**95.3**

*denotes unlisted security.

Classification	Name	Market value £'000	% of total assets
Fixed Interest			
Sterling denominated	AMP Group Finance 6.875% 2022	2,122	
	AMP Group Finance 7.125% 2019	1,980	
	BAA 5.75% 2031	2,752	
	Business Mortgage Finance FRN 2037	1,670	
	Cairngorm Limited Class E FRN 2016	3,180	
	Delamare Finance 6.067% 2029	996	
	Dignity Finance 8.151% 2030	2,977	
	Daimler Chrysler 5.375% 2007	2,004	
	Eurotunnel 8.15% 2026	1,522	
	France Telecom 8% 2017	2,420	
	Lloyds Society 6.875% 2025	2,110	
	Resolution 6.5864% Perpetual 2016	1,980	
	Safeway 6.125% 2018	2,056	
	Scottish Mutual 7.25% Perpetual 2021	3,341	
	Tube Lines Finance 8.6801% 2031	1,522	
	Tube Lines Finance 11.1776% 2031	1,711	
		34,343	1.7
Euro denominated	CME 8.25% 2012	1,554	
	Duchess II D2 FRN 2015	1,395	
	Duchess II E2 FRN 2015	1,449	
	Eco-Bat PIK 10% 2015	3,043	
	Euro Max IV Income Notes	2,791	
	Europa Two 14% 2027	1,762	
	Fresenius Finance 5% 2013	1,039	
	Nymphenburg FRN 2025	1,079	
	Skye CLO Income Notes 2019	2,323	
	Talanx 4.5% 2025	1,973	
	Wood Street CLO Income Notes 2021	2,093	
		20,501	1.0
US$ denominated	CMA CGM 7.25% 2013	1,997	
	Ford Motor Company 7.25% 2008	3,139	
	Old Mutual 8% Perpetual 2008	2,408	
	Stagecoach 8.625% 2009	829	
	TCW Gem VII Income Notes 2016	2,796	
		11,169	0.6
Total Fixed Interest		**66,013**	**3.3**
Total Investments		**1,956,580**	**98.6**
Net Liquid Assets		**28,582**	**1.4**
Total Assets at Market Value		**1,985,162**	**100.0**
(before deduction of debentures, long and short term borrowings)			

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* (market) p	Net asset value per share* (book) p	Share price p	Discount† (market) %	Discount† (book) %
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	434.9	457.3	375.5	13.7	17.9
2000	2,206,594	279,010	1,927,584	569.1	549.2	570.2	493.5	10.1	13.5
2001	1,660,182	195,893	1,464,289	445.4	430.9	447.5	377.0	12.5	15.8
2002	1,509,887	206,899	1,302,988	421.4	409.4	423.6	369.0	9.9	12.9
2003	1,051,545	207,225	844,320	283.3	268.0	285.5	234.5	12.5	17.9
2004	1,355,341	227,560	1,127,781	379.3	362.8	381.5	305.0	15.9	20.1
2005§	1,455,704	213,083	1,242,621	420.4	398.8	422.6	333.0	16.5	21.2
2006	**1,985,162**	**231,809**	**1,753,353**	**608.6**	**584.1**	**610.9**	**521.5**	**10.7**	**14.6**

* Net asset value per ordinary share has been calculated after deducting prior charges at either book value or market value (see note 23, page 48).

† Discount is the difference between Scottish Mortgage's quoted share price and its underlying net asset value at either book value or market value.

§ Restated, see notes 1 and 2 on pages 38 and 39.

Revenue

Gearing Ratios

Year to 31 March	Gross revenue £'000	Available for ordinary shareholders £'000	Revenue earnings per ordinary share‡ p	Dividend paid and proposed per ordinary share net p	Total expense ratio§§ %	Actual gearing¶	Potential gearing‖
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
2004	35,829	23,931	8.05	7.00	0.60	111	120
2005	35,456	21,809	7.37	7.35	0.52	110	117
2006	**41,456**	**25,738**	**8.82**	**8.50**	**0.52**	**108**	**113**

‡ 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 9, page 41).

§§ 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 (taking 1996 as 100)

At 31 March	Net asset value per share (book)	Net asset value total return (book)††	Benchmark	Benchmark total return‡‡	Share price	Share price total return††	Revenue earnings per ordinary share	Dividend paid and proposed per ordinary share net	Retail price index
1996	100	100	100	100	100	100	100	100	100
1997	109	111	106	109	108	111	115	111	103
1998	141	147	137	145	143	149	101	115	106
1999	148	156	149	161	140	150	95	118	108
2000	184	196	173	189	184	198	132	122	111
2001	144	156	148	165	140	154	128	129	114
2002	137	150	140	160	137	153	127	134	115
2003	92	103	95	111	87	100	125	142	119
2004	123	143	118	142	113	135	136	151	122
2005	136	157	128	159	124	149	124	158	126
2006	**197**	**232**	**162**	**206**	**194**	**238**	**149**	**183**	**129**
Compound annual returns									
5 year	6.4%	8.4%	1.8%	4.5%	6.7%	9.2%	3.1%	7.2%	2.5%
10 year	7.0%	8.8%	4.9%	7.5%	6.9%	9.1%	4.0%	6.2%	2.6%

†† Source: AITC.

‡‡ Source: Thomson Financial Datastream.

The figures prior to 2005 have not been restated for the changes in accounting policies detailed in notes 1 and 2 on pages 38 and 39.

Past performance is no guarantee of future performance.

Directors' Report

The Directors have pleasure in submitting their Annual Report together with the results of the Company for the year to 31 March 2006.

Business Review

Objective

Scottish Mortgage carries on business as an Investment Trust. The investment objective is to maximise total return, whilst also generating real dividend growth, from a focused and actively managed global portfolio. The equity portfolio is relatively concentrated and investments are chosen on their long-term merits rather than with reference to geographical asset allocation or the composition of an index.

Investment Strategy

Scottish Mortgage is positioned as a truly active fund and does not attempt to track its benchmark index. Investments are chosen for inclusion within the equity portfolio by looking closely at the merits of individual companies. The investment approach focuses on three points:

- Taking a global perspective;
- Maintaining a relatively concentrated equity portfolio;
- Having a long-term investment horizon.

Further details of investment strategy can be found in the Chairman's Statement on page 4 and the Managers' Review on pages 8 to 13.

Gearing

Borrowings are invested in equity markets when it is considered that investment grounds merit the Company taking a geared position to equities. Gearing levels, and the extent of equity gearing, both in absolute terms and relative to the peer group, are discussed by the Board and Managers at every Board meeting. The portion of borrowings which is not invested in equities may be invested in fixed interest securities.

Discount

The Board recognises that it is in the long term interests of shareholders to reduce discount volatility and believes that the prime driver of discounts over the longer term is performance. The Board does not intend to issue a precise discount target at which shares will be bought back as it believes that the announcement of specific targets is likely to hinder rather than help the successful execution of a buyback policy. Future buybacks will be considered by reference to the Company's discount relative to its peers.

During the year the Company bought back a total of 7,530,000 shares for cancellation, increasing net asset value per share by 0.44%.

Performance

At each Board meeting, the Directors consider a number of performance measures to assess the Company's success in achieving its objectives.

The key performance indicators (KPIs) used to measure the progress and performance of the Company over time are established industry measures and are as follows:

- The movement in net asset value per ordinary share (after deducting debentures at market value);
- The movement in the share price;
- The movement of net asset value and share price performance compared to the Benchmark;
- The discount (after deducting debentures at market value);
- The total expense ratio;
- Earnings per share;
- Dividend per share.

The one and five year records of the KPIs are shown on pages 2, 3 and 21.

In addition to the above, the Board considers peer group comparative performance. A range of comparator groups are used including: a group of the five largest AITC Global Growth investment trusts (Large Trust Peer Group), a universe of global growth trusts as defined by Winterflood Securities, the AITC Global Growth Sector and the larger Standard and Poor's universe of Global Growth Trusts. The Company's net asset value and share price total return performance compared to the Large Trust Peer Group and the AITC Global Growth Sector is shown in the following table. The Board also reviews the absolute and relative discount. At 31 March 2006 the discount was 10.7% compared to 7.8% for the weighted average of the AITC Global Growth Sector.

Directors' Attendance at Meetings

	Board	Audit Committee	Nomination Committee
Number of meetings	**7**	**2**	**2**
Sir Donald MacKay	7	2	2
GA Ball	7	2	2
MM Gray	5	2	1
WG McQueen	7	2	2
JPHS Scott	6	2	1
Lord Strathclyde	6	2	2

Net Asset Value and Share Price Total Return† Performance

	One Year %	Five Years %
Net Asset Value ‡	47.7	48.6
Benchmark	29.7	24.5
Large Trust Peer Group weighted average net asset value	34.6	28.4
AITC Global Growth Sector weighted average net asset value	36.6	34.5
Share Price	60.1	53.9
Large Trust Peer Group weighted average share price	39.0	30.2
AITC Global Growth Sector weighted average share price	40.9	38.0

Source: AITC/Fundamental Data

† Total return includes both capital growth and income reinvested.

‡ Net asset value total return after deducting debentures at par.

Current and future development

A review of the main features of the year is contained in the Chairman's Statement and the Manager's Review on pages 4 to 5 and 8 to 13 respectively. The Board's main focus is on the investment return and approach. Attention is paid to the integrity and success of the investment approach and on factors which may have an impact on this approach. Due regard is paid to the marketing and promotion of the Company, including effective communication with shareholders and other external parties. The Board is updated regularly on wider investment trust sector issues. Detailed papers are presented to the Board at the Annual Strategy Meeting where a wide discussion takes place on development and strategic direction. The Company's brokers, UBS, present to the Board on an annual basis and cover the topics of sector developments, perception of the Company and relevant strategic issues.

Principal Risks and Uncertainties

The principal risks facing the Company relate to the Company's investment activities and include market risk, interest rate risk, credit risk, liquidity risk, foreign currency risk and loss of investment trust status. An explanation of these risks and how they are managed are contained in note 23 to the accounts on page 46.

Financials

In the year under review, the Company has had to comply with a number of new Financial Reporting Standards which were introduced as part of the UK convergence programme with International Financial Reporting Standards. The main changes to the Company's financial statements resulting from these new Standards are that investments are now valued at bid prices rather than mid, income from fixed interest securities is calculated using the effective interest method and dividends declared after the period end are no longer treated as a liability at the period end. These changes are explained in more detail in note 1 on page 38.

The Company has additional long term finance in the format of long dated bonds. There are four debentures in issue, all are listed and quoted on the London Stock Exchange and details are given on pages 43 and 48. In addition, shorter term bank borrowings and loan facilities are in place which are also shown on pages 43 and 48.

The financial highlights for the year under review are as follows: the net asset value per share increased by 46.5% during the year, compared to an increase in the benchmark of 26.3%, dividends increased by 15.6% to 8.50p per share and the discount narrowed from 16.5% to 10.7%.

Dividends

The Board recommends a final dividend of 4.65p per ordinary share which, together with the interim of 3.85p already paid, makes a total of 8.50p for the year compared with 7.35p for the previous year.

If approved, the recommended final dividend on the ordinary shares will be paid on 5 July 2006 to shareholders on the register at the close of business on 9 June 2006. The ex-dividend date is 7 June 2006.

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. In the opinion of the Directors, the Company conducts its affairs so as to enable it to obtain approval by the Inland Revenue as an investment trust under section 842 of the Income and Corporation Taxes Act 1988. The Company was approved as an investment trust for the year ended 31 March 2005, subject to matters that may arise from any subsequent enquiry by the Inland Revenue into the Company's tax return. The Company will continue to seek approval under section 842 of the Income and Corporation Taxes Act 1988 each year.

Directors' interests

Name	Nature of interest	Ordinary 25p shares held at 31 March 2006	31 March 2005
Sir Donald MacKay	Beneficial	2,469	2,469
GA Ball	Beneficial	10,000	10,000
MM Gray	Beneficial	272,900	272,900
	Non-beneficial	12,500	12,500
WG McQueen	Beneficial	1,500	1,500
	Non-beneficial	3,000	3,000
JPHS Scott	Beneficial	30,566	15,464
Lord Strathclyde	Beneficial	3,142	3,142

The Directors at the year end, and their interests in the Company, were as shown above.
There have been no changes intimated in the Directors' interests up to 9 May 2006.

Corporate Governance

The Board is committed to achieving and demonstrating high standards of Corporate Governance. This statement outlines how the principles of the Combined Code on Corporate Governance (the "Combined Code") were applied throughout the financial year.

Compliance

The Company has complied throughout the year under review with the provisions of the Combined Code except that no limit has been imposed on the overall length of service of Directors.

The Directors recognise the value of progressive refreshing of, and succession planning for, company Boards and the Board composition is reviewed annually. However, the Board is of the view that length of service will not necessarily compromise the independence or contribution of Directors of an investment trust company, where continuity and experience can add significantly to the strength of the Board. Consequently, no limit has been imposed on the overall length of service. All Directors are however required to retire and, if appropriate seek re-election, at least every three years. Directors who have more than nine years' service submit themselves for re-election annually.

The Board is also adhering to the principles of the AITC Code in all material respects.

The Board

The Board has overall responsibility for the Company's affairs. It has a number of matters reserved for its approval including strategy, investment policy, currency hedging, gearing, treasury matters, dividend and corporate governance policy. A separate meeting devoted to strategy is held each year. The Board also reviews the financial statements, investment transactions, revenue budgets and performance. Full and timely information is provided to the Board to enable the Board to function effectively and to allow Directors to discharge their responsibilities.

The Board currently comprises six Directors, all of whom are non-executive. The executive responsibility for investment management has 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. The Senior Independent Director is Mr GA Ball.

The Directors believe that the Board has a balance of skills and experience that enable it to provide effective strategic leadership and proper governance of the Company. Information about the Directors, including their relevant experience, can be found on page 6.

There is an agreed procedure for Directors to seek independent professional advice, if necessary, at the Company's expense. The Company also maintains Directors' and Officers' Liability insurance.

Independence of Directors

All the Directors are considered by the Board to be independent of the Managers and free of any business or other relationship that could interfere with the exercise of their independent judgement.

Mr GA Ball, who has served on the Board for more than nine years, offers himself for re-election annually. The Board subscribes to the view expressed in the AITC Code that long-serving Directors should not be prevented from being considered as independent. Following a formal performance evaluation, the Board has concluded that, notwithstanding his length of service, Mr Ball retains independence of character and judgement and his skills and experience add to the strength of the Board.

Meetings

There is an annual cycle of Board meetings which is designed to address, in a systematic way, overall strategy, review of investment policy, investment performance, marketing, revenue budgets, dividend policy and communication with shareholders. The Board considers that it meets sufficiently regularly to discharge its duties effectively. The table above shows the attendance record for the Board and Committee Meetings held during the year.

Nomination Committee

The Nomination Committee consists of the independent non-executive Directors and the Chairman of the Board is Chairman of the Committee. The Committee meets on an annual basis and at such other times as may be required. The Committee has written terms of reference which include reviewing the Board, identifying and nominating new candidates for appointment to the Board, Board appraisal, succession planning and training. Appointment of new Directors are considered by the Nomination Committee taking into account the need to maintain a balanced Board. The terms of reference are available on the Managers' website: **www.bailliegifford.com**.

Substantial Holdings

Name	No. of ordinary 25p shares held	% of issue
DC Thomson & Co Ltd	15,000,000	5.2
Prudential plc	10,938,100	3.8
Legal & General Investment Management	9,783,613	3.4

The above information has been intimated to the Company as at 9 May 2006 in compliance with section 198 of the Companies Act 1985.

Performance Evaluation

The Nomination Committee met to assess the performance of the Chairman, each Director, the Board as a whole and its committees, after inviting each Director and the Chairman to consider and respond to a set of questions. The appraisal of the Chairman was led by Mr GA Ball.

The appraisals considered amongst, other criteria, the balance of skills of the Board, the contribution of individual Directors and the overall effectiveness of the Board and its Committees. Following this process it was concluded that the performance of each Director, the Chairman, the Board and its Committees continues to be effective and each Director and the Chairman remain committed to the Company.

A review of the Chairman's and other Directors' commitments was carried out and the Nomination Committee is satisfied that they are capable of devoting sufficient time to the Company. There were no significant changes to the Chairman's other commitments during the year.

Terms of Appointment and Re-elections

Letters which specify the terms of appointment, are issued to new Directors. The letters of appointment are available for inspection on request.

Under the provisions of the Company's Articles of Association, a Director appointed during the year is required to retire and seek election by shareholders at the next Annual General Meeting. Directors are required to submit themselves for re-election at least once every three years and Directors who have served for more than nine years offer themselves for re-election annually.

The names of Directors retiring and offering themselves for re-election together with the reasons why the Board supports the re-elections are set out on page 27.

Induction and Training

New Directors are provided with an induction programme which is tailored to the particular circumstances of the appointee. Directors receive other relevant training as necessary.

Remuneration

Since all the Directors are non-executive, the provisions of the Combined Code in respect of Directors' remuneration are not relevant to the Company except to the extent that they relate specifically to non-executive directors. Consequently there is no requirement for a separate remuneration committee. Directors' fees are considered by the Board as a whole within the limits approved by shareholders. 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 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 confirms that a process is applied for identifying, evaluating and managing the significant risks faced by the Company in accordance with the guidance "Internal Control: Guidance for Directors on the Combined Code".

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 are 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 Baillie Gifford & Co heads of Business Risk & Internal Audit and Regulatory Risk provide the Board with regular reports on Baillie Gifford & Co's monitoring programmes. The reporting procedures for these departments are defined and formalised within a service level agreement. Baillie Gifford & Co conduct an annual review of their system of internal controls which is documented within an internal controls report (FRAG21). This report is independently reviewed by Baillie Gifford & Co's auditors and a copy is submitted to the Board.

The Company's investments are segregated from those of Baillie Gifford & Co and their other clients through the appointment of The Bank of New York as independent custodian of the Company's investments.

A detailed risk map is prepared which identifies the significant risks faced by the

Company and the key controls employed to minimise these risks.

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 and continue to be in place up to the date of approval of this Report.

Internal Audit

The Board has reviewed the need for an internal audit function and has decided that the compliance and internal control systems in place within the Investment Managers provide sufficient assurance that a sound system of internal control, which safeguards shareholders' investment and the Company's assets, is maintained. An internal audit function, specific to the trust, is therefore considered unnecessary.

Accountability and Audit

The respective responsibilities of the Directors and the Auditors in connection with the Financial Statements are set out on pages 31 to 33.

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 directors. Its authority and duties are clearly defined within its written terms of reference which are available on the Managers' website. Mr WG McQueen is chairman of the Audit Committee. The Committee's responsibilities which were discharged during the year include:

- monitoring and reviewing the integrity of the interim and annual financial statements and the internal financial controls;
- making recommendations to the Board in relation to the appointment of the external auditors and approving the remuneration and terms of their engagement;
- developing and implementing policy on the engagement of the external auditors to supply non-audit services;
- reviewing and monitoring the independence, objectivity and effectiveness of the external auditors;
- reviewing the arrangements in place within Baillie Gifford & Co whereby their staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters insofar as they may affect the Company;
- reviewing the terms of the Investment Management Agreement; and
- considering annually whether there is a need for the Company to have its own internal audit function.

The Audit Committee considers the experience and tenure of the audit director and staff and the nature and level of services provided. The Committee receives confirmation from the auditors that they have complied with the relevant UK professional and regulatory requirements on independence. Non audit fees for the year to 31 March 2006 were £4,750 and related to the certification of results for the debenture trustees and the credit rating issuer. The Committee does not believe that this has impaired the auditors' independence. In accordance with the professional rules on independence the current audit director will be replaced with a new audit director next year.

Relations with Shareholders

The Board places great importance on communication with shareholders. The Company's Managers meet regularly with institutional shareholders and report shareholders' views to the Board. The Chairman is available to meet with shareholders as appropriate. Shareholders wishing to communicate with any members of the Board may do so by writing to them at the address on the back cover.

The Company's Annual General Meeting provides a forum for communication with all shareholders. The Board announces the level of proxies lodged, including votes withheld, and the information is also published on the Managers' website. The notice period for the Annual General Meeting is at least twenty working days.

Shareholders and potential investors may obtain up-to-date information on the Company from the Managers' website.

Voting Policy and Socially Responsible Investment

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. The Managers' policy has been reviewed and endorsed by the Board.

Investment Managers

An Investment Management Agreement between the Company and Baillie Gifford & Co set 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. Details of the fee arrangements with Baillie Gifford & Co are shown on page 40.

The Board considers the Company's investment management and secretarial arrangements for the Company on a regular basis and a formal review is conducted annually. The Board considers, amongst others, the following topics in its review: the quality of the personnel assigned to handle the Company's affairs; success of the investment strategy; investment performance; the administrative services provided by the Secretaries and the marketing efforts undertaken by the Managers. Following the most recent review it is the opinion of the Directors that the continuing appointment of Baillie Gifford & Co as Managers, on the terms agreed, is in the interests of shareholders as a whole. Investment performance over the period under review has been excellent and the Managers and Secretaries also continue to maintain high standards in the provision of ancillary services.

Directors

Mr MM Gray and Mr WG McQueen retire by rotation at the Annual General Meeting and will offer themselves for re-election.

Mr GA Ball, having served for more than nine years, offers himself for re-election.

Following formal performance evaluation, their performance continues to be effective and each remain committed to the Company. Their contribution to the Board is greatly valued and the Board recommends their re-election to shareholders.

Disclosure of Information to Auditors

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company auditors are aware of that information.

Authority to Allot Shares and Disapply Pre-emption Rights

Resolution 10, which is being proposed as a special resolution and will therefore not be passed unless 75% of those voting are in favour, seeks to give the Directors power to sell ordinary shares held in treasury (see below) for cash up to a maximum of £7,145,628 in aggregate (representing 10% of the issued ordinary share capital of the Company as at 9 May 2006) without first being required to offer such shares to existing shareholders in accordance with the statutory pre-emption procedure.

This power will last until the Annual General Meeting of the Company to be held in 2007 or on 27 December 2007, whichever is earlier.

The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 (as amended) ("Treasury Shares Regulations") came into force on 1 December 2003. The Treasury Shares Regulations give flexibility concerning what the Company can do with any of its ordinary shares which it may buy-back. The Company may now hold such shares "in treasury" and then sell them at a later date for cash rather than simply cancelling them. The Treasury Shares Regulations require such sale to be on a pre-emptive, pro rata, basis to existing shareholders unless shareholders agree by special resolution to disapply their pre-emption rights. Accordingly, special resolution 10 will give the Directors power to sell ordinary shares held in treasury on a non pre-emptive basis, subject always to the limitations noted above. (Treasury shares are explained in more detail under the heading "Purchase of Shares" below). The Directors consider that the power proposed to be granted by Resolution 10 is advantageous should the shares trade at a premium to net asset value and natural liquidity is unable to meet demand. The Directors do not intend to use this power to sell shares on a non pre-emptive basis at a discount to net asset value.

The Directors believe that granting the power to sell treasury shares in the above circumstances is in the best interests of shareholders as a whole and recommend that shareholders vote in favour of the resolution.

Purchase of Shares

At the Annual General Meeting held on 30 June 2005 the Company renewed its authority to purchase shares in the market, in respect of up to 44,066,869 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 respect of the year ending 2006 or 29 December 2006, whichever is earlier, unless previously varied, revoked or renewed.

During the year to 31 March 2006 the Company bought back 7,530,000 ordinary shares (nominal value £1,882,500), on the London Stock Exchange for cancellation. The total consideration for these shares was £30,260,547. Between 1 April 2006 and the date of this report the Company has bought back a further 2,250,000 shares for cancellation at a cost of £11,756,746.

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 manage imbalances between the supply of and the demand for the Company's shares which exacerbates any 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 14 on page 44). As a result of such purchases the net asset value of the Company has increased by approximately 0.44%.

Resolution 9, which is being proposed as a special resolution, will authorise the Company to make market purchases of its own ordinary shares. In the past, own shares bought back by the Company pursuant to such authority had to be cancelled. With the new Treasury Shares Regulations the Company may, in addition, hold bought-back shares "in treasury" and then:

(a) sell such shares (or any of them) for cash (or its equivalent under the Treasury Shares Regulations); or

(b) cancel such shares (or any of them).

All buy-backs up to the 10% issued share capital limit imposed by the Treasury Share Regulations will initially be held in treasury (while shares bought back in excess of that limit will be cancelled as before). Shares will only be re-sold from treasury at (or at a premium to) the net asset value per ordinary share.

Treasury shares do not receive distributions and the Company will not be entitled to exercise the voting rights attaching to them.

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 respect of the year ending 2007 or 27 December 2007, whichever is earlier. Any such shares purchased shall either be cancelled or held in treasury. Under the Listing Rules of the UK Listing Authority of the Financial Services Authority, the maximum price (exclusive of expenses) that may be paid on the exercise of the authority shall be an amount equal to the higher of (a) 105% of the average of the middle market quotations (as derived from the Daily Official List of the London Stock Exchange) for the shares over the 5 business days immediately preceding the date of purchase and (b) the higher of the price of the last independent trade and the highest current independent bid as stipulated by Article 5(1) of Commission Regulation (EC) 22 December 2003 implementing the Market Abuse Directive as regards exemptions for buy-back programmes and stabilisation of financial instruments (No 2273/2003). The minimum price (again exclusive of expenses) 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. The Company does not have any warrants or options in issue. Your attention is drawn to Special Resolution No. 9, in the Notice of Annual General Meeting.

This authority, if conferred, will only be exercised if to do so would result in an increase in net asset value per ordinary share for the remaining shareholders and if it is in the best interests of shareholders generally.

Recommendation

The Board unanimously recommends you to vote in favour of the resolutions to be proposed at the Annual General Meeting.

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 2006 or 31 March 2005.

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
Baillie Gifford
Managers and Secretaries
10 May 2006

Directors' Remuneration Report

The Board has prepared this report, in accordance with the requirements of Schedule 7A to the Companies Act 1985. 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 pages 32 and 33.

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 and comparative information 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. This policy will continue for the year ended 31 March 2007 and subsequent years.

Directors' emoluments for the year (audited)

	2006 £	2005 £
Directors who served during the year:		
Sir Donald MacKay (Chairman)	27,000	27,000
GA Ball	18,000	18,000
MM Gray	18,000	18,000
WG McQueen	18,000	18,000
JPHS Scott	18,000	18,000
Lord Strathclyde	18,000	18,000
	117,000	117,000
Past Directors:		
The Earl of Portarlington (retired 1 July 2004)	–	4,537
	117,000	**121,537**

The Directors who served in the year received the above emoluments in the form of fees.

The fees for the non-executive Directors are determined within the limits set out in the Company's Articles of Association. Shareholders' approved an increase of the aggregate limits (pursuant to Article 90 of the Articles of Association) at the Annual General Meeting held on 30 June 2005. Article 90 of the Articles of Association now states that the fees paid to, and benefits in kind received by, the Chairman shall not exceed in aggregate £45,000 per annum and those paid to, or received by, a Director shall not exceed in aggregate £30,000 per annum or such higher amounts as the Company may from time to time by ordinary resolution determine. Non-executive Directors are not eligible for any other remuneration apart from the reimbursement of allowable expenses.

The Board carried out a review of the level of Directors' fees during the year, and concluded that the fees should remain unchanged at £27,000 for the Chairman and £18,000 for each Director.

Directors' service details

	Date of appointment	Due date for re-election
Sir Donald MacKay	1 July 1999	AGM 2007
GA Ball	17 February 1983	AGM June 2006
MM Gray	26 February 2004	AGM June 2006
WG McQueen	15 February 2001	AGM June 2006
JPHS Scott	31 October 2001	AGM 2007
Lord Strathclyde	26 February 2004	AGM 2007

Directors' service contracts

It is the Board's policy that none of the Directors has a service contract. All of the Directors have been provided with revised appointment letters dated 22 April 2004 and 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, Directors are obliged to retire by rotation and, if they wish, to offer themselves for re-election, no longer than every three years after that. Any Director who has served on the Board for more than nine years will submit himself for re-election annually. There is no notice period and no provision for compensation upon early termination of appointment.

Performance Graph

Scottish Mortgage's Share Price, FTSE All-Share Index and Benchmark*

(figures have been rebased to 100 at 31 March 2001)

* 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).

Past performance is no guarantee of future performance.

Company performance

The graph opposite 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).

Approval

The Directors' Remuneration Report on pages 29 and 30 was approved by the Board of Directors and signed on its behalf on 10 May 2006.

SIR DONALD MACKAY
Chairman

Statement of Directors' Responsibilities in Respect of the Annual Report and the Financial Statements

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards.

The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company 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 UK 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 that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They 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.

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

Independent Auditors' Report

to the members of Scottish Mortgage Investment Trust PLC ('the Company')

We have audited the financial statements of Scottish Mortgage Investment Trust PLC for the year ended 31 March 2006 which comprise the Income Statement, Balance Sheet, Reconciliation of Movements in Shareholders' Funds, the Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

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

Respective Responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 31.

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

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes the specific information presented in the Chairman's Statement, the Managers' Review and the Ten Year Record that is cross referenced from the Business Review section of the Directors' Report. We also report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

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

Basis of Audit Opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements 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, in accordance with UK Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 March 2006 and of its return for the year then ended;

- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985; and

- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Edinburgh

10 May 2006

	Notes	for the year ended 31 March 2006 Revenue £'000	Capital £'000	**Total £'000**	for the year ended 31 March 2005 Revenue £'000	Capital Restated† £'000	**Total Restated† £'000**
Gains on investments	10	–	554,074	**554,074**	–	116,181	**116,181**
Currency (losses)/gains	15	–	(4,098)	**(4,098)**	–	1,534	**1,534**
Income	3	41,456	–	**41,456**	35,456	–	**35,456**
Investment management fee	4	(3,062)	(3,062)	**(6,124)**	(2,385)	(2,385)	**(4,770)**
Other administrative expenses	5	(1,714)	–	**(1,714)**	(1,382)	–	**(1,382)**
Net return before finance costs and taxation		36,680	546,914	**583,594**	31,689	115,330	**147,019**
Finance costs of borrowings	6	(7,722)	(7,722)	**(15,444)**	(7,385)	(7,385)	**(14,770)**
Return on ordinary activities before taxation		28,958	539,192	**568,150**	24,304	107,945	**132,249**
Tax on ordinary activities	7	(3,220)	2,057	**(1,163)**	(2,495)	392	**(2,103)**
Return on ordinary activities after taxation		25,738	541,249	**566,987**	21,809	108,337	**130,146**
Return per ordinary share	9	**8.82p**	**185.58p**	**194.40p**	**7.37p**	**36.58p**	**43.95p**

† Various changes in accounting policies, as described in notes 1 and 2 on pages 38 and 39, have had the cumulative effect of increasing reported net assets by £13,185,000 for the year ended 31 March 2005.

* The total 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 38 to 48 are an integral part of this statement.

A Statement of Total Recognised Gains and Losses is not required as all gains and losses of the Company have been reflected in the above statement.

	Notes	at 31 March 2006 £'000	at 31 March 2006 £'000	at 31 March 2005 Restated† £'000	at 31 March 2005 Restated† £'000
Fixed assets					
Investments held at fair value	10		1,956,580		1,448,352
Current assets					
Debtors	11	9,922		9,293	
Cash and short term deposits	23	22,650		10,892	
		32,572		20,185	
Creditors					
Amounts falling due within one year	12	(54,918)		(44,586)	
Net current liabilities			(22,346)		(24,401)
Total assets less current liabilities			1,934,234		1,423,951
Creditors					
Amounts falling due after more than one year	13		(180,881)		(181,330)
			1,753,353		**1,242,621**
Capital and reserves					
Called-up share capital	14		72,019		73,901
Capital redemption reserve	15		18,161		16,279
Capital reserve – realised	15		892,063		773,424
Capital reserve – unrealised	15		702,315		309,966
Revenue reserve	15		68,795		69,051
Equity shareholders' funds	16		**1,753,353**		**1,242,621**
Net asset value per ordinary share (after deducting debentures at market value)	23		**584.1p**		**398.8p**
Net asset value per ordinary share (after deducting debentures at par)	17		**610.9p**		**422.6p**

The Accounts were approved by the Board and signed on their behalf on 10 May 2006.

SIR DONALD MACKAY
Chairman
Donald Mackay

†See notes 1 and 2 on pages 38 and 39.

The accompanying notes on pages 38 to 48 are an integral part of this statement.

	Notes	Share capital £'000	Capital redemption reserve £'000	Capital reserve – realised £'000	Capital reserve – unrealised £'000	Revenue reserve £'000	Total shareholders' funds £'000
Shareholders' funds at 1 April 2005 as previously reported		73,901	16,279	773,424	311,709	54,123	**1,229,436**
Prior year adjustments:							
Revaluation of investments at bid prices	1	–	–	–	(1,743)	–	**(1,743)**
Reversal of provision of final dividend	1	–	–	–	–	14,928	**14,928**
Shareholders' funds at 1 April 2005 restated		73,901	16,279	773,424	309,966	69,051	**1,242,621**
Return on ordinary activities after taxation	15	–	–	148,900	392,349	25,738	**566,987**
Shares purchased for cancellation	14	(1,882)	1,882	(30,261)	–	–	**(30,261)**
Dividends paid during the year	8	–	–	–	–	(25,994)	**(25,994)**
Shareholders' funds at 31 March 2006		**72,019**	**18,161**	**892,063**	**702,315**	**68,795**	**1,753,353**

	Notes	Share capital £'000	Capital redemption reserve £'000	Capital reserve – realised £'000	Capital reserve – unrealised £'000	Revenue reserve £'000	Total shareholders' funds £'000
Shareholders' funds at 1 April 2004 as previously reported		74,326	15,854	777,982	205,578	54,041	**1,127,781**
Prior year adjustments:							
Revaluation of investments at bid prices		–	–	–	(3,599)	–	**(3,599)**
Reversal of provision of final dividend		–	–	–	–	1,189	**1,189**
Shareholders' funds at 1 April 2004 restated		74,326	15,854	777,982	201,979	55,230	**1,125,371**
Return on ordinary activities after taxation		–	–	350	107,987	21,809	**130,146**
Shares purchased for cancellation	14	(425)	425	(4,908)	–	–	**(4,908)**
Dividends paid during the year	8	–	–	–	–	(7,988)	**(7,988)**
Shareholders' funds at 31 March 2005		**73,901**	**16,279**	**773,424**	**309,966**	**69,051**	**1,242,621**

The accompanying notes on pages 38 to 48 are an integral part of this statement.

	Notes	for the year ended 31 March 2006 £'000	£'000	for the year ended 31 March 2005 £'000	£'000
Net cash inflow from operating activities	18		32,386		30,443
Servicing of finance					
Interest paid		(15,654)		(14,766)	
Net cash outflow from servicing of finance			(15,654)		(14,766)
Taxation					
Income tax (paid)/refunded		(1)		55	
Overseas tax incurred		(1,149)		(1,079)	
Total tax paid			(1,150)		(1,024)
Financial investment					
Acquisitions of investments		(465,922)		(458,473)	
Disposals of investments		503,640		473,165	
Realised currency loss		(393)		(268)	
Net cash inflow from financial investment			37,325		14,424
Equity dividends paid			(25,994)		(21,069)
Net cash inflow before use of liquid resources and financing			26,913		8,008
Liquid resources					
Acquisition of term deposits		(258,518)		(41,579)	
Disposal of term deposits		258,877		41,686	
Net cash inflow from use of liquid resources			359		107
Financing					
Shares purchased for cancellation		(30,261)		(4,908)	
Bank loans repaid		(34,674)		(72,949)	
Bank loans drawn down		49,421		60,240	
Net cash outflow from financing			(15,514)		(17,617)
Increase/(decrease) in cash	19		**11,758**		**(9,502)**
Reconciliation of net cash flow to movement in net debt	19				
Increase/(decrease) in cash in the period			11,758		(9,502)
(Increase)/decrease in bank loans			(14,747)		12,709
Exchange movement on bank loans			(4,064)		1,695
Increase in short term deposits			(359)		(107)
Exchange movement on short term deposits			359		107
Other non-cash changes			85		73
Movement in net debt in the year			(6,968)		4,975
Net debt at 1 April			(202,191)		(207,166)
Net debt at 31 March			**(209,159)**		**(202,191)**

The accompanying notes on pages 38 to 48 are an integral part of this statement.

1 Principal Accounting Policies

A number of new UK Financial Reporting Standards have been introduced with which the Company must comply this year. These standards are part of the UK convergence programme with International Accounting Standards and as such have required most UK listed companies to restate prior year figures to reflect the new accounting treatment. The financial statements for the year to 31 March 2006 have been prepared on the basis of the accounting policies set out in the Company's Annual Financial Statements at 31 March 2005 except as detailed below:

- investments have been valued at fair value through profit or loss in accordance with FRS 26 'Financial Instruments: Measurement'. The effect is to move from a mid to a bid basis of valuation, resulting in a reduction in the value of investments and unrealised capital reserves of £2,341,000 (2005 – £1,743,000);
- in compliance with FRS 21 'Events after the Balance Sheet Date', dividends declared after the period end are no longer treated as a liability at the period end. The effect is to reduce creditors and increase revenue reserves by £13,395,000 (2005 – £14,928,000);
- income from fixed interest securities has been calculated using the effective interest rate method. The net effect of this change in the year to 31 March 2006 is to increase unrealised capital reserves by £31,000, increase realised capital reserves by £17,000 and reduce revenue reserves by £48,000 respectively. Comparative figures have not been restated as the effect on prior periods is immaterial;
- the implementation of FRS 25 and the revision of the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies' (SORP) in 2005 has resulted in changes in the presentation of total returns. Previously dividend distributions in respect of a year were disclosed on the face of the Statement of Total Return and the revenue column of that statement was deemed to be the profit and loss account of the Company. We now present an Income Statement which does not show on its face the distribution in respect of equity shares and, whilst it still shows information on capital and revenue returns, it is the total column which is regarded as the profit and loss account of the Company. Dividend distributions are now shown in the Reconciliation of Movements in Shareholders' Funds and in the Notes to Accounts.

The overall effect of these changes in shareholders' funds and reserves is detailed in note 2.

(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' issued in 2003, revised 2005.

In order to reflect better the activities of the trust and in accordance with guidance issued by the AITC, supplementary information which analyses the profit and loss account between items of a revenue and capital nature has been presented in the Income Statement.

Financial assets and financial liabilities are recognised in the Company's balance sheet when it becomes a party to the contractual provisions of the instrument.

(b) Investments
Listed investments are valued at fair value through profit or loss. The fair value of listed investments is bid 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.

The fair value of unlisted investments uses valuation techniques, 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 effective interest rate 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 attributable to the stepped interest debentures. 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. Gains and losses on the repurchase or early settlement of debt is wholly charged to capital.

(f) Taxation
The tax effect of different items of income and expenditure is allocated between revenue and capital on the same basis as the particular item to which it relates, under the marginal method, using the Company's effective tax rate for the accounting period.

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
(i) 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.

(ii) Capital Reserves Unrealised:
Unrealised appreciation represents the amount by which assets and liabilities valued at fair value differs from their book value and is dealt with in this reserve.

2 Summary of the Effect of Changes to Accounting Policies

The overall impact upon the Company's shareholders' funds and reserves as a result of the changes detailed in note 1 is as follows:

	At 31 March 2006 £'000	At 31 March 2005 £'000
Effect on shareholders' funds:		
Investments	(2,341)	(1,743)
Creditors: dividends payable	13,395	14,928
	11,054	**13,185**
Effect on reserves:		
Capital reserve – realised	17	–
– unrealised	(2,310)	(1,743)
Revenue reserve	13,347	14,928
	11,054	**13,185**

3 Income

	2006 £'000	2005 £'000
Income from investments*		
Franked investment income	18,225	17,479
UK unfranked investment income†	3,862	3,954
Overseas dividends	16,651	11,498
Overseas interest	2,003	2,047
	40,741	**34,978**
Other income		
Deposit interest	650	408
Underwriting commission and commitment fees	65	70
	715	**478**
Total income	**41,456**	**35,456**
Total income comprises:		
Dividends	35,701	29,793
Interest from investments	5,040	5,185
Other	715	478
	41,456	**35,456**
Income from investments		
Listed UK	19,362	19,447
Listed overseas	21,379	15,531
	40,741	**34,978**

† Includes OEIC income.

* Franked investment income includes a special dividend of £743,000 from Rio Tinto (2005 – overseas dividends includes a special dividend of £1,236,000 from Microsoft).

4 Investment Management Fee

	Revenue £'000	2006 Capital £'000	Total £'000	Revenue £'000	2005 Capital £'000	Total £'000
Investment management fee	2,829	2,829	**5,658**	2,190	2,190	**4,380**
Irrecoverable VAT thereon	233	233	**466**	195	195	**390**
	3,062	**3,062**	**6,124**	**2,385**	**2,385**	**4,770**

Baillie Gifford & Co are 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 OEIC's share class held by the Company does itself not attract a management fee.

5 Other Administrative Expenses – all charged to revenue

	2006 £'000	2005 £'000
General administrative expenses	1,574	1,244
Directors' fees (see Directors' Remuneration Report page 29)	117	122
Auditors' remuneration for audit services	18	16
Auditors' remuneration for non-audit services	5	–
	1,714	**1,382**

6 Finance Costs of Borrowings

	Revenue £'000	2006 Capital £'000	Total £'000	Revenue £'000	2005 Capital £'000	Total £'000
Bank loans and overdrafts repayable within five years	772	772	**1,544**	428	428	**856**
Debentures repayable wholly or partly in more than five years	6,950	6,950	**13,900**	6,957	6,957	**13,914**
	7,722	**7,722**	**15,444**	**7,385**	**7,385**	**14,770**

7 Tax on Ordinary Activities

	Revenue £'000	2006 Capital £'000	Total £'000	Revenue £'000	2005 Capital £'000	Total £'000
UK corporation tax	2,057	(2,057)	**–**	392	(392)	**–**
Overseas tax – current year	1,163	–	**1,163**	1,085	–	**1,085**
Overseas tax – adjustment to prior years	–	–	**–**	1,018	–	**1,018**
	3,220	**(2,057)**	**1,163**	**2,495**	**(392)**	**2,103**

7 Tax on Ordinary Activities (continued)

	2006 £'000	2005 £'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	28,958	24,304
Revenue return on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2005 – 30%)	8,687	7,291
Income not taxable (franked investment income)	(5,467)	(5,244)
Overseas refundable tax deemed as irrecoverable	–	1,018
Overseas refundable tax claimed as a deduction	–	(305)
Surplus management expenses of a revenue nature available for offset	–	(265)
Current tax charge for the year	**3,220**	**2,495**

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

At 31 March 2006 the Company had surplus management expenses of £51 million (2005 – £46 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.

8 Ordinary Dividends

	2006	2005 Restated	2006 £'000	2005 Restated £'000
Amounts recognised as distributions in the period:				
Previous year's final (paid 6 July 2005)	5.05p	0.40p	14,876	1,189
Interim (paid 25 November 2005)	3.85p	2.30p	11,118	6,799
	8.90p	**2.70p**	**25,994**	**7,988**

We also set out below the total dividends paid and proposed in respect of the financial year, which is the basis on which the requirements of section 842 of the Income and Corporation Taxes Act 1988 are considered. The revenue available for distribution by way of dividend for the year is £25,738,000 (2005 – £21,809,000).

	2006	2005	2006 £'000	2005 £'000
Dividends paid and proposed in the period:				
Interim dividend per ordinary share (paid 25 November 2005)	3.85p	2.30p	11,118	6,799
Proposed final dividend per ordinary share (payable 5 July 2006)	4.65p	5.05p	13,395	14,928
Adjustment to provision for 2005 final dividend re shares bought back	–	–	(52)	–
	8.50p	**7.35p**	**24,461**	**21,727**

9 Return per Ordinary Share

	2006 Revenue	2006 Capital	2006 **Total**	2005 Revenue	2005 Capital Restated	2005 **Total Restated**
	8.82p	**185.58p**	**194.40p**	**7.37p**	**36.58p**	**43.95p**

Revenue return per ordinary share is based on the net revenue on ordinary activities after taxation of £25,738,000 (2005 – £21,809,000), and on 291,656,348 (2005 – 296,098,814) 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 gain for the financial year of £541,249,000 (2005 – net capital gain of £108,337,000), and on 291,656,348 (2005 – 296,098,814) ordinary shares, being the weighted average number of ordinary shares in issue during the year.

10 Fixed Assets – Investments

	2006 £'000	2005 Restated £'000
Listed at market value – UK	707,675	640,741
– overseas	1,232,357	798,952
Unlisted	16,548	8,659
	1,956,580	**1,448,352**

	Listed in UK £'000	Listed overseas £'000	Unlisted £'000	**Total £'000**
Cost of investments held at 1 April 2005	502,600	629,115	5,967	**1,137,682**
Unrealised appreciation at 1 April 2005 – restated	138,141	169,837	2,692	**310,670**
Value of investments held at 1 April 2005 – restated	640,741	798,952	8,659	**1,448,352**
Movements in year:				
Purchases at cost	142,296	303,168	11,069	**456,533**
Sales – proceeds	(221,387)	(269,874)	(11,070)	**(502,331)**
– realised profits on sales	54,753	101,508	5,102	**161,363**
Amortisation of fixed interest book cost	(55)	7	–	**(48)**
Increase in unrealised appreciation	91,327	299,228	2,156	**392,711**
Change in listing †	–	(632)	632	**–**
Value of investments held at 31 March 2006	**707,675**	**1,232,357**	**16,548**	**1,956,580**
Cost of investments held at 31 March 2006	478,207	763,292	11,700	**1,253,199**
Unrealised appreciation at 31 March 2006	229,468	469,065	4,848	**703,381**
Value of investments held at 31 March 2006	**707,675**	**1,232,357**	**16,548**	**1,956,580**

The purchases and sales proceeds figures above include transaction costs of £911,000 (2005 – £1,237,000) and £522,000 (2005 – £620,000) respectively.

† Unlisted investment acquired as a distribution by its parent Norilsk Nickel.

	2006 £'000	2005 Restated £'000
Gains/(losses) on investments		
Realised gains/(losses) on sales	161,363	(1,102)
Increase in unrealised appreciation	392,711	117,283
	554,074	**116,181**

Of the realised gains/(losses) on sales during the year a net gain of £37,556,000 (2005 – gain of £17,523,000) was included in unrealised appreciation at the previous year end.

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

	2006 C income shares held	2006 % of share class held	2005 C income shares held	2005 % of share class held
Baillie Gifford European Smaller Companies Fund	5,767,177	94.5	7,910,800	95.9

11 Debtors

	2006 £'000	2005 £'000
Due within one year:		
Income accrued	9,698	7,830
Sales for subsequent settlement	–	1,309
UK taxation recoverable	22	21
Other debtors and prepayments	202	133
	9,922	**9,293**

12 Creditors – Amounts falling due within one year

	2006 £'000	2005 Restated £'000
ING Bank N.V. US$ loan	–	31,753
BNP Paribas multi currency loan	50,928	–
Purchases for subsequent settlement	–	9,389
Other creditors and accruals	3,990	3,444
	54,918	**44,586**

Included in other creditors is £838,000 (2005 – £404,000) in respect of the investment management fee.

Borrowing facilities

A 364 day £50 million loan facility has been arranged with BNP Paribas.
A 3 year £35 million multi-currency loan facility has been arranged during the year with National Australia Bank Limited.
A £100 million short term multi-currency loan facility has been arranged with The Royal Bank of Scotland plc.

At 31 March 2006 drawings were as follows:

BNP Paribas	Euro 73 million at an interest rate of 2.85% per annum.
National Australia Bank Limited	¥5,900 million at an interest rate of 0.74% per annum (see note 13).

The main covenants relating to the above loans are:
(i) Total borrowings shall not exceed 35% of the Company's net asset value.
(ii) The Company's minimum net asset value shall be £700 million.

13 Creditors – Amounts falling due after more than one year

	Nominal rate	Effective rate	2006 £'000	2005 £'000
Debenture stocks:				
£20 million 8–14% stepped interest debenture stock 2020	14.0%	12.3%	22,267	22,323
£75 million 6.875% debenture stock 2023	6.875%	6.9%	74,377	74,340
£50 million 6–12% stepped interest debenture stock 2026	12.0%	10.8%	54,734	54,800
4½% irredeemable debenture stock			675	675
National Australia Bank Limited multi-currency loan			28,828	29,192
			180,881	**181,330**

Debenture stocks

The debenture stocks are stated in accordance with the requirements of Financial Reporting Standard 4 'Capital Instruments' ('FRS4'); the cumulative effect is to increase the carrying amount of borrowings by £6,378,000 (2005 – £6,463,000) over redemption value.

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

14 Called-up Share Capital

	2006 Number	2006 £'000	2005 Number	2005 £'000
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	**288,075,115**	**72,019**	**295,605,115**	**73,901**

At the Annual General Meeting on 30 June 2005 the Company renewed its authority to purchase shares in the market, in respect of 44,066,869 ordinary shares (equivalent to 14.99% of its issued share capital at that date). In the year to 31 March 2006, a total of 7,530,000 (2005 – 1,700,000) ordinary shares with a nominal value of £1,882,000 (2005 – £425,000) were bought back at a total cost of £30,261,000 (2005 – £4,908,000). At 31 March 2006 the Company had authority to buy back a further 38,166,869 ordinary shares.

Under the provisions of the Company's Articles the share buy-backs were funded from the realised capital reserve.

15 Capital and Reserves

	Share capital £'000	Capital redemption reserve £'000	Capital reserve – realised £'000	Capital reserve – unrealised £'000	Revenue reserve £'000	Total shareholders' funds
At 1 April 2005 as previously stated	73,901	16,279	773,424	311,709	54,123	1,229,436
Effects of change in accounting policy:						
Revaluation of investments at bid prices	–	–	–	(1,743)	–	(1,743)
Reversal of provision of final dividend	–	–	–	–	14,928	14,928
At 1 April 2005 – restated	73,901	16,279	773,424	309,966	69,051	1,242,621
Net gain on realisation of investments	–	–	161,363	–	–	161,363
Increase in unrealised appreciation	–	–	–	392,711	–	392,711
Exchange differences	–	–	(34)	–	–	(34)
Exchange differences on multi-currency loans	–	–	(3,702)	(362)	–	(4,064)
Shares purchased for cancellation	(1,882)	1,882	(30,261)	–	–	(30,261)
Investment management fee	–	–	(3,062)	–	–	(3,062)
Finance costs of borrowings	–	–	(7,722)	–	–	(7,722)
Tax relief on management fee and finance costs	–	–	2,057	–	–	2,057
Dividends paid in year	–	–	–	–	(25,994)	(25,994)
Retained net revenue for the year	–	–	–	–	25,738	25,738
At 31 March 2006	**72,019**	**18,161**	**892,063**	**702,315**	**68,795**	**1,753,353**

16 Total Shareholders' Funds

	2006 £'000	2005 Restated £'000
Total shareholders' funds are attributable as follows:		
Equity shares	**1,753,353**	**1,242,621**

Total shareholders' funds have been calculated in accordance with the provisions of FRS26. However, the net asset value per share figures in note 17 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)	£1,753,353,000	£1,242,621,000
Number of ordinary shares in issue at the year end	288,075,115	295,605,115
Shareholders' funds per ordinary share	608.6p	420.4p
Additions/(deductions)		
– expenses of debenture issue	(0.7p)	(0.8p)
– allocation of interest on borrowings	3.0p	3.0p
Net asset value per ordinary share	**610.9p**	**422.6p**

17 Net Asset Value per Ordinary Share

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

	2006	2005 Restated	2006 £'000	2005 Restated £'000
Ordinary shares	**610.9p**	**422.6p**	**1,759,731**	**1,249,084**

	2006 £'000	2005 Restated £'000
The movements during the year of the assets attributable to the ordinary shares were as follows:		
Total net assets at 1 April	1,249,084	1,131,907
Total recognised gains and losses for the year	566,987	130,146
Dividends appropriated in the year	(25,994)	(7,988)
Adjustment to debentures	(85)	(73)
Shares purchased for cancellation	(30,261)	(4,908)
Total net assets at 31 March	**1,759,731**	**1,249,084**

Net asset value per ordinary share is based on net assets (adjusted to reflect the deduction of the debentures at par) and on 288,075,115 (2005 – 295,605,115) 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 have been computed in accordance with the provisions of FRS26. A reconciliation of the two sets of figures under these two conventions is given in note 16.

18 Reconciliation of Net Return before Finance Costs and Taxation to Net Cash Inflow from Operating Activities

	2006 £'000	2005 £'000
Net return on ordinary activities before finance costs and taxation	583,594	147,019
Gains on investments	(549,976)	(117,715)
Amortisation of fixed income book cost	48	–
(Decrease)/increase in accrued income	(1,882)	1,247
(Decrease)/increase in debtors	(69)	48
Increase/(decrease) in creditors	671	(156)
	32,386	**30,443**

19 Analysis of Change in Net Debt

	At 1 April 2005 £'000	Cash flows £'000	Other non-cash changes £'000	Exchange movement £'000	At 31 March 2006 £'000
Cash at bank and in hand	10,892	11,758	–	–	**22,650**
Term deposits	–	(359)	–	359	**–**
Loans due within one year	(31,753)	(14,747)	–	(4,428)	**(50,928)**
Loans due in two to five years	(29,192)	–	–	364	**(28,828)**
Debenture stocks	(152,138)	–	85	–	**(152,053)**
	(202,191)	**(3,348)**	**85**	**(3,705)**	**(209,159)**

20 Directors' Interest 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.

21 Contingencies, Guarantees and Financial Commitments

At the year end the Company had a contingent liability amounting to £10 million (2005 – £14 million) under a subscription agreement relating to participating loan notes. The obligation will expire on 31 December 2010.

22 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.

23 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. As such, the Company is exempt from capital gains tax on the sale of its investments. The Managers monitor investment movements, the level of forecast income and expenditure and the amount of proposed dividends to ensure that the provisions of S842 are not breached. 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 prohibited from being distributed in the form of dividends.

Gearing
The Company has long term and short term borrowings. The aim of the use of gearing is to enhance long term returns to shareholders by investing borrowed funds in equities and other assets. Gearing is actively managed. How and where borrowings are invested is reviewed by the Board in consultation with the Managers at every Board meeting. In light of the decisions made, appropriate adjustments to the gearing position are then made by the Managers. Details of borrowings and where they are invested is given in monthly Factsheets published on the Managers' website, **www.bailliegifford.com**.

The Company has been given an Aaa Issuer Rating by Moody's. Issuer Ratings are opinions of the ability of entities to honour senior unsecured financial obligations and contracts.

The Company's income 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 year.

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.

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.

Market Risk
The Company is exposed to market risk due to fluctuations in the market prices of its investments. The Company's managers actively monitor market and economic data and report to the Board, which considers investment policy on a regular basis.

Interest Rate Risk
The Company finances its operations by means of called up share capital, 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 periods up to 3 years.

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.

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

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 Company's overseas income is subject to currency fluctuation. The Company does not hedge this currency risk.

23 Derivatives and Other Financial Instruments (continued)

Foreign Currency Risk

Exposure to currency risk through asset allocation is indicated below.

	Investments £'000	2006 Cash and deposits £'000	Short term debtors £'000	Investments Restated £'000	2005 Cash and deposits £'000	Short term debtors £'000
Sterling	708,398	14,958	7,324	680,869	1,856	8,306
US dollar	726,286	6,923	1,852	381,907	5,530	307
Canadian dollar	21,962	–	50	45,016	–	54
Euro	150,369	738	436	80,784	–	348
Swedish kroner	85,623	–	–	50,279	974	–
Swiss franc	–	–	–	7,273	–	–
Japanese yen	77,958	–	260	69,349	2,532	278
Hong Kong dollar	33,427	–	–	24,541	–	–
Korean won	52,063	–	–	31,119	–	–
Australian dollar	40,003	–	–	39,540	–	–
Singapore dollar	15,628	–	–	7,391	–	–
Indian rupee	32,721	31	–	21,191	–	–
South African rand	12,142	–	–	9,093	–	–
	1,956,580	**22,650**	**9,922**	**1,448,352**	**10,892**	**9,293**

The following currency amounts are included in current and long term liabilities.

	Loans and Debentures £'000	2006 Purchases for subsequent settlement £'000	Other creditors and accruals £'000	Loans and Debentures £'000	2005 Purchases subsequent settlement £'000	Other creditors and accruals Restated £'000
Sterling	152,053	–	3,721	152,138	–	3,051
US dollar	–	–	1	31,753	4,991	325
Euro	50,928	–	201	–	974	–
Japanese yen	28,828	–	67	29,192	2,532	68
Indian rupee	–	–	–	–	892	–
	231,809	**–**	**3,990**	**213,083**	**9,389**	**3,444**

Interest Rate Risk

The interest rate risk profile of financial assets and financial liabilities at 31 March was:

Financial Assets

	2006 Market value £'000	Weighted average interest rate	Weighted average period until maturity	2005 Market value Restated £'000	Weighted average interest rate	Weighted average period until maturity
Fixed rate:						
UK bonds	24,172	5.8%	15 years	22,683	5.9%	12 years
UK bonds (perpetual)*	5,321	6.3%	N/A	3,460	6.0%	N/A
European bonds	16,578	9.4%	13 years	9,920	11.8%	12 years
US bonds	8,761	10.9%	6 years	4,487	6.8%	8 years
US bonds (perpetual)*	2,408	6.1%	N/A	–	–	–
Floating rate:						
UK bonds (interest rate linked to sterling LIBOR)	4,850	5.5%	18 years	30,517	3.0%	54 years
European bonds (interest rate linked to euro LIBOR)	3,923	7.3%	12 years	3,774	7.4%	13 years

* Based on expected maturity dates.

The cash deposits generally comprise call or short term money market deposits of less than one month which are repayable on demand. The benchmark rate which determines the interest payments received on cash balances is the bank base rate.

23 Derivatives and Other Financial Instruments (continued)

Interest Rate Risk (continued)
Financial Liabilities

	2006 £'000	2005 £'000
The interest rate risk profile of the Company's financial liabilities at 31 March was:		
Floating rate – US$ denominated	–	31,753
Floating rate – Euro denominated	50,928	–
Fixed rate – sterling denominated	152,053	152,138
Fixed rate – yen denominated	28,828	29,192
	231,809	**213,083**
The maturity profile of the Company's financial liabilities at 31 March was:		
In one year or less, or on demand	50,928	31,753
In two to five years	28,828	29,192
In more than five years (weighted average period fixed 18 years)	151,378	151,463
No fixed date for repayment	675	675
	231,809	**213,083**

Fair Value of Financial Assets and Financial Liabilities

The Directors are of the opinion that the financial assets and liabilities of the Company are stated at fair value in the balance sheet with the exception of long term borrowing. The debenture stocks are stated in accordance with FRS4. The fair value is shown under the heading 'Financial Liabilities' below.

Financial Assets

A full list of the Company's investments is given on pages 17 to 20. 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.

Financial Liabilities

The debenture stock issues are included in the accounts in accordance with FRS25. A comparison with the fair value (closing offer value) is as follows:

		2006			2005	
	Nominal £'000	Book £'000	Fair £'000	Nominal £'000	Book £'000	Fair £'000
8–14% stepped interest debenture stock 2020	20,000	22,267	37,892	20,000	22,323	37,665
6.875% debenture stock 2023	75,000	74,377	90,545	75,000	74,340	87,146
6–12% stepped interest debenture stock 2026	50,000	54,734	93,658	50,000	54,800	90,429
4½% irredeemable debenture stock	675	675	633	675	675	568
	145,675	**152,053**	**222,728**	**145,675**	**152,138**	**215,808**

The fair value of the fixed rate yen loan at 31 March 2006 was £28,833,000 (2005 – £29,402,000).

All short term borrowings are stated at fair value.

Deducting prior charges at market value would have the effect of reducing the net asset value per share from 610.9p to 584.1p. Taking the market price of the ordinary shares at 31 March 2006 of 521.5p, this would have given a discount to net asset value of 10.7% as against 14.6% on a traditional basis. At 31 March 2005 the effect would have been to reduce the net asset value from 422.6p to 398.8p. Taking the market price of the ordinary shares at 31 March 2005 of 333.0p, this would have given a discount to net asset value of 16.5% as against 21.2% on a traditional basis.

Further Shareholder Information

How to Invest

The Company's shares are traded on the London Stock Exchange. They can be bought by placing an order with a stockbroker, by asking a professional adviser to do so, or through the Baillie Gifford savings vehicles (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 on the Baillie Gifford website and are updated monthly. These are available from Baillie Gifford on request.

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 in early July. The AGM is normally held in late June or early July.

Capital Gains Tax

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 on behalf of the Company. In the event of queries regarding shares registered in your own name, please contact the Registrar on 0870 702 0010. By quoting the reference number on your share certificate you can check your holding on the Registrar's web site: **www-uk.computershare.com/investor**.

Telephone Share Dealing Service

A telephone share dealing service has been established with our Registrar, Computershare Investor Services PLC, which provides shareholders with a way of buying or selling Scottish Mortgage Investment Trust PLC ordinary shares on the London Stock Exchange. 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. Please ensure you have your Shareholder Reference Number (SRN) ready when making the call. The SRN appears on your share certificate. For further information about this service please phone 0870 702 0000.

Please note that this share dealing service is not available to shareholders participating in the Baillie Gifford Investment Trust Share Plan, Children's Savings Plan, ISA, PEP and Select Pension.

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 you originally invested.

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.

Electronic Communications and Proxy Voting

If you hold stock in your own name you can choose to receive communications from the Company, and vote, in electronic format. This method reduces costs, is environmentally friendly and, for many, is convenient too. The paragraphs below explain how you can use these services.

- **Electronic Communications** If you would like to take advantage of this service, please visit our Registrar's website at **www-uk.computershare.com/investor** and register. You will need your shareholder reference number (which is on your share certificate and tax voucher)

Analysis of Shareholders

	At 31 March 2006 Number of shares held	%	At 31 March 2005 Number of shares held	%
Institutions	115,762,290	40.2	118,877,323	40.2
Intermediaries	94,006,279	32.6	91,072,436	30.8
Individuals	51,608,130	17.9	58,373,673	19.7
Baillie Gifford Share Plans/PEP/ISA	19,021,034	6.6	19,437,547	6.6
Marketmakers	7,677,382	2.7	7,844,136	2.7
	288,075,115	**100.0**	**295,605,115**	**100.0**

to hand. If you then agree to the terms and conditions, in future, on the day that documents are sent to shareholders by post, you will receive an e-mail providing the website address link to the documents. After you register, paper documents will be available on request.

- **Electronic Proxy Voting** You can also return proxies electronically at **www-uk.computershare.com/proxy**. If you have registered for electronic communications you will be issued a PIN number to use when returning proxies to the secure Registrar website. You do not need to register for electronic communications to use electronic proxy voting, paper proxy forms will contain a PIN number to allow you to return proxies electronically.

If you have any questions about these services please contact Computershare on 0870 702 0000.

CREST Proxy Voting

If you are a user of the CREST system (including a CREST Personal Member), you may appoint one or more proxies or give an instruction to a proxy by having an appropriate CREST message transmitted. To appoint a proxy or to give an instruction to a proxy (whether previously appointed or otherwise) via the CREST system, the CREST message must be received by the issuer's agent (ID number 3RA50) not later than 48 hours before the time appointed for holding the meeting. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp generated by the CREST system) from which the issuer's agent is able to retrieve the message. CREST Personal Members or other CREST sponsored members should contact their CREST sponsors for assistance with appointing proxies via CREST. For further information on CREST procedures, limitations and systems timings, please refer to the CREST Manual. The Company may treat as invalid a proxy appointment sent by CREST in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001. 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:

- Participation in a diversified portfolio of shares.
- Constant supervision by experienced professional managers.
- The Company is free from capital gains tax on capital profits realised within its portfolio although investors are still liable for capital gains tax on profits when selling their investment.

These accounts have been approved by the Directors of Scottish Mortgage Investment Trust PLC. 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, the Manager of the Baillie Gifford Investment Trust Share Plan and Children's Savings Plan and the promoter of the Baillie Gifford Select Pension. Alliance Trust Savings Limited is the provider, trustee and administrator of the Alliance Trust Personal Pension Plan through which the Baillie Gifford Select Pension is made available. 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 and the Directors may hold shares in Scottish Mortgage and may buy or sell such shares subject to Baillie Gifford's personal account dealing rules.

Risks

Past performance is no guarantee of future performance.

The value of your investment and any income from it is not guaranteed and may go down as well as up and you may not get back the amount invested. This is because the share price is determined by the changing conditions in the relevant stockmarkets in which the Trust invests and by the supply and demand for the Trust's shares. You should regard your investment as medium to long-term.

Scottish Mortgage has borrowed money to make further investments. This is commonly referred to as gearing. The risk is that, when this money is repaid by the Trust, the value of these investments may not be enough to cover the borrowing and interest costs, and the Trust will make a loss. If the Trust's investments fall in value, gearing will increase the amount of the loss in value to investors. The more highly geared the Trust, the greater this effect will be.

As Scottish Mortgage invests in overseas securities changes in the rates of exchange may also cause the value of your investment (and any income it may pay) to go down or up.

The value of tax reliefs will depend on your personal circumstances and tax rates and reliefs, as well as the tax treatment of ISAs and PEPs, could change at any time in the future.

The Annual General Meeting of the Company will be held at the offices of Baillie Gifford & Co, Calton Square, 1 Greenside Row, Edinburgh EH1 3AN, on Wednesday, 28 June 2006 at 4.00 pm.

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

Baillie Gifford may record your call.

Notice of Annual General Meeting

Notice is hereby given that the ninety-seventh Annual General Meeting of Scottish Mortgage Investment Trust PLC will be held within the Registered Office of the Company, Calton Square, 1 Greenside Row, Edinburgh EH1 3AN, on Wednesday, 28 June 2006 at 4.00 pm for the following purposes:

Ordinary Business

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

1. To approve the Accounts of the Company for the year to 31 March 2006 with the Reports of the Directors and of the Auditors thereon.
2. To approve the Directors' Remuneration Report for the year to 31 March 2006.
3. To declare a dividend.
4. To re-elect Mr GA Ball as a Director.
5. To re-elect Mr MM Gray as a Director.
6. To re-elect Mr WG McQueen as a Director.
7. To reappoint KPMG Audit Plc as Auditors.
8. To authorise the Directors to determine the remuneration of the Auditors.

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

9. That, in substitution for any existing authority under section 166 of the Companies Act 1985 (the 'Act'), but without prejudice to the exercise of any such authority prior to the date hereof, the Company be authorised, in accordance with section 166 of 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 (either for retention as treasury shares for future sale or cancellation) ('Shares'), provided that:

(a) the maximum aggregate number of Shares hereby authorised to be purchased shall be 14.99% of the issued ordinary 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 (exclusive of expenses);

(c) the maximum price (exclusive of expenses) which may be paid for a Share shall be an amount equal to the higher of (a) 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 5 business days immediately preceding the date of purchase and (b) the higher of the price of the last independent trade and the highest current independent bid as stipulated by Article 5(1) of Commission Regulation (EC) 22 December 2003 implementing the Market Abuse Directive as regards exemptions for buy-back programmes and stabilisation of financial instruments (No 2273/2003); and

(d) unless previously varied, revoked or renewed by the Company in general meeting, the authority hereby conferred shall expire at the conclusion of the Annual General Meeting of the Company to be held in 2007 or 27 December 2007, whichever is the earlier, save that the Company may, prior to the expiry of such authority, enter into a contract or contracts to purchase Shares under such authority which will or might be completed or executed wholly or partly after the expiration of such authority and may make a purchase of Shares pursuant to any such contract or contracts.

10. That, the Directors of the Company be and they are hereby generally empowered pursuant to section 95 of the Companies Act 1985 (the "Act") to sell relevant shares (as defined in sections 94(2) to 94(3A) and section 94(5) of the Act) in the Company if, immediately before the sale, such shares are held by the Company as treasury shares (as defined in section 162A(3) of the Act) ("treasury shares") for cash (as defined in section 162D(2) of the Act) as if subsection (1) of section 89 of the Act did not apply to any such sale, provided that this power shall be limited to:

(a) the sale of treasury shares in connection with a rights issue in favour of the holders of ordinary shares of 25p each in the Company ("Shares") where the equity securities respectively attributable to the interests of all such shareholders are proportionate (as nearly as may be practicable) to the respective number of Shares held (or deemed or notionally held) by them but subject to such exclusions or other arrangements as the Directors deem necessary or expedient in relation to fractional entitlements or to deal with problems under the laws, or requirements of, any regulatory body or stock exchange in any territory; and

(b) the sale of treasury shares (other than pursuant to paragraph (a) of this resolution) of up to an aggregate nominal value of £7,145,628 being 10% of the Company's issued Share capital as at 9 May 2006;

and shall expire at the conclusion of the next Annual General Meeting of the Company to be held in 2007 or on 27 December 2007, whichever is the earlier, save that the Company may, before such expiry, make any offer or enter into an agreement which would or might require treasury shares to be sold after the expiry of such power, and the Directors of the Company may sell treasury shares in pursuance of such offer or agreement as if the power conferred hereby had not expired.

By order of the Board

Baillie Gifford & Co
Managers and Secretaries
26 May 2006

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 and to be valid must be lodged with the Registrar of the Company not less than 48 hours before the time set for the meeting.

2 Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the Company specifies that only those shareholders entered on the Register of Members of the Company as at 4.00 pm on 26 June 2006 or, in the event that the meeting is adjourned, on the Register of Members 48 hours before the time of any adjourned meeting, shall be entitled to attend or vote at the meeting in respect of the number of ordinary shares registered in their name at that time. Changes to the entries on the Register of Members after 4.00 pm on 26 June 2006 or, in the event that the meeting is adjourned, in the Register of Members 48 hours before the time of any adjourned meeting, shall be disregarded in determining the rights of any person to attend or vote at the meeting, notwithstanding any provisions in any enactment, the Articles of Association of the Company or other instrument to the contrary.

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.

Baillie Gifford & Co

Scottish Mortgage'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 savings vehicles – see below.

Baillie Gifford's Investment Trust Share Plan

You can invest from £250 or from £30 per month. The plan is designed to be a cost-effective way of saving on a regular or lump sum basis.

Baillie Gifford's Investment Trust ISA

You can invest in a tax efficient way by investing a minimum of £2,000 or from £250 per month or by transferring an ISA with a value of at least £2,000 from your existing manager.

Baillie Gifford's Children's Savings Plan

A cost-effective plan tailored especially to meet the requirements to save for children. You can invest a minimum of £250 or from £30 per month.

Baillie Gifford's Investment Trust PEP Transfer

You can transfer an existing PEP to access a different market or to change your investment manager (minimum value of £2,000).

Baillie Gifford Select Pension

The Baillie Gifford Select Pension, provided by Alliance Trust Savings Limited is a self-invested personal pension. The minimum contribution is £50 per month.

Further Information

Client Relations Team
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We may record your call

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Website: www.bailliegifford.com

Fax: 0131 275 3955

Directors

Chairman:
Sir Donald MacKay
MA FRSE FRSGS

GA Ball FCA
Dr MM Gray OBE DL
WG McQueen BSc CA FCIBS
JPHS Scott FCII FSI
The Rt Hon Lord Strathclyde PC

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Company Broker

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Auditor

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Saltire Court
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Company registration No. 7058

Managers, Secretaries and Registered Office

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