

Shires Income plc



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COMPANIES HOUSE 20/10/2006

Company No: 386561

Annual Report 2006

Managed By

Shires Income plc

About Your Trust

Trust Objective

The Company aims to provide shareholders with a high level of income, together with growth of both income and capital from a portfolio substantially invested in UK equities.

Assets

Portfolio Assets

Shires Income had total assets of £124.02 million as at 31 March 2006. These assets were invested by the Managers, Glasgow Investment Managers Limited ("*Glasgow*"), in what they believe is the appropriate way of achieving the Company's objectives. Of the total assets, £94.35 million were invested in ordinary shares and hedge instruments, £6.96 million in convertible securities and £30.41 million in preference shares, offset by net current liabilities of £7.69 million. The Company's assets will therefore tend to perform well when ordinary shares rise, particularly when higher yielding ordinary shares do better than lower or nil paying ordinary shares, and vice versa. Convertibles will tend to rise or fall with equities but to a lesser degree. Preference shares will tend to be more sensitive to interest rate movements; rising in value as rates fall or falling in value as rates rise.

Shires Smaller Companies plc

Rather than the trust holding a number of smaller companies shares, Shires Income currently invests indirectly in this part of the equity market through one holding in Shires Smaller Companies which is also managed by *Glasgow*. It has an attractive dividend yield.

Glasgow Investment Managers Limited

Shires Income owns 49.9% of its Manager, *Glasgow*. This is included in the portfolio as an unquoted equity. The original investment was made in 1990. The other 50.1% is owned by Sutherland Holdings, a Company principally owned by the retired founder of *Glasgow* and existing staff.

Earnings and Dividends

The Company aims to provide a high level of income. Based on the proposed final dividend, the Company will have paid out for the financial year just ended dividends totalling 19.25p. Using the share price at the end of the year of 313.5p this gives a yield of 6.1%. Given that the UK equity market currently yields around 2.9%, the assets of Shires Income have to yield a great deal more for the dividend to be paid from the surplus of income over expenses. There is, therefore, a bias in the portfolio to high yielding ordinary shares. One of the reasons 30.1% of total assets is invested in convertible securities and preference shares is that they typically provide more income than ordinary shares.

Dividends from ordinary shares, convertibles and preference shares are not the only way, however, that the Company generates income. It is also achieved by writing put and call options on shares owned, or shares the Managers would like to own. By doing so, the Company generates premium income.

Income can also be derived from owning appreciating shares in the dealing subsidiary, *Wiston*. On an occasional basis the Managers identify stocks that may rise in the short term. This activity is deemed to be trading and realised gains are treated as income rather than capital. In the past, the Company's investment in *Glasgow* has also produced healthy dividends. It is hoped that this will be a source of income again in the future.

The Directors and Managers put a great deal of emphasis on being able at least to maintain the current level of dividend. This would, however, be put at risk if the dividends paid by UK companies in general declined, or the Managers were not able to take advantage of option writing opportunities, or trading profits were not generated in *Wiston*. There is a sizeable revenue reserve, equivalent to 14.5p per share, (excluding IFRS dividend adjustment) which could be drawn on if required.

Gearing

In the long term, to help income generation and capital growth, the Company has borrowed to invest in the assets described above. This is undertaken in the belief that equities will produce a greater total return than the cost of the borrowing over time. Shires Income utilises two methods of borrowing. The first is a debenture, which has its interest cost and capital repayment linked to inflation (RPI). This debenture will be redeemed between 2008 and 2010. The other is by bank loans and overdrafts. At 31 March 2006 the total gearing was 35.1% with equity gearing 3.9% and therefore the Company will be slightly more sensitive to equity market rises and falls than if it were not equity geared.

Hedging

The Company also has in place a hedging arrangement that is there to protect the net assets of the Company against a dramatic fall in equity prices. If that were to occur not only would shareholders' wealth be eroded, but the covenants in place to protect the owners of the index-linked debenture could be breached, triggering a forced early repayment of the debenture resulting in significant penalties. The cost of this hedge is small in relation to the portfolio and it can be viewed as a type of insurance policy.

Contents

Company Administration	2
Company Profile	3
Financial Information	
Highlights	4
Performance	4
Absolute Performance	5
Relative Performance	5
Premium/(Discount)	5
Net Dividend Yield	5
Chairman's Statement	6
Board Review	8
How the Board Operates	9
Investment Managers' Review	
Managers' Review	10
Distribution of Assets and Liabilities	13
Sector Analysis of Listed Equity Portfolio	13
Sector Analysis of Listed Equity Portfolio relative to the FTSE All-Share Index	13
Portfolio of Investments	14
Historical Record	15
Information for Shareholders	
Analysis of Shareholders	16
Useful Information for Shareholders	16
Directors' Report	
Directors' Report	18
Directors' Remuneration Report	24
Directors' Responsibilities	25
Independent Auditors' Report	26
Financial Statements	
Consolidated Income Statement	28
Balance Sheets	29
Consolidated Cash Flow Statement	30
Consolidated and Company Statement of Changes in Equity	31
Notes to the Financial Statements	32
Further Information for Shareholders	
Glasgow Investment Managers Limited	49
Glossary of Technical Terms	50
Notice of Annual General Meeting	51

Company Administration

Managers and Secretaries

Glasgow Investment Managers Limited
Sutherland House
149 St Vincent Street
Glasgow G2 5DR
(Authorised and regulated by the Financial Services Authority)

Auditors

KPMG Audit Plc

Solicitors

Maclay Murray & Spens
Travers Smith Braithwaite

Stockbrokers

JPMorgan Cazenove Limited

Bankers

HSBC Bank plc

Registrars and Transfer Office

Lloyds TSB Registrars Scotland
PO Box 28506
Finance House
Orchard Brae
Edinburgh EH4 1WQ
Telephone: 0870 601 5366

Registered Office

165 Queen Victoria Street
London EC4V 4DD

Company Registration Number

386561 (England)

Company Profile

Objective

To provide for shareholders a high level of income together with growth of both income and capital from a portfolio substantially invested in UK Equities.

Investment policy

The Company invests principally in UK quoted companies and convertibles with above average yields. Stocks are selected according to their valuation compared to the FTSE All-Share Index and the relevant industrial sector.

Gearing is used with the intention of enhancing long-term returns.

Benchmark

FTSE All-Share Index (Total Return).

Capital structure and voting rights

Number of ordinary shares of 50p each in issue	29,676,982
3.5% cumulative preference shares of £1 each	50,000
5% Index-Linked Debenture 2008/2010	£26,499,000

Each of the ordinary shares and the cumulative preference shares has equal voting rights per single share.

Dividends

Dividends on the ordinary shares are payable quarterly at the end of January, April, July and October.

Continuation Vote

The Company's Articles of Association do not require shareholders to vote periodically on whether or not to carry on as an investment trust. Consequently, the Company has no termination date.

Management Company and Fee

Glasgow Investment Managers Limited ("*Glasgow*") acts as Managers and Secretaries to the Company under a management contract which is terminable by one year's notice on either side. The fee is at 0.45% p.a. for funds up to £100 million and 0.40% for funds over £100 million (*see note 3 to the financial statements on page 35*).

Glasgow is principally owned by its staff and retired founder with Shires Income plc currently holding the remaining 49.9% interest.

SIPPs, ISAs and PEPs

The Company's ordinary shares are available for investment in SIPPs, ISAs and PEPs.

AITC

The Company is a member of the Association of Investment Trust Companies (AITC).

Financial Information

Highlights

	As at 31 March 2006	As at 31 March 2005 (Restated under IFRS)	% change
Total Investments	£131.7m	£116.1m	13.4
Ordinary shareholders' funds	£97.5m	£81.0m	20.4
Market capitalisation	£93.0m	£78.9m	17.9
Net asset value (NAV) per ordinary share	328.4p	272.9p	20.4
Ordinary share price	313.5p	266.0p	17.9
(Discount)/Premium (ordinary share price to adjusted NAV)*	(1.4%)	1.3%	-
Revenue return per ordinary share	19.51p	19.58p	(0.4)
Dividends per ordinary share	19.25p	19.25p	-
Total expense ratio*	1.06%	1.11%	-
Gearing	35.1%	42.5%	-
Debt at Fair Value Disclosures			
NAV with debt at Fair Value [†]	306.6p	249.6p	22.8
Premium with debt at Fair Value [†]	2.3%	6.6%	-

Year's highs and lows	Year to 31 March 2006		Year to 31 March 2005	
	High	Low	High	Low
NAV per ordinary share ¹ *	317.9p	250.1p	270.3p	225.2p
Ordinary share price ¹	324.0p	240.5p	272.5p	200.0p
Premium/(Discount) ¹	4.9%	(2.5%)	2.9%	(12.1%)

Performance – Total Return

	1 year %	3 years %	5 years %
Shires Income plc			
– Net asset value	29.9 ² *	133.2 ³	7.5 ³
– Share price	26.5 ²	185.8 ³	11.5 ³
FTSE All-Share Index (Benchmark)	28.0 ⁴	93.8 ⁴	31.2 ⁴

Discrete Annual Performance

Year to:	31 March 2006	31 March 2005	31 March 2004	31 March 2003	31 March 2002
Shires Income plc	26.5% ²	29.8% ²	74.4% ²	(53.9)% ²	(15.5)% ²

Bid to bid closing share price, net income re-invested.

Past performance should not be seen as an indication of future performance.

	As at 31 March 2006	As at 31 March 2005
Net dividend yield		
Shires Income plc ⁵	6.1%	7.2%
FTSE All-Share Index (Benchmark)	2.9%	3.1%

*Based on IFRS NAV reduced by the dividend adjustment of 10.45p (see Chairman's statement on page 6).

¹ Based on month-end values (measured at mid-price)

² Source: Glasgow Investment Managers Limited – Based on fully diluted net asset values.

³ Source: Fundamental Data for the Association of Investment Trust Companies.

⁴ Source: Datastream.

⁵ Based on year end share price and total dividend for the year ended 31 March 2006.

[†] Based on IFRS NAV excluding dividend adjustment and incorporating Debenture stock at fair value (see note 15 on page 40).

Absolute Performance

Figures are total return and have been rebased to 100 at 31 March 2001.

Relative Performance

Premium/(Discount)

Net Dividend Yield

Chairman's Statement

Highlights

I am pleased to report continued growth in your Company in the year to 31 March 2006. The total return on net assets over the year was 29.9%, compared to the FTSE All-Share Index total return of 28.0%. The share price total return was 26.5%. Subject to shareholder approval, total dividends will be maintained at 19.25p, producing a dividend yield of 6.1% based upon the share price as at 31 March 2006, considerably higher than the 2.9% yield on the FTSE All-Share Index, the Company's benchmark.

The Revenue return per share was 19.51p, marginally down from 19.58p in the previous year.

The Board is recommending a final dividend of 6.05p per ordinary share, bringing total dividends for the year to 19.25p, the same level as paid last year. If approved, the final dividend will be paid on 31 July 2006 to shareholders on the register at close of business on 7 July 2006.

J. Martin Haldane *Chairman*

International Financial Reporting Standards

These are the Company's first annual financial statements under International Financial Reporting Standards (IFRS) which came into effect on 1 January 2005. As referred to in the Interim Report, the format of the financial statements shows significant changes from previous reports. The main presentational differences are two-fold. First, the Consolidated Statement of Total Return has been replaced with a Consolidated Income Statement, although this continues to follow the three columned approach showing the division between revenue and capital. Secondly, dividends are now shown in a new statement called the Consolidated Statement of Changes in Equity. Under the new IFRS requirements, only dividends which are paid in the financial period are included in the financial statements and shown in the Consolidated Statement of Changes in Equity. As a result, the 19.25p included in these financial statements is represented by the third interim dividend and final dividend in respect of the 2005 financial year totalling 10.45p plus the first two interims in respect of the 2006 financial year totalling 8.80p. The third interim dividend and final dividend of the 2006 financial year will be included in the financial statements for the year ended 31 March 2007.

The net asset value of the Company at 328.4p is 9.4p higher than it would have been under the old accounting rules. This is predominantly due to the exclusion, as liabilities, of the third interim dividend and final dividend of 2005/06 totalling 10.45p. The remaining small differences are represented by the move from mid to bid value for investments, a change in the method for accounting for debt securities and a change in the basis of valuation for the securities held in the dealing subsidiary. It should be noted that for calculating performance figures and regular reporting to the stockmarket, the Association of Investment Trust Companies has recommended the exclusion of the dividend adjustment above.

Investment Returns

The Company's total return on net assets was 29.9%, 1.9 percentage points ahead of the benchmark. This outperformance was due mainly to gearing the equity portfolio in a rising stockmarket and the positive contribution of the fixed interest portfolio in the year.

Over the year, there was a small drop in the rating of the Company's shares in the stockmarket. The share price moved from a premium of 1.3% to net asset value per share at 31 March 2005 to a discount of 1.4% at 31 March 2006. As a result, the share price total return at 26.5% was lower than the total return on net assets.

Portfolio Profile

Total gearing decreased from 42.5% to 35.1% during the year. Equity gearing was reduced from 14.4% to 3.9%, due principally to a rise in ordinary share prices and purchases of preference securities. This means that of the Company's gearing, only a small part is invested in equity instruments, resulting in the Company being less sensitive to rises and falls in the equity market than at 31 March 2005. Gearing in preference shares rose from 28.1% to 31.2% which reflected additional investment during the year in high-yielding fixed income securities, which made a major contribution to the high level of income distributed to shareholders.

Outlook

Global economic growth forecasts continue to be influenced by the rising levels of demand from China and India. Western economies have benefited from the lower labour costs in these areas, which have tended to keep wage rises subdued in the OECD. This has had a positive effect on the level of global inflation. On the other hand, rising demand in emerging regions and a lack of available new supply has led to a sharp increase in commodity prices. This could have a lagged effect on inflation statistics which may be reflected in a tendency for Central Banks to raise interest rates over the next six months rather than reduce them.

Equity markets have reacted positively to this strong global growth but, after a period of strong performance, bond markets have responded negatively to the prospect of higher short-term interest rates. Equity valuations are supported by rising corporate profits and, in the short-term, the rising level of dividends. Equities remain good value compared to fixed interest but may be subject to periods of profit taking after a healthy rise.

While not a forecast of earnings, the Board believes that, subject to any unforeseen circumstances, the existing level of dividend will be maintained in respect of the year ended 31 March 2007. The Board is hopeful that the Company will be able to increase the dividend in the medium term.

Board

Hamish Buchan, after five years on the Board, is proposing to retire at the conclusion of the Annual General Meeting in July. On behalf of shareholders I would like to thank him for his valuable contribution to the Company.

As described in the Directors' Report on page 18, the Board has undertaken a formal review of its own performance and that of individual Directors in the year to 31 March 2006. The Board recommends to shareholders the re-election of Joanna R. Davidson and myself at the Company's forthcoming Annual General Meeting.

J. Martin Haldane, *Chairman*

Directors

J. Martin Haldane C.A. (Chairman)

Age 64. Joined the Board in 1996 and Chairman since 1 January 2003. Formerly Senior Partner in Chiene & Tait, Chartered Accountants, and Deputy Chairman of The Scottish Life Assurance Company, Chairman of Investors Capital Trust PLC and a director of other companies which are unlisted.

Hamish N. Buchan

Age 61. Joined the Board in 2001. Involved for over thirty years as an analyst in the investment trust sector. Chairman of the Association of Investment Trust Companies (AITC) and Chairman of its Statistics Committee. He is also a non-executive director of Aberforth Smaller Companies Trust plc, JP Morgan American Investment Trust plc (Chairman), Personal Assets Trust plc, The Scottish Investment Trust plc and Standard Life European Private Equity Trust plc.

Mervyn D. Couve

Age 58. Joined the Board in 2003. Previously Managing Partner and Senior Partner of Speechly Bircham Solicitors and currently still a Partner. Trustee of English National Opera Trust. Former member of the CBI Smaller Firms Council and the CBI Company Law Panel.

The Hon. Mrs Joanna R. Davidson

Age 48. Joined the Board in 2000. Previously Marketing Director of the Chitty Food Group plc and Dawkins International Limited, as well as Non-Executive Director of The UA Group plc. Joined The Royal Bank of Scotland Group as Head of Corporate Responsibility in June 2003. She is also a director of GIM Holdings Limited.

David P. Kidd

Age 46. Joined the Board in February 2004. He has over twenty years experience in investment management, of which three quarters has been in the role of Chief Investment Officer. Previously he held this position with Chiswell Associates Limited and with the Royal Bank of Scotland's investment management arm. Currently Chief Investment Officer of the private bank, Arbuthnot Latham & Co. Limited. He is also a non-executive director of Martin Currie Portfolio Investment Trust plc.

How the Board Operates

Composition

The Board currently consists of five non-executive Directors. The table below sets out the number of Directors' meetings (including Committee meetings) held during the financial year and the number of meetings attended by each Director (whilst a Director or Committee member). There were seven Board Meetings during the financial year. The Board has appointed Glasgow Investment Managers Limited ("Glasgow"), in which the Company has a substantial minority interest, to manage the Company's investment portfolio within the guidelines set by the Board and to provide it with accounting and secretarial services. *Glasgow* is not represented on the Board, but key *Glasgow* investment and secretarial staff attend all Board Meetings to report relevant matters to the Board and to be available to answer any queries from Board members.

Reporting

Glasgow provides the Board with monthly reports on the Company's activities. These include statistics analysing the Company's performance relative to various stockmarket indicators, details of investments purchased and sold, results announcements of investee companies, projections of future income from investments and cash management details. An important part of the induction process for new Directors is guidance on understanding and appraising such data.

Decision Making Process

The Board has a formal schedule of matters specifically reserved to it for decision. These are discussed at regular intervals (and at least once a year) and comprise corporate matters, the Company's objective, benchmark, investment guidelines, advisors, Managers (including the investment in *Glasgow*) and management agreement. The Directors meet without the Managers present for part of every Board meeting.

Audit Committee

All Directors with the exception of J. M. Haldane and J. R. Davidson are members of the Audit Committee which is chaired by H. N. Buchan. This committee met twice during the year. The external auditors attended both of these meetings. Part of each meeting was conducted without the Managers being present.

Management Engagement Committee

All Directors with the exception of J. R. Davidson are members of the Management Engagement Committee, which is chaired by J. M. Haldane. This committee met once during the year.

Nominations Committee

All Directors with the exception of J. R. Davidson are members of the Nominations Committee, which is chaired by J. M. Haldane. This committee did not meet during the year as the board did not deem it necessary but did meet subsequent to the financial year end. Board composition has been formally considered at Board meetings.

Director	Board of Directors		Audit Committee		Management Engagement Committee		Nominations Committee	
	Held	Attended	Held	Attended	Held	Attended	Held	Attended
J. M. Haldane ¹ , <i>Chairman</i>	7	7	2	2	1	1	–	–
H. N. Buchan ²	7	7	2	2	1	1	–	–
M. D. Couve	7	6	2	1	1	1	–	–
J. R. Davidson	7	6	2	2	–	–	–	–
D. P. Kidd	7	7	2	2	1	1	–	–

¹ *Chairman of Management Engagement Committee and Nominations Committee*

² *Chairman of Audit Committee*

Investment Managers' Review

Background

The year to 31 March 2006 completed another strong period for UK equity investors and represented the third consecutive year of positive returns. For the year under review, the total return on the FTSE All Share Index was 28.0% and the outcome was significantly ahead of returns in other asset classes such as government debt and cash. Although the period included events such as the London bombings, Hurricane Katrina and further oil price strength, equities appreciated, with only a small correction in October 2005.

Equity investors benefited from strong company results, accompanied by profits upgrades, and the general strengthening of corporate balance sheets. Merger and acquisition activity gained momentum as the year progressed, fuelled by strong demand from both the private equity and the corporate sectors. A number of well known British companies including BOC, BPB and P&O were the subject of successful bids. Cash was returned to investors through both bids and share buy backs, some of which has been reinvested in equities helping to support the stockmarket.

Continuing one of last year's trends, the Mid Cap area of the stockmarket performed much better than the larger FTSE 100 companies. In the year to end March 2006, the total return of the FTSE 250 Mid Cap index was 41.7% reflecting the high incidence of takeovers in that part of the stockmarket. At the sector level, Mining, General Financials, Aerospace and Electricity outperformed most due to strong global economic conditions and high commodity prices. The underperforming sectors included Food and General Retailers, Leisure and Media, which were exposed to the slower UK domestic economy and lower retail spending. Competition in the retail sector adversely affected the Food Producers who faced higher input costs but were unable to reclaim those costs from price increases to the end consumer.

Portfolio Strategy

During the year, the absolute amount of our liabilities changed very little but the overall gearing level fell from 42.5% to 35.1%. The lower gearing was principally due to strong growth in net assets which increased by 20.4 % to £97.5m by the end of March 2006. During the year, £10.3m was disinvested from equities and convertibles and reinvested into high yielding preference shares. All these factors reduced equity gearing from 14.4% to 3.9%.

Revenue Account

The table below sets out the main sources of the Company's income for the last five years

Financial Year End	2006	2005	2004	2003	2002
	%	%	%	%	%
Ordinary Dividends	44.3	45.5	51.5	56.6	62.5*
Preference Dividends	25.6	26.9	16.4	13.4	13.3
Shires Smaller Companies plc	11.2	11.4	11.7	11.5	10.5
Fixed Interest and Bank Interest	1.9	1.5	2.7	5.0	3.2
Glasgow Dividends and Interest	0.0	0.0	0.3	0.8	3.8
Preference Share Switching	0.0	6.5	6.8	9.2	0.0
Dealing Subsidiary	2.2	(1.5)	7.1	0.2	(0.2)
Traded Option Premiums	14.8	9.7	3.5	3.3	6.9
	100.0	100.0	100.0	100.0	100.0
Total Income (£000s)	7,741	7,611	7,392	7,542	8,246

* includes special dividends: 2002 – 3.6% of total income.

The Revenue Account Table identifies the sources of the portfolio's income and the proportion generated from each area. In 2006, the largest source of income was dividends from ordinary shares, including Shires Smaller Companies, followed by dividends from preference shares. Together these investments generated 81.1% of total income.

The balance of the income, at 18.9%, came from debt securities, bank interest, traded option writing and a small amount from Wiston Investment Company, our dealing subsidiary. Last year, the Chairman noted that the Company would be increasing traded option writing to supplement income as preference share switching would no longer be treated as income under the new accounting rules.

The total income generated by the portfolio increased from £7.61m to £7.74m during the year.

Equities

The value of the listed equity portfolio increased from £81.9m to £90.5m, and by the end of March 2006 accounted for 92.8% of net assets.

The portfolio's three largest sector exposures were to Financials, Consumer Services and Industrials. The underweight positions continued to be in Oil & Gas, Technology, Telecom and Health Care. Two of the portfolio's holdings were taken over. BPB was bid for by the French construction group, St Gobain while P&O was eventually acquired by Dubai Ports after an auction developed between them and Singapore Ports, a rival operator. Both companies were acquired at considerable premiums to their pre-bid share prices.

During the year, a number of changes were made to the portfolio, especially to investments in the Financial sector. In the Banking sector, the holding in Barclays was sold due to concerns about their overseas acquisition strategy. The proceeds were re-invested in Alliance & Leicester which focuses on the UK mortgage and savings markets.

The existing investment in Lloyds TSB was increased as the results and dividend cover improved. In the Insurance sectors, the holdings in large companies such as Aviva and Royal & Sun Alliance were sold and switched into smaller, higher growth companies. New holdings were established in Highway Insurance which is a motor insurer, Friends Provident and, latterly, Jardine Lloyd Thompson where new management has been appointed. Real Estate forms part of the Financials exposure and two new issues joined the portfolio. Dawney Day Carpathian is a company which specialises in retail developments in Eastern Europe while Bulgarian Land Development is involved in residential property schemes. Both investments also provide above average dividend yields.

Competition and cost price inflation took its toll on the Food Producers sector. As the trading outlook deteriorated, the risk of downgrades at Northern Foods increased and, despite the high dividend yield, the holding was sold. In its place, a holding was established in Tate & Lyle where international earnings and growth in Splenda, its branded sugar substitute, support the healthy yield.

The tough retail climate prompted the sale of the holding in Marks & Spencer after a period of re-rating by the stockmarket.

In the Industrial sectors, the BBA holding was increased following conversion of their convertible preference shares in May 2005. A new holding was established in Titan Europe when the company announced a placing to acquire a wheel manufacturer in Italy. Titan is a specialist manufacturer of wheels for construction and mining vehicles. The holding in ATH Resources was increased after the company had a placing during the year to acquire two new open cast coal mines in Scotland.

Finally, a new investment was made in Rentokil Initial. The support services company is undergoing a major re-organisation and re-focusing of its businesses.

Shires Smaller Companies plc

Smaller companies have performed strongly over recent years relative to larger companies. There has been demand for shares in Shires Smaller Companies plc and it was deemed prudent to take the opportunity to reduce our holding. On 31 January 2006 2,286,808 shares were sold at a small discount to market price reducing the holding from 28.4% to 18.1% of Shires Smaller Companies plc issued share capital.

MacKintosh High Income OEIC

In March 2006 *Glasgow* launched an OEIC which aims to provide a high yield. This fund will invest primarily in FTSE 100 shares but will also have exposure to corporate bonds. On 10 March 2006 Shires Income plc invested £1.2 million in the fund, with a further £3.8 million invested after 31 March 2006.

Investment Managers' Review (Continued)

Convertibles

During the year, around £1.05m was realised from convertibles and the value of the portfolio declined from £7.5m to £6.9m. The main events were the redemption of the BBA 6.75% convertible preference shares at the end of May 2005 and the reconstruction of My Travel bonds in August.

Preference Shares

During the year, there was net investment of £5.8m in the preference share portfolio. The holdings in R.E.A. 9% and Halifax 6.125% were sold and funds invested across the other existing holdings including Aviva 8.75%, Standard Chartered 8.25% and Royal & Sun Alliance 7.375%. The preference share portfolio contributed 25.6% of the income to the revenue account during the year.

Investment Performance Analysis

	2006 Contribution %
FTSE All-Share Index, total return	28.0
Equities (inc Shires Smaller Companies) relative to benchmark	-0.1
Equity Gearing	1.4
Fixed Income portfolio, total return	7.2
Unlisted Investments, including <i>Glasgow</i>	0.1
Option writing and hedging activity	-1.9
Index Linked Debenture Stock	-2.9
Other Financing Costs and Expenses	-1.9
Total Return on Net Assets	29.9

The total return of the company during the year outperformed the FTSE All-Share Index. Equity stock selection was broadly in line with the Index, with positive contributions coming from being geared to equities during the year and from the fixed income portfolio. Option writing and the hedging arrangements were negative influences during the year along with the cost of the Index Linked Debenture Stock and the expenses associated with running the Company.

Prospects

The global economic background is encouraging for investors and supports further growth in company profits. In the UK, consensus growth in corporate earnings is forecast to be 7.4% in 2006 followed by 6.0% in 2007. Dividends are also expected to grow by around 9% in the current year. Add merger and acquisition activity to the positive earnings and dividend forecasts and equities remain attractive compared to other asset classes. The main risk to the outlook comes from higher than expected inflation and the consequent impact on interest rate policy. The recent setback in equity markets reflects those concerns. Macroeconomic events are likely to cause further short bouts of consolidation, but the longer term outlook for UK equities remains positive.

Distribution of Assets and Liabilities

	Valuation at 31 March 2005		Movements during the year			Valuation at 31 March 2006	
	£000	%	Purchases £000	Sales £000	Appreciation/ (Depreciation) £000	£000	%
Listed Investments							
Ordinary Shares	81,897	101.0	44,731	(53,996)	17,861	90,493	92.8
Convertibles	7,538	9.3	-	(1,048)	465	6,955	7.1
Preference Shares	22,748	28.1	10,901	(5,081)	1,838	30,406	31.2
Portfolio Hedge Instruments	89	0.1	2,723	-	(2,450)	362	0.4
	<u>112,272</u>	<u>138.5</u>	<u>58,355</u>	<u>(60,125)</u>	<u>17,714</u>	<u>128,216</u>	<u>131.5</u>
Unlisted Investments	3,213	4.0	-	-	285	3,498	3.6
	<u>115,485</u>	<u>142.5</u>	<u>58,355</u>	<u>(60,125)</u>	<u>17,999</u>	<u>131,714</u>	<u>135.1</u>
Other Current assets	2,797	3.4				3,357	3.4
Other Current liabilities	(11,514)	(14.2)				(11,048)	(11.3)
Non current liabilities	(25,716)	(31.7)				(26,499)	(27.2)
NET ASSETS	<u>81,052</u>	<u>100.0</u>				<u>97,524</u>	<u>100.0</u>
NET ASSET VALUE PER ORDINARY SHARE	<u>272.9p</u>					<u>328.4p</u>	

Sector Analysis of Listed Equity Portfolio (based on value of Ordinary Shares above)*

Sector Analysis of Listed Equity Portfolio relative to the FTSE All-Share Index*

* Both graphs above reflect the sector composition of Shires Smaller Companies' listed equity portfolio.

Portfolio of Investments

as at 31 March 2006

	Market value £'000	% of total assets
ORDINARY SHARES		
Shires Smaller Companies	10,640	8.1
Lloyds TSB	5,088	3.9
Severn Trent	5,022	3.8
Bradford & Bingley	4,990	3.8
Legal & General	4,961	3.8
Friends Provident	4,483	3.4
Alliance & Leicester	3,705	2.8
Rio Tinto	3,651	2.8
BBA	3,408	2.6
Gallaher	3,358	2.5
Renrokil Initial	3,115	2.4
Arriva	3,075	2.3
British American Tobacco	2,925	2.2
EMI	2,528	1.9
Provident Financial	2,471	1.9
ATH Resources	2,434	1.8
Dawuay Day Carpathian	2,275	1.7
DSG International	2,211	1.7
National Express	2,125	1.6
Highway Insurance Holdings	2,049	1.6
Titan Europe	1,899	1.4
Jardine Lloyd Thompson	1,809	1.4
Holidaybreak	1,712	1.3
BP	1,651	1.3
Tate & Lyle	1,597	1.2
Advance UK Trust	1,506	1.1
Woolworths	1,489	1.1
MacKintosh High Income OEIC	1,187	0.9
AWG	1,128	0.9
Chesnara	1,032	0.8
Bulgarian Land	525	0.4
Other (8)	444	0.3
	<u>90,493</u>	<u>68.7</u>
CONVERTIBLES		
BAE Systems 7.75%	2,591	2.0
Slough Estates 8.25p	2,443	1.8
SMG 6.5%	1,133	0.9
Balfour Beatty 10.75p	788	0.6
	<u>6,955</u>	<u>5.3</u>
PREFERENCE SHARES		
Royal & Sun Alliance 7.375%	4,435	3.4
Abbey National 10.375%	4,361	3.3
General Accident 8.875%	3,759	2.8
Aviva 8.75%	3,736	2.8
Ecclesiastical Insurance 8.625%	3,001	2.3
Standard Chartered 8.25%	2,998	2.3
National Westminster 9%	2,697	2.0
Abbey National 8.625%	2,345	1.8
Bellway 9.5%	1,000	0.8
Premier Farnell 89.2%	812	0.6
Standard Chartered 7.375%	653	0.5
General Accident 7.875%	609	0.5
	<u>30,406</u>	<u>23.1</u>
TOTAL LISTED PORTFOLIO		
Glasgow Investment Managers Limited	127,854	97.1
Other Unlisted (4)	2,596	1.9
Other Unlisted (4)	902	0.7
Portfolio Hedge Instruments	362	0.3
TOTAL INVESTMENTS	<u>131,714</u>	<u>100.0</u>

All investments are listed on the London Stock Exchange, except where indicated. The MacKintosh High Income OEIC is not listed on the London Stock Exchange but the price of units is quoted on a daily basis in the Financial Times. Included in "Other" are investments totalling £212,000 which are listed in the USA.

Historical Record

Capital History¹

As at 31 March	Total assets less current liabilities £m	Ordinary Shareholders' funds £m	Net asset value per Ordinary Share		Share price p	Premium/ (Discount) %	Actual Gearing %
			Undiluted p	Fully diluted p			
1996	104.7	80.6	291.6	285.4	248.0	(13.1)	33.2
1997	114.8	90.7	325.0	317.6	293.5	(7.6)	29.8
1998	158.6	134.3	475.7	462.5	424.5	(8.2)	21.3
1999	164.2	139.0	490.7	477.7	446.0	(6.6)	22.1
2000	172.4	134.3	452.8	452.8	399.0	(11.9)	28.8
2001	164.6	126.0	425.1	425.1	413.0	(2.8)	37.1
2002	148.1	108.9	366.9	366.9	332.5	(9.4)	43.7
2003	75.4	51.2	172.7	172.7	141.5	(18.1)	50.3
2004	93.0	68.1	229.5	229.5	224.0	(2.4)	43.4
2005*	103.7	77.9	262.5	262.5	266.0	1.3	48.2
2006*	120.9	94.4	318.0	318.0	313.5	(1.4)	39.5

Cumulative Performance^{2,3}

As at 31 March	NAV' (fully diluted)	NAV' total return ⁴	Share price	Share price total return ⁴	Benchmark	Benchmark total return ⁴
1996	100.0	100.0	100.0	100.0	100.0	100.0
1997	111.3	117.6	118.3	126.0	113.9	118.7
1998	162.1	179.0	171.2	191.4	150.9	162.0
1999	167.4	192.3	179.8	209.4	157.0	172.9
2000	158.7	187.9	160.9	193.4	168.7	190.0
2001	148.9	183.8	166.5	209.6	147.1	169.6
2002	128.6	166.7	134.1	177.1	138.7	164.2
2003	60.5	84.7	57.1	81.8	94.2	115.3
2004	80.4	122.7	90.3	142.9	119.2	151.0
2005	92.0	152.2	107.3	184.8	133.3	174.5
2006	111.4	196.5	126.4	233.7	165.3	223.4

Revenue History¹

Year ended 31 March	Fully diluted earnings per share p	Rebased ³	Dividends per ordinary share p	Rebased ³	Retail price index ¹ p	Total expense ratio ⁵ %
1996	18.81	100.0	16.80	100.0	100.0	0.85
1997	15.70	83.5	16.80	100.0	102.6	0.79
1998	19.64	104.4	17.50	104.2	106.1	0.78
1999	17.57	93.4	18.00 ³	107.1	108.3	0.74
2000	19.56	104.0	18.65	111.0	111.2	0.69
2001	19.27	102.4	19.00	113.1	113.7	0.76
2002	19.35	102.9	19.25	114.6	115.2	0.84
2003	19.72	104.8	19.25	114.6	118.7	1.11
2004	19.45	103.4	19.25	114.6	121.8	1.22
2005	19.58	104.1	19.25	114.6	125.7	1.11
2006	19.51	103.7	19.25	114.6	128.7	1.06

* Based on IFRS NAV reduced by the dividend adjustment of 10.45p (see Chairman's statement)

¹ Data supplied by Glasgow Investment Managers Limited.

² Data supplied by Fundamental Data for the Association of Investment Trust Companies.

³ Rebased to 100 at 31 March 1996.

⁴ Total return figures are based on reinvestment of net income.

⁵ Additionally, a special dividend of 0.65p per share was paid.

⁶ Annual operating costs, excluding interest, divided by average shareholders' funds.

Analysis of Shareholders

as at 31 March 2006

Number of Shareholders (5,110)

Number of Shares Held (29,676,982)

Useful Information for Shareholders

Annual General Meeting

This year's Annual General Meeting will be held at Trinity House, Tower Hill, London EC3N 4DH on 7 July 2006 at 12 noon.

Financial Calendar for 2006

7 July	Annual General Meeting
31 July	Ordinary Shares final dividend 2005/2006 payable
29 September	3.5% Preference Shares half-year dividend payable
31 October	Ordinary Shares first interim dividend 2006/2007 payable
October/November	Interim results announced
October/November	Interim Report published

Price and Net Asset Value information

The price of the ordinary shares is quoted in the *Financial Times*, *The Daily Telegraph*, *The Herald* and *The Times*. The Company's Net Asset Value is calculated weekly and announced to the London Stock Exchange.

The Glasgow Investment Collection

The Glasgow Investment Collection was launched in January 2004. It offers the opportunity for investors to choose to invest in one or a combination of all of the following three investment trusts: Shires Income plc, Glasgow Income Trust plc and Shires Smaller Companies plc, the investment trusts managed by Glasgow Investment Managers Limited ("*Glasgow*"). These investments can be made through an ISA, TrustPlan, PEP Transfer or a new Children's Savings Plan.

The Glasgow Investment Collection offers:

- Regular Monthly Savings, from as little as £20 per month.
- Lump Sum Investment from £200.
- PEP or ISA Transfers.
- A Share Exchange Scheme.
- Dividend Reinvestment.

Further information may be obtained from *Glasgow* on FREEFONE 0800 435 797 and on the website www.glasgowinvestmentmanagers.co.uk.

Share Register enquiries

The Company's Registrars, Lloyds TSB Registrars Scotland, maintain the share register. In the event of queries regarding your shares, please contact the Registrars on 0870 601 5366. Changes of name or address must be notified in writing to Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA.

Shareview website

The Registrars provide an on-line service that enables shareholders to access details of their shareholdings. A shareholder wishing to view that information, together with additional information such as indicative share prices and details of recent dividends, should visit www.shareview.co.uk.

Shares held in nominee names

Where notification has been received in advance, the Company will provide nominee companies with copies of shareholder communications for distribution to their customers. Shareholders whose shares are held in nominee names may, if appointed as a proxy by the nominee company, attend general meetings and speak when invited by the Chairman.

Directors' Report

Status of the Company

The Company, which was incorporated in 1929, has received approval as an investment trust by the Inland Revenue for all accounting periods up to and including 31 March 2005 and has since conducted its affairs so as to enable it to retain such approved status. It is a member of the Association of Investment Trust Companies. The Company is an investment company within the meaning of Section 266 of the Companies Act 1985. So far as the Directors are aware the close company provisions of the Income and Corporation Taxes Act 1988 do not apply to the Company.

Business Review

Activities

The Company is an investment trust. Its subsidiary undertaking, Wiston Investment Company Limited, operates as an investment dealing company. The objective of the Company is set out on page 3 of this Annual report.

The Company has a 49.9% interest in its managers and secretaries, Glasgow Investment Managers Limited ("*Glasgow*"), an unlisted company, and a 18.1% interest in Shires Smaller Companies plc, a listed investment trust managed by *Glasgow*. It also has a holding in the Mackintosh High Income OEIC which is also managed by *Glasgow*. Further details on this investment can be found in note 11 to the financial statements on page 39.

Results and Dividends

The financial statements for the year ended 31 March 2006 appear on pages 28 to 48. Dividends paid in the year amounted to 19.25p per ordinary share.

A third interim dividend of 4.4p per ordinary share was declared on 3 March 2006 and paid on 28 April 2006. A final dividend of 6.05p per ordinary share is proposed. Under International Financial Reporting Standards (IFRS) both these dividends will be accounted for in the financial year ended 31 March 2007.

Current and Future Development

A review of the business is given in the Chairman's Statement and the Investment Managers' Review. Key performance indicators ("KPIs") are shown in the Financial Information on page 4 with historical performance being shown on page 15. These KPIs include net asset value total return, share price total return, and the premium/discount at which the shares trade. The Board also considers the marketing and promotion of the Company, including effective communications with shareholders, which is explained in more detail in the Relations with Shareholders section on page 21. The Board considers the future direction of the Trust at an annual strategy meeting where a wide discussion takes place on development and strategic direction. The Company's brokers, JP Morgan Cazenove, present to the Board at that meeting and cover the topics of sector development, 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 and liquidity risk. An explanation of these risks and how they are managed are contained in note 19 to the accounts on page 43.

Directors

The Directors are shown on page 8. All held office throughout the year. J. M. Haldane, having served as a Director since 1996 retires, and, being eligible, offers himself for re-election. J. R. Davidson, being deemed as connected with the Company's Managers as explained on page 19, retires, and, being eligible, offers herself for re-election.

The Board has reviewed its performance and in particular the performance of Mr Haldane and Mrs Davidson. The Board believes that they provide a significant contribution through their knowledge and expertise and their re-election is recommended to shareholders.

Directors' Interests in Shares

The interests of the Directors in office at 31 March 2006 in the ordinary 50p shares in the Company were as follows:

	Beneficial Interest		Non-beneficial interest	
	31 March 2006	31 March 2005	31 March 2006	31 March 2005
H. N. Buchan	12,000	12,000	—	—
M. D. Couve	2,000	2,000	—	—
J. R. Davidson	4,000	4,000	—	—
J. M. Haldane	11,800	11,800	720	720
D. P. Kidd	1,000	1,000	—	—

No Director had an interest in the 3.5% cumulative preference share capital at any time during the year. There have been no changes in the Directors' interests between 1 April 2006 and 19 May 2006.

Corporate Governance

The Board has in place Corporate Governance arrangements, which it believes are appropriate for an investment trust company, and enable the Company to comply with the relevant principles set out in the revised Combined Code on Corporate Governance ("the Combined Code") issued by the Financial Reporting Council in July 2003. Subject to the special circumstances of the Company as an investment trust, the Company has complied with the provisions set out in the Combined Code save for the exceptions explained and detailed below.

The Board has also reviewed the AITC Code of Corporate Governance ("the AITC Code") issued in July 2003 and endorses its recommendations in all material aspects. The Company recognises the recent decision of the Financial Reporting Council to endorse the AITC Code, meaning that Investment Trusts which follow the AITC Code will be deemed to be meeting their obligations under the Combined Code. The Company intends to take advantage of this decision and solely follow the AITC Code for the forthcoming year.

The Board

The Board currently consists of five non-executive Directors. There is no Chief Executive position within the Company, as day to day management of the Company's affairs has been delegated to the Managers, Glasgow Investment Managers Limited ("*Glasgow*"). Similarly, the Board does not believe that there is a need for a Senior Independent Director in addition to the separate roles of Chairman and Chairman of the Audit Committee. Biographies of the Directors appear on page 8, which demonstrate the wide range of skills and experience which each brings to the Board. Each Director has signed a letter of appointment to formalise in writing the terms of his/her engagement as a non-executive Director. Copies of these letters are available for inspection at the registered office of the Company and at the offices of *Glasgow* during normal business hours, and will also be available for fifteen minutes prior to the Annual General Meeting.

The Board regularly reviews the independence of its members and, having due regard to the definitions and current AITC guidelines on independence, considers all Directors to be independent of the Company's Managers. J. R. Davidson is deemed by the Combined Code and AITC Code to be connected with the Company's Managers, *Glasgow*, in which the Company has a 49.9% minority interest, as she is a non-executive Director of GIM Holdings Limited, the immediate parent company of *Glasgow*. The Chairman, J. M. Haldane, has sat on the Board for ten years. The Board has considered the independence of these two Directors with particular care. While Mr Haldane and Mrs Davidson are prima facie not considered independent under the Combined Code, the Board feels they display all the characteristics of independence and can be relied upon so to act at all times. In order to comply with the AITC Code, Mr Haldane and Mrs Davidson will be subject to re-election this year and on an annual basis thereafter.

The Combined Code provides that the Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual Directors. In order to review its effectiveness, the Board carries out a process of formal self appraisal. The Directors consider how the Board functions as a whole and also review the individual performance of its members. This process is led by the Chairman and encompasses quantitative and qualitative measures of performance implemented by way of an evaluation survey questionnaire and Board discussion. The appraisal of the Chairman is carried

Directors' Report (Continued)

out via the Chairman of the Audit Committee, Mr Buchan, who reviews the performance of the Chairman with other non-executive Directors. This process has been carried out in respect of the year under review and will be conducted on an annual basis.

The Board has appointed *Glasgow* to manage the Company's investment portfolio within guidelines set by the Board and to provide it with accounting and secretarial services. *Glasgow* provides the Board with monthly reports on the Company's activities. The Board has a formal schedule of matters specifically reserved to it for decision including an annual review of the Managers and the management agreement. There is an agreed procedure for Directors to take independent professional advice if necessary and at the Company's expense. This is in addition to the access which every Director has to the advice of *Glasgow* as secretaries of the Company.

The Board has appointed three committees to cover specific operations as set out on the following pages. Copies of the terms of reference of each committee are available on request from *Glasgow* and will also be available at the Annual General Meeting.

Each Director is entitled to be indemnified by the Company against all costs, charges, losses, expenses and liabilities in the discharge of his/her duties or in relation to those duties.

Audit Committee

The Audit Committee comprises all of the Directors of the Company, with the exception of J. M. Haldane and J. R. Davidson. Mr Haldane does not sit on the Audit Committee as he is Chairman of the Company. Mrs Davidson does not sit on the Audit Committee due to her connection with *Glasgow*. Although not members of the Committee both sit in attendance at the Audit Committee meetings. The Audit Committee meets at least twice per year to coincide with the annual and interim reporting and audit cycle. The Chairman is H. N. Buchan. The principal role of the Audit Committee is to review the annual and interim financial statements and the accounting policies applied therein and ensure compliance with financial and regulatory reporting requirements. The external auditors, KPMG Audit Plc, whose continued appointment is also reviewed and ratified by the Audit Committee, attend at least one meeting of the Audit Committee per year. In addition the Audit Committee reviews the independence of the external auditors in relation to the audit of the annual financial statements. In completing this review, the Audit Committee has taken into account the standing, experience and tenure of the audit Director, the nature and level of service provided and confirmation that the firm have complied with relevant UK independence guidelines. The Audit Committee considers KPMG Audit Plc to be independent both of the Company and the Managers in all respects.

The Audit Committee has also reviewed the provision of non-audit services by the auditors, which were provided in relation to taxation services and advice in relation to International Financial Reporting Standards and the basis of the valuation of *Glasgow*. The fees for tax and IFRS advisory services amounted to £14,000 for the financial year and the Audit Committee considers these to be cost effective and in no way an impediment to the independence of the auditors.

The Audit Committee's responsibilities also include reviewing the arrangements in place within *Glasgow* 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.

Management Engagement Committee

The Management Engagement Committee comprises all Directors of the Company with the exception of J. R. Davidson, due to her connection with *Glasgow*. The Management Engagement Committee met once in the past year. The purpose of the Committee is to review the terms of the agreements with the Managers including, but not limited to, the management fee and also to review the performance of the Managers in relation to the achievement of the Company's objectives. These reviews have been conducted during the year and the outcomes are noted below.

Investment Management Agreement

The key terms of the Investment Management Agreement and specifically the fee charged by *Glasgow* and how it is calculated are set out in note 3 to the financial statements. The Board believes the fee charged by *Glasgow* is competitive with reference to other investment trusts with a similar investment mandate and is priced appropriately given the level of service provided by *Glasgow*.

Performance

The objective of the Company is to provide for shareholders a high level of income together with growth of both income and capital. The benchmark is the FTSE All-Share Index (Total Return).

The combination of providing a high level of income together with capital growth while matching the benchmark represents a demanding mandate. Performance statistics are shown on page 4, and page 15 contains details of the ten year historical record. The outperformance and underperformance have in certain years been considerable. The underperformance in the year ended 31st March 2003 has been a particular drag on the longer term statistics, but the Board is very encouraged by the outperformance in each of the last three years. This has been achieved while maintaining a very high yield on the assets, although it has not been possible to increase the dividend in the last four years.

Summary

Taking the above factors into account, it is the opinion of the Board that the continuing appointment of *Glasgow*, on the terms agreed, is in the interest of the shareholders as a whole.

Nominations Committee

The Nominations Committee comprises all Directors of the Company with the exception of J. R. Davidson, due to her connection with *Glasgow*. The Nominations Committee considers appointments of new Directors undertaking a thorough and open process involving, where appropriate, professional recruitment consultants and committee interviews with candidates identified with the intention that the composition of the Board reflects a breadth of commercial, professional and industry experience. The Nominations Committee did not meet as there were no proposed changes to the Board composition in the year but did meet subsequent to the financial year end.

Board Composition

Under the Articles of Association:

(i) new Directors are subject to election at the first Annual General Meeting after their appointment, (ii) all Directors retire in rotation and (iii) a Director who has reached the age of seventy must retire at the end of the next Annual General Meeting following his/her seventieth birthday. Directors do not have service contracts or fixed terms in office, but, in accordance with the AITC Code, they are required to submit themselves for re-election every three years and annually after nine years. New Directors are provided with sufficient guidance and instruction to enable them to understand the economic environment in which investment trusts operate and carry out an effective and objective evaluation of the Company's performance therein.

Relations with Shareholders

All shareholders have the opportunity to attend and vote at Annual General Meetings at which Directors and the Managers are available to discuss key issues affecting the Company. The Managers have also conducted a series of meetings with shareholders throughout the year to discuss issues relating to the Company and also to give them the opportunity to meet the Board, if requested. As recommended by the Combined Code, the Company announces at general meetings the proxy votes cast. At least twenty working days' notice is given of the Annual General Meeting.

Internal Control

The Board is ultimately responsible for the Company's system of internal control and for reviewing its effectiveness. However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss.

Under the Combined Code, it is a requirement that the Board reviews the effectiveness of the Company's system of internal controls at least annually, comprising all controls including financial, operational, compliance and risk management. To achieve this, the Board has in place regular review procedures for the identification, evaluation and management of significant risks to the Company, to enable full compliance with guidance issued in September 1999 by the Turnbull Committee. This process has been in place throughout the year under review and up to the date of approval of the Annual Report.

The Board has delegated certain functions. The main service providers are *Glasgow*, the Managers and Secretaries; HSBC Bank plc, the Custodian; and Lloyds TSB Registrars Scotland, the Registrars. *Glasgow* provides the Board with monthly reports, which cover investment activities and financial matters, and with periodic reports on its control procedures and its system of internal financial control. An independent custodian, HSBC Bank plc, is appointed to safeguard the Company's investments, which are registered in the name of the custodian's nominee company. In view of the controls that are in place, the Directors do not consider that there is any need for an internal audit function.

Going Concern

The Board considers that the Group has adequate financial resources to continue in operational existence for the foreseeable future. For this reason it continues to apply the going concern basis in preparing the financial statements.

Responsibilities as an Institutional Shareholder

In October 2002, The Institutional Shareholders' Committee, of which the AITC is a member, published a Statement of Principles setting out best practice guidelines designed to enable institutional shareholders to derive the best possible value out of the companies in which they invest. The following General Policy is a statement of the procedures and policies followed by the Board in discharging its responsibilities over all investee companies.

General Policy

The Board delegates to the Managers responsibility for selecting the portfolio of investments, within investment guidelines established by the Board after discussion with *Glasgow*, and for monitoring the performance and activities of investee companies. *Glasgow* carries out detailed research of investee companies and possible future investee companies by a combination of broker and internally generated research, assisted by independent research consultants. The research on a company comprises an evaluation of fundamental details such as financial strength, quality of management, market position and product differentiation, plus an appraisal of issues relevant to it, including policies relating to social, ethical and environmentally responsible investment.

The Company's voting rights in respect of investee companies are delegated to the Managers, who vote at all general meetings of UK companies. The Managers consider each case on its individual merits with the primary aim of the use of voting rights being to ensure a satisfactory return from investments.

Glasgow Investment Managers Limited ("*Glasgow*")

Shires Income plc has a 49.9% stake in GIM Holdings Limited, the immediate parent company of *Glasgow*. This investment is wholly managed by the Directors of Shires Income plc with *Glasgow* having no control over the management of this interest. In order to reflect the views of Shires Income plc, Mrs J.R. Davidson sits on the Board of GIM Holdings Limited. No management fee is charged in respect of the amount of Shires Income plc's net assets attributable to this holding.

Shires Smaller Companies plc

The Company has a 18.1% (2005 – 28.4%) interest in the share capital of this listed investment trust which is also managed by *Glasgow* in the same manner as stated in the above General Policy. All of the Directors of Shires Smaller Companies plc are independent of Shires Income plc. *Glasgow* has no control over the management of the interest in Shires Smaller Companies plc and does not charge any management fee in respect of the amount of Shires Income plc's net assets attributable to this holding.

Payment Policy

The Company's policy, in relation to all of its suppliers, is to settle the terms of payment when agreeing the terms of the transaction and to abide by those terms. The Company does not have trade creditors.

Substantial Interests

As at 19 May 2006 the Company had received notification of the following interests in its ordinary shares:

	Number of Shares	% of total
Sun Life and Provincial Holdings plc, a subsidiary of AXA S.A.	2,975,960	10.0
Barclays PLC	1,319,055	4.4
In addition, the Company is aware of the following substantial interests in its ordinary shares as at 19 May 2006:		
Glasgow Investment Managers Limited as Plan Manager of The Glasgow Investment Collection	2,207,872	7.4

Directors' Remuneration Report

Under the Directors' Remuneration Report Regulations 2002, the report, which appears on pages 24 and 25, must be approved by the Directors and laid before the Members of the Company at the same time as the audited financial statements and be the subject of a separate resolution as part of the Ordinary Business at the Annual General Meeting. Accordingly, Resolution 2 will be proposed as an ordinary resolution to enable Members either to show that they approve of the contents of the Directors' Remuneration Report by voting "For" the resolution, or to show their disapproval by voting "Against" the resolution.

Authority to Allot Shares

This authority gives Directors power under Section 80 of the Companies Act 1985 to allot shares in the Company for a further five year period as permitted by the Companies Act. Accordingly Resolution 7 will be proposed as an ordinary resolution giving the Directors general authority to allot shares in the Company up to a maximum nominal amount of £4,946,163, being one-third of the Company's present issued ordinary share capital.

Authority to Disapply Statutory Pre-emption Rights

The power given to Directors at the last Annual General Meeting to allot shares for cash otherwise than in accordance with statutory pre-emption rights expires on the date of the forthcoming Annual General Meeting. Since in certain circumstances it may be in the best interests of the Company to issue shares for cash otherwise than pro rata to existing shareholders, the Directors consider that it is appropriate for this power to be renewed at the forthcoming Annual General Meeting. Accordingly Resolution 8 will be proposed as a special resolution giving the Directors power to allot for cash, as if section 89(1) of the Companies Act 1985 did not apply, equity securities in connection with a rights issue and, provided the shares are issued at a price not less than their underlying net asset value, in other cases up to an aggregate nominal amount of £741,924, which is equivalent to approximately 5% of the present ordinary share capital of the Company. This power will require to be renewed at the Annual General Meeting in 2007. New shares will be issued only in compliance with the policies of the UK Listing Authority concerning the issuing of new shares for cash.

Authority to buy back shares

The resolution passed at the last Annual General Meeting to authorise the Company to make market purchases of up to 14.99% of its own ordinary shares expires on the date of the forthcoming Annual General Meeting. Accordingly, Resolution 9 will be proposed as a special resolution to renew this authority for a further year.

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/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

A resolution re-appointing KPMG Audit Plc as auditors and authorising the Directors to determine their remuneration will be proposed at the Annual General Meeting.

By Order of the Board



Glasgow Investment Managers Limited
Secretaries
26 May 2006

Directors' Remuneration Report

Policy

The Board as a whole sets the rates of remuneration payable to each Director following an annual review. The Board is aware that remuneration should be comparable to market rates in order to attract and retain Directors of the appropriate calibre and reflect the time spent and responsibilities borne by Directors in exercising the stewardship required of this Company. In setting these rates, the Board uses information gathered by the Managers, Glasgow Investment Managers Limited ("*Glasgow*"), who monitor rates of Directors' remuneration in companies of comparable size and activities and carry out any other relevant research requested by the Board. No separate remuneration committee has been constituted in view of the level of work delegated to *Glasgow*. Further details of the services provided by *Glasgow* are contained in note 3 to the financial statements.

The Board considers that the present policy to remunerate Directors exclusively by fixed fees in cash is appropriate and adequate for the Company in its present and foreseeable circumstances and there are no plans to introduce additional or alternative remuneration schemes.

No Director has a service contract with the Company or its subsidiary undertakings, although each has a letter of appointment from the Company confirming their appointment and setting out their remuneration as at the date of the letter. These letters contain no provisions regarding notice period, nor do they make provision for compensation payable upon early termination of the Director's appointment. J.M. Haldane, H.N. Buchan and J.R. Davidson have appointment letters dated 19 August 2005. Mr Haldane and Mrs Davidson are appointed until the earlier of the AGM in 2006 or the date on which they are required to retire by rotation under the Articles of Association. Mr Buchan is appointed until his intended retirement date at the AGM in July 2006. M. D. Couve and D. P. Kidd both have appointment letters dated 2 August 2004. The date to which Mr Couve and Mr Kidd are appointed is the earlier of the AGM in 2007 or the date on which they are required to retire by rotation under the Articles of Association.

Directors' Remuneration Rates

The annual rates of remuneration with effect from 1 April 2005 were £18,000 for the Chairman and £12,000 for each other Director. The rates for the forthcoming year commencing 1 April 2006 are £19,500 for the Chairman and £13,000 for each other Director.

The Articles of Association of the Company set a maximum aggregate limit within a financial year for non-executive Directors' remuneration. This limit, which was last adjusted by special resolution at the Annual General Meeting of the Company held on 30 June 2000, is £70,000 per annum, subject to annual upward adjustment on 1 April each year in line with the change in the Retail Price Index from March 2000. The limit for the year ended 31 March 2006 was therefore £79,186 on the basis of there being five Directors.

The total fee payable to each Director who served during the present and previous financial years of the Company is shown in the following table (audited):

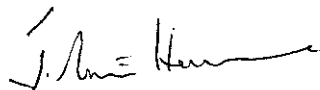
	Group and Company	
	2006	2005
	£	£
J. M. Haldane	18,000	17,250
H. N. Buchan	12,000	11,500
M. D. Couve	12,000	11,500
J. R. Davidson	12,000	11,500
D. P. Kidd	12,000	11,500
	<u>£66,000</u>	<u>£63,250</u>

The fees payable to M. D. Couve are paid to a third party. There is no performance related remuneration scheme such as an annual bonus, or a long-term incentive scheme such as the granting of share options. The Company does not operate a pension scheme for the Directors and no Director received any form of remuneration during the present or preceding financial years other than the fees shown above.

Performance

The Absolute Performance graph on page 5 of this Annual Report shows the total return to an investor in the Company as measured both on a share price and net asset value basis, both with dividends reinvested, during the five years ended 31 March 2006, together with the performance over the same period of the FTSE All-Share Index (Total Return), the benchmark index applicable to the Company.

Approved by the Board of Directors on 26 May 2006 and signed on its behalf.



J. Martin Haldane, Chairman

Directors' Responsibilities in respect of the Annual Report and the Financial Statements

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

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they are required to prepare the group financial statements in accordance with IFRSs as adopted by the EU and they have elected to prepare the parent company financial statements on the same basis.

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

In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and parent company will continue in business.

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

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

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

Independent Auditors' Report to the Members of Shires Income plc

We have audited the group and parent company financial statements (the "financial statements") of Shires Income plc for the year ended 31 March 2006 which comprise the Consolidated Income Statement, the Group and Company Balance Sheets, the Group Cash Flow Statement, the Consolidated and Company Statements of Changes in Equity and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the group and company financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, and for preparing the Directors' Remuneration Report in accordance with applicable law are set out in the Statement of Directors' Responsibilities on page 25.

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

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes the information presented in the Chairman's Statement and Manager's Review 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 group's corporate governance procedures or its risk and control procedures.

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

Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report to be audited.

Independent Auditors' Report to the Members of Shires Income plc (continued)

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the group's and parent company's affairs as at 31 March 2006 and of its profit for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 March 2006;
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Glasgow
26 May 2006

Consolidated Income Statement

for the year ended 31 March 2006

	Notes	2006 Revenue £000	2006 Capital £000	Total £000	2005 Revenue £000	2005 Capital £000	Total £000
GAINS AND LOSSES ON INVESTMENTS							
Gains on investments at fair value	11	-	18,088	18,088	-	11,353	11,353
INVESTMENT INCOME							
Dividend income		6,282	-	6,282	6,754	-	6,754
Interest income		123	(102)	21	157	(98)	59
Traded option premiums		1,138	-	1,138	734	-	734
Deposit interest		15	-	15	8	-	8
Other revenue on Financial Assets held for trading		10	-	10	2	-	2
Income of dealing subsidiary		173	-	173	(44)	-	(44)
	2	7,741	17,986	25,727	7,611	11,255	18,866
EXPENSES							
Investment management fee	3	(246)	(246)	(492)	(202)	(202)	(404)
Other administrative expenses	4	(409)	-	(409)	(401)	-	(401)
Finance costs of borrowings	6	(1,294)	(1,345)	(2,639)	(1,198)	(1,249)	(2,447)
		(1,949)	(1,591)	(3,540)	(1,801)	(1,451)	(3,252)
PROFIT BEFORE TAX		5,792	16,395	22,187	5,810	9,804	15,614
Tax expense	7	-	-	-	-	-	-
PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY							
		5,792	16,395	22,187	5,810	9,804	15,614
Earnings per ordinary share (pence)		19.51p	55.24p	74.75p	19.58p	33.04p	52.62p

The total column of this statement represents the Group's Income statement, prepared in accordance with IFRS. The supplementary revenue and capital columns are both prepared under guidance published by the Association of Investment Trust Companies. All items in the above statement derive from continuing operations.

All income is attributable to the equity holders of the parent company. There are no minority interests.

The following table shows the revenue profit for each year under IFRS less the dividends declared in respect of the financial year to which they relate. This table is not part of the Consolidated Income Statement.

	Year to 31 March 2006 £000	Year to 31 March 2005 £000
Revenue for the year	5,792	5,810
Dividends for the year	(5,715) ¹	(5,715) ²
	<u>77</u>	<u>95</u>

¹ Relates to first three interim dividends (each 4.4p) and the final dividend (6.05p) declared in respect of the financial year 2005/06.

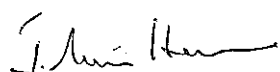
² Relates to first three interim dividends (each 4.4p) and the final dividend (6.05p) declared in respect of the financial year 2004/05.

Balance Sheets

As at 31 March 2006

	Notes	Group		Company	
		2006 £000	2005 £000	2006 £000	2005 £000
NON CURRENT ASSETS					
Ordinary shares		90,493	81,897	90,493	81,897
Convertibles		6,955	7,538	6,955	7,538
Other fixed interest		30,406	22,748	30,406	22,748
Hedge Instruments		362	716	362	716
Unlisted Investments		3,498	3,213	3,498	3,213
	11	131,714	116,112	131,714	116,112
CURRENT ASSETS					
Trade and other receivables		30	30	92	760
Accrued income and prepayments		1,614	1,770	1,614	1,770
Financial assets of dealing subsidiary		501	995	-	-
Cash and cash equivalents		1,212	2	1,212	2
Hedge Instruments		-	126	-	126
	13	3,357	2,923	2,918	2,658
CURRENT LIABILITIES					
Trade and other payables		(733)	(409)	(743)	(419)
Short-term borrowings		(10,315)	(11,105)	(10,315)	(11,105)
Hedge Instruments		-	(753)	-	(753)
	14	(11,048)	(12,267)	(11,058)	(12,277)
NON CURRENT LIABILITIES					
Index Linked Debenture Stock	15	(26,499)	(25,716)	(26,499)	(25,716)
NET ASSETS					
		97,524	81,052	97,075	80,777
Issued capital and reserves attributable to equity holders of the parent					
Called up share capital	16	14,888	14,888	14,888	14,888
Share premium account	17	18,936	18,987	18,936	18,987
Retained Earnings					
Realised capital reserve	18	32,667	27,714	32,539	27,586
Unrealised capital reserve	18	23,615	12,122	23,734	12,241
Revenue reserve	18	7,418	7,341	6,978	7,075
SHAREHOLDERS' FUNDS					
		97,524	81,052	97,075	80,777
NET ASSET VALUE PER ORDINARY SHARE (PENCE)					
		328.4p	272.9p		

Approved by the Board of Directors on 26 May 2006 and signed on its behalf



J. Martin Haldane, *Chairman*

The accompanying notes are an integral part of these balance sheets

Consolidated & Company Cash Flow Statement

For the year ended 31 March 2006

	Year to 31 March 2006 £000	Year to 31 March 2005 £000
CASH FLOWS FROM OPERATING ACTIVITIES		
Investment income received	6,550	7,062
Deposit interest received	12	10
Investment management fee paid	(506)	(421)
Sales less purchases of current financial assets held for trading	667	(834)
Other cash receipts	1,099	722
Other cash expenses	(332)	(339)
CASH GENERATED FROM OPERATIONS	7,490	6,200
Interest paid	(1,854)	(1,612)
Taxation	-	-
NET CASH INFLOWS FROM OPERATING ACTIVITIES	5,636	4,588
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(55,325)	(78,918)
Sales of investments	60,125	69,833
Purchases of hedge instruments	(2,722)	(72)
Sale of hedge instruments	-	100
NET CASH INFLOW/(OUTFLOW) FROM INVESTING ACTIVITIES	2,078	(9,057)
CASH FLOWS FROM FINANCING ACTIVITIES		
Equity dividends paid	(5,715)	(5,715)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	1,999	(10,184)
Cash and cash equivalents at start of period	(11,102)	(918)
CASH AND CASH EQUIVALENTS AT END OF PERIOD	(9,103)	(11,102)
CASH AND CASH EQUIVALENTS COMPRISE:		
Cash and cash equivalents	1,212	(102)
Short-term borrowings	(10,315)	(11,000)
	(9,103)	(11,102)

Consolidated Statement of Changes in Equity

For the year ended 31 March 2006

	Notes	Share Capital £000	Share Premium £000	Realised Capital Reserve £000	Unrealised Capital Reserve £000	Retained Revenue Reserve £000	Total £000
AS AT 1 APRIL 2004		14,888	19,038	27,871	2,111	7,246	71,154
Revenue profit for the year		-	-	-	-	5,810	5,810
Capital profit for the year		-	(51)	(157)	10,011	-	9,803
Equity dividends	9	-	-	-	-	(5,715)	(5,715)
AS AT 31 MARCH 2005		14,888	18,987	27,714	12,122	7,341	81,052
Revenue profit for the year		-	-	-	-	5,792	5,792
Capital profit for the year		-	(51)	4,953	11,493	-	16,395
Equity dividends	9	-	-	-	-	(5,715)	(5,715)
AS AT 31 MARCH 2006		14,888	18,936	32,667	23,615	7,418	97,524

Company Statement of Changes in Equity

For the year ended 31 March 2006

	Notes	Share Capital £000	Share Premium £000	Realised Capital Reserve £000	Unrealised Capital Reserve £000	Retained Revenue Reserve £000	Total £000
AS AT 1 APRIL 2004		14,888	19,038	27,743	2,230	6,936	70,835
Revenue profit for the year		-	-	-	-	5,854	5,854
Capital profit for the year		-	(51)	(157)	10,011	-	9,803
Equity dividends	9	-	-	-	-	(5,715)	(5,715)
AS AT 31 MARCH 2005		14,888	18,987	27,586	12,241	7,075	80,777
Revenue profit for the year		-	-	-	-	5,618	5,618
Capital profit for the year		-	(51)	4,953	11,493	-	16,395
Equity dividends	9	-	-	-	-	(5,715)	(5,715)
AS AT 31 MARCH 2006		14,888	18,936	32,539	23,734	6,978	97,075

Notes to the Financial Statements

1. ACCOUNTING POLICIES

(a) Basis of Accounting

The financial statements of the Group and Company have been prepared in accordance with International Financial Reporting Standards (IFRSs as endorsed by the EU) which comprise standards and interpretations approved by the International Accounting Standards Board ("IASB"), and International Accounting Standards and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee ("IASC") that remain in effect, and to the extent that they have been adopted by the European Union ("Endorsed IFRS"). The disclosures required by IFRS 1 First-time Adoption of International Financial Reporting Standards ("IFRS 1") concerning the transition from UK GAAP to IFRSs are given in note 21. The financial statements do not reflect any changes in respect of the recent amendments to IAS 39 – 'Financial Instruments Recognition and Measurement' for the fair value options. Corresponding figures for the year to 31 March 2005 have, where appropriate, been restated in accordance with IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 39. IFRS7 'Financial Instruments: disclosures' was available for early application but has not been applied by the Company in these financial statements. Its application in 2006 would not have affected the balance sheet or income statement as the Standard is concerned only with disclosure.

The financial statements have been prepared under the historical cost convention as modified to include the revaluation of securities held at fair value and on the assumption that approval as an investment trust will continue to be granted. The principal accounting policies adopted are set out below. These policies have been applied consistently throughout the year. Where presentational guidance set out in the Statement of Recommended Practice ("SORP") for investment trusts issued by the Association of Investment Trust Companies in December 2005 is consistent with the requirements of Endorsed IFRS, the Directors have sought to prepare the financial statements on a basis compliant with the recommendations of the SORP except as referred to in paragraph (d) below.

In order to reflect better the activities of an investment trust company and in accordance with guidance issued by the AITC, supplementary information which analyses the income statement between items of a revenue and capital nature has been presented alongside the income statement. In accordance with the Company's status as a UK investment company under section 266 of the Companies Act 1985, net capital returns may not be distributed by way of dividend. Additionally, the net revenue of the Company is the measure the Directors believe appropriate in assessing the Group's compliance with certain requirements set out in section 842 of the Income and Corporation Taxes Act 1988.

(b) Consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 March each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. All intra-group transactions, balances, income and expenses are eliminated on consolidation. The Company has availed itself of the relief from showing a revenue account for the parent company granted under Section 230 of the Companies Act 1985.

(c) Investments – Securities held at Fair Value

Investments are recognised or derecognised on the trade date where a purchase or sale is under contract whose terms require delivery within the timeframe established by the market concerned, and are initially measured at fair value.

The Group's investments including the hedge instruments are designated as fair value through profit or loss. All investments are designated upon initial recognition at fair value and are measured at subsequent reporting dates at their fair value which, for quoted Investments, is the bid price as at close of business on the balance sheet date. Hedge Accounting is not applied.

Gains and losses arising from the changes in fair value are included in the net profit or loss for the period as a capital item. Transaction costs on acquisition of investments and on the disposals of investment are expensed and accounted for through capital.

Fair value for unquoted investments are established using appropriate valuation techniques. For the Company's interest in Glasgow Investment Managers ("Glasgow") the Directors, in making the valuation, consider amongst other factors, funds under management, earnings and dividend yields. Investments held by investment dealing subsidiaries are shown as current assets at fair value. Realised and unrealised gains and losses arising on these investments are dealt with in the revenue column of the Consolidated Income Statement.

Notes to the Financial Statements

(continued)

1. ACCOUNTING POLICIES (continued)

(d) Income

Dividend Income from equity investments including preference shares which have a discretionary dividend is accounted for when the shareholders' rights to receive payment has been established, normally the ex-dividend date.

Interest from debt securities which includes preference shares which do not have a discretionary dividend are accounted for on an effective interest rate basis. Any write-off of the premium or discount on acquisition as a result of using this basis is allocated against unrealised capital reserve. The SORP recommends that such a write off should be allocated against revenue. The Directors believe this treatment is not appropriate for a high yielding investment trust which frequently trades in debt securities and believe any premium or discount paid for such an investment is a capital item.

Traded option contracts are restricted to writing out-of-the-money options with a view to generating income. Premiums received on traded option contracts are recognised as income evenly over the period from the date they are written to the date when they expire or are exercised or assigned. Gains and losses on the underlying shares acquired or disposed of as a result of options exercised are included in the capital account. Unexpired traded option contracts at the year end are accounted for at their fair value.

Interest from deposits is dealt with on an effective interest basis.

Underwriting commission is recognised when the underwriting services are provided and taken to revenue, unless any shares underwritten are required to be taken up, in which case the proportionate commission received is deducted from the cost of the investment.

(e) Expenses

All expenses are accounted for on an accruals basis. In respect of the analysis between revenue and capital items presented within the Income Statement, all expenses have been presented as revenue items except those where a connection with the maintenance or enhancement of the Investments held can be demonstrated. Accordingly, the investment management fee and finance costs of borrowings are charged 50% to capital and 50% to revenue, in order to reflect the Directors expected long-term view of the nature of the investment returns of the Company.

(f) Bank Borrowings

Interest-bearing bank loans and overdrafts are initially recognised at cost being the fair value of the consideration received net of any issue expenses. The finance costs, being the difference between the net proceeds of borrowings and the total amount of payments that require to be made in respect of that borrowing, accrue evenly over the life of the borrowing and are allocated between capital and revenue.

(g) Index-Linked Debenture Stocks

The Index-Linked adjustments to the redemption value of the Index-Linked Debenture stocks, and the interest payable on the Debentures are aggregated. The total is then charged 50% to capital and 50% to revenue. The amortisation of discounts and expenses of issue are charged wholly to share premium.

This allocation between capital and revenue reflects the expected long-term split of returns as mentioned in note (e).

(h) Taxation

The tax payable is based on the taxable profit for the year. Taxable profit differs from net profit as reported in the Income Statement because it excludes items of income or expenditure that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group has no liability for current tax.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of assets or liabilities that affect neither accounting nor taxable profit other than in a business combination, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

(i) Foreign currency

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. Foreign exchange gains or losses on investments are recognised in capital through fair value movement. Any other 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 the revenue account as appropriate.

Notes to the Financial Statements

(continued)

2. INCOME

	2006	2005
	£000	£000
Income from listed investments		
Dividend income	6,260	6,754
Interest income from investments	123	157
	<u>6,383</u>	<u>6,911</u>
Other unlisted dividend income	22	-
	<u>6,405</u>	<u>6,911</u>
Other income from investment activity		
Deposit interest	15	8
Traded option premiums	1,138	734
Sales of investments in dealing subsidiary	1,188	262
Cost of sales in dealing subsidiary	(974)	(252)
Decrease in fair value of investments in dealing subsidiary	(41)	(54)
	<u>173</u>	<u>(44)</u>
Other Income	10	2
	<u>1,336</u>	<u>700</u>
	<u>7,741</u>	<u>7,611</u>
Total income comprises:		
Dividends and interest from investments	6,405	6,911
Deposit interest	15	8
Other income from investment activity	1,321	692
TOTAL INCOME	<u>7,741</u>	<u>7,611</u>

UK dividend income includes a special dividend of £77,000 (2005 - £Nil). All dividend income was received from UK companies. The amount of £102,000 (2005: £98,000) included in the capital column of Investment Income represents the write off of the premium or discount on acquisition of debt securities referred to in note 1(d).

Notes to the Financial Statements

(continued)

3. MANAGEMENT AND SECRETARIAL FEE

Glasgow acts as investment managers and secretaries to the Company under a contract terminable by one year's notice on either side. The fee payable is based on shareholders' funds plus long-term indebtedness. The annual fee rate since 1 April 1993 has been fixed at 0.45% for funds up to £100 million and 0.40% for funds over £100 million. The fee is subject to proportionate reductions to reflect the Company's investments in Glasgow and Shires Smaller Companies plc and the MacKintosh High Income OEIC, which are managed by Glasgow.

The Company has a substantial minority interest in GIM Holdings Limited, Glasgow's holding company (see note 11).

The fee for the year ended 31 March 2006 was £492,000 (2005 – £404,000) including VAT. The fee is in respect of investment management and is allocated 50% to capital and 50% to revenue. From 1 April 2005 the Company also pays an annual marketing and secretarial fee of £47,000 (including VAT). This fee is wholly allocated to revenue.

4. MANAGEMENT AND ADMINISTRATIVE EXPENSES

	2006			2005		
	Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
Directors' remuneration – fees as directors	66	–	66	63	–	63
Investment management fee	246	246	492	202	202	404
Marketing & Secretarial fee	47	–	47	29	–	29
Fees payable to auditors and associates						
– as auditors	19	–	19	17	–	17
– for tax services & IFRS advice	14	–	14	9	–	9
Other management expenses	263	–	263	283	–	283
	<u>655</u>	<u>246</u>	<u>901</u>	<u>603</u>	<u>202</u>	<u>805</u>

5. DIRECTORS' REMUNERATION

The Company had no employees during the year (2005 – Nil). No pension contributions were paid for Directors (2005 – £Nil).

Details of Directors' remuneration are shown on page 24.

6. FINANCE COSTS OF BORROWINGS

	2006			2005		
	Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
Bank loans and overdrafts						
repayable within five years	268	268	536	173	173	346
5% Index-Linked Debenture Stock 2008/2010	1,026	1,026	2,052	1,025	1,025	2,050
Amortisation of Issue Expenses on Debenture Stock	–	51	51	–	51	51
	<u>1,294</u>	<u>1,345</u>	<u>2,639</u>	<u>1,198</u>	<u>1,249</u>	<u>2,447</u>

7. TAXATION

At 31 March 2006 the Company had surplus management expenses and loan relationship debits with a tax value of £5,511,000 (2005 – £4,911,000) in respect of which a deferred tax asset has not been recognised. 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.

The following table is a reconciliation of taxation to the charges/credits which would arise if all ordinary activities were taxed at the standard UK corporation tax rate of 30% (2005 – 30%).

Notes to the Financial Statements

(continued)

7. TAXATION (continued)

	2006			2005		
	Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
Profit on ordinary activities before taxation	5,792	16,446	22,238	5,810	9,855	15,665
Corporation tax @ 30%	1,737	4,934	6,671	1,743	2,957	4,700
Effects of:						
Non-taxable dividend income	(1,905)	–	(1,905)	(2,059)	–	(2,059)
Non-taxable write off of debt security premium/discount	–	30	30	–	30	30
Current year losses not utilised	168	462	630	316	419	735
Non-taxable realisation (gains)	–	(5,426)	(5,426)	–	(3,406)	(3,406)
Total tax charge for the year	0	0	0	0	0	0

8. REVENUE AFTER TAXATION FOR THE FINANCIAL YEAR

The revenue after taxation for the financial year includes £5,618,000 (2005 – £5,888,000) which has been dealt with in the Company's financial statements.

9. DIVIDENDS

	2006 £000	2005 £000
Amounts recognised as distributions to equity holders in the period:		
Third interim dividend for the year ended 31 March 2005 of 4.4p (2004: 4.4p) per share	1,306	1,306
Final dividend for the year ended 31 March 2005 of 6.05p (2004: 6.05p) per share	1,795	1,795
First two interim dividends for the year ended 31 March 2006 totalling 8.8p (2005: 8.8p) per share	2,612	2,612
	<u>5,713</u>	<u>5,713</u>
3.5% Cumulative preference shares	<u>2</u>	<u>2</u>

The third interim dividend of 4.4p for the year to 31 March 2006 paid on 28 April 2006 and the final dividend for the year to 31 March 2006 payable on 31 July 2006 have not been included as liabilities in these financial statements.

We also set out below the total dividend payable in respect of the financial year, which is the basis on which the requirements of Section 842 Income and Corporation Taxes Act 1988 are considered.

	2006 £000	2005 £000
Three interim dividends for the year ended 31 March 2006 totalling 13.2p (2005: 13.2p) per share	3,918	3,918
Final proposed dividend for the year ended 31 March 2006 of 6.05p (2005: 6.05p) per share	1,795	1,795
	<u>5,713</u>	<u>5,713</u>

Notes to the Financial Statements

(continued)

10. RETURN AND NET ASSET VALUE PER ORDINARY SHARE

	2006	2005
Revenue return	£5,792,000	£5,810,000
Capital return	£16,395,000	£9,804,000
Weighted average number of ordinary shares	29,676,982	29,676,982

Net asset value per ordinary share is based on net assets attributable to ordinary shareholders of £97,474,000 (2005 – £81,002,000) and on the 29,676,982 (2005 – 29,676,982) ordinary shares in issue at 31 March 2006.

11. NON CURRENT ASSETS – Securities at fair value

	Group and Company	
	2006	2005
	£'000	£'000
Listed on recognised stock exchanges:		
In the United Kingdom	127,642	112,109
Overseas	212	74
Hedge instruments (Included in Non Current assets)	362	716
	<u>128,216</u>	<u>112,899</u>
Unlisted	3,498	3,213
	<u>131,714</u>	<u>116,112</u>
Hedge instruments (included in Current assets)	–	126
Hedge instruments (included in Current liabilities)	–	(753)
	<u>131,714</u>	<u>115,485</u>

	Group					
	2006			2005		
	Listed	Unlisted	Total	Listed	Unlisted	Total
	invest- ments	invest- ments	£'000	invest- ments	invest- ments	£'000
	£'000	£'000	£'000	£'000	£'000	£'000
Cost at 31 March 2005	101,449	1,516	102,965	93,643	1,516	95,159
Unrealised appreciation at 31 March 2005	10,823	1,697	12,520	400	2,040	2,440
Valuation at 31 March 2005	<u>112,272</u>	<u>3,213</u>	<u>115,485</u>	<u>94,043</u>	<u>3,556</u>	<u>97,599</u>
Purchases	58,355	–	58,355	76,909	–	76,909
Sales – proceeds	(60,125)	–	(60,125)	(70,233)	–	(70,233)
– net gains on sales	6,493	–	6,493	1,243	–	1,243
Amortised cost adjustment to debt securities						
– Charged to revenue	–	–	–	(14)	–	(14)
– Charged to capital	(102)	–	(102)	(98)	–	(98)
Movement in fair value	<u>11,323</u>	<u>285</u>	<u>11,608</u>	<u>10,422</u>	<u>(343)</u>	<u>10,079</u>
Valuation at 31 March 2006	<u>128,216</u>	<u>3,498</u>	<u>131,714</u>	<u>112,272</u>	<u>3,213</u>	<u>115,485</u>
Cost at 31 March 2006	106,070	1,516	107,586	101,449	1,516	102,965
Unrealised appreciation at 31 March 2006	22,146	1,982	24,128	10,823	1,697	12,520
Valuation at 31 March 2006	<u>128,216</u>	<u>3,498</u>	<u>131,714</u>	<u>112,272</u>	<u>3,213</u>	<u>115,485</u>

Notes to the Financial Statements

(continued)

11. NON CURRENT ASSETS – Securities at fair value (continued)

	Company					
	2006			2005		
	Listed invest- ments £000	Unlisted invest- ments £000	Total £000	Listed invest- ments £000	Unlisted invest- ments £000	Total £000
Cost at 31 March 2005	101,714	1,131	102,845	93,908	1,131	95,039
Unrealised appreciation at 31 March 2005	10,558	2,082	12,640	135	2,425	2,560
Valuation at 31 March 2005	112,272	3,213	115,485	94,043	3,556	97,599
Purchases	58,355	–	58,355	76,909	–	76,909
Sales – proceeds	(60,125)	–	(60,125)	(70,233)	–	(70,233)
– net gains on sales	6,493	–	6,493	1,243	–	1,243
Amortised cost adjustment to debt securities						
– Charged to revenue	–	–	–	(14)	–	(14)
– Charged to capital	(102)	–	(102)	(98)	–	(98)
Movement in fair value	11,323	285	11,608	10,422	(343)	10,079
Valuation at 31 March 2006	128,216	3,498	131,714	112,272	3,213	115,485
Cost at 31 March 2006	106,335	1,131	107,466	101,714	1,131	102,845
Unrealised appreciation at 31 March 2006	21,881	2,367	24,248	10,558	2,082	12,640
Valuation at 31 March 2006	128,216	3,498	131,714	112,272	3,213	115,485

	Group and Company	
	2006 £000	2005 £000
Net realised gains on sales of investments	7,884	1,489
Movement in fair value of investments	11,686	10,493
Call options exercised	(1,391)	(246)
Put options assigned	(79)	(413)
Movement in unrealised depreciation of traded options	(12)	30
	18,088	11,353

The cost of the exercising of call options and the assigning of put options is the difference between the market price of the underlying shares and the strike price of the options. The premiums earned on options expired, exercised or assigned of £1,138,000 (2005 – £734,000) have been dealt with in the revenue account.

The movement in the provision for traded options has been calculated in accordance with the accounting policy stated in note 1(d) and has been charged to the unrealised capital reserve.

The total transaction costs on the purchases and sales of investments in the year was £322,000 (2005 – £549,000).

Notes to the Financial Statements

(continued)

11. NON CURRENT ASSETS – Securities at fair value (continued)

At 31 March 2006 the Company held the following investments comprising more than 3% of the class of share capital held:

Company	Country of incorporation	Number and class of shares held	Percentage of class held
ATH Resources plc	England	1,250,000 ordinary	3.1%
GIM Holdings Limited	Scotland	42,336 A ordinary	49.9%
Shires Smaller Companies plc	Scotland	4,000,000 ordinary	18.1%
Sierra Monitor Corporation	USA	1,549,134 shares of common stock	14.1%
Submersible Television Surveys Limited	Scotland	186,490 8% cum rd pref	40.8%
MacKintosh High Income OEIC		1,200,000 units	48.3%

Glasgow Investment Managers, the Company's Managers and Secretaries, whose business is the management of investments, is a wholly owned subsidiary undertaking of GIM Holdings Limited ("Glasgow Group"). This unlisted equity investment, which cost £304,000, was valued at 31 March 2006 at £2,596,000 (2005 – £2,246,000) in accordance with accounting policy note 1(c). Consolidated pre-tax profits of GIM Holdings Limited were £184,000 for the year to 31 March 2005 (2004 £137,000) on a turnover of £2,542,000 (2004 £2,703,000). Net assets of the Glasgow Group at that date were £2,258,000 (2004 –£2,110,000). The earnings per share of the Glasgow Group for the year to 31 March 2005 were £1.80 (2004 £1.01).

At 31 March 2006 Shires Income plc held 1,200,000 units of the Mackintosh High Income OEIC which is managed by Glasgow Investment Managers Limited. On 4 April 2006 Shires Income plc purchased a further 3,789,011 units at a cost of £3,800,000 in the Mackintosh High Income OEIC resulting in Shires Income plc holding 77.1% of the fund. No management fee is charged in respect of the amount of Shires Income plc's net assets attributable to this holding

12. SUBSIDIARY UNDERTAKINGS

As at 31 March 2006, the Company owned the whole of the issued ordinary share capital of its two subsidiary undertakings, Topshire Limited and Wiston Investment Company Limited, both of which are investment dealing companies registered in England. Topshire Limited has been dormant since 1989.

In the opinion of the Directors, the values of its investments in these subsidiary undertakings are not less than cost.

13. CURRENT ASSETS

	Group		Company	
	2006 £000	2005 £000	2006 £000	2005 £000
Accrued income & prepayments	1,614	1,770	1,614	1,770
Hedge Investments	–	126	–	126
Due from subsidiary undertakings	–	–	62	730
Investments of dealing subsidiary at fair value	501	995	–	–
Other debtors	30	30	30	30
Cash at bank	1,212	2	1,212	2
	<u>3,357</u>	<u>2,923</u>	<u>2,918</u>	<u>2,658</u>
Included above are the following amounts owed by GIM Holdings:				
Other debtors	<u>30</u>	<u>30</u>	<u>30</u>	<u>30</u>

Notes to the Financial Statements

(continued)

14. CURRENT LIABILITIES

	Group		Company	
	2006 £000	2005 £000	2006 £000	2005 £000
Bank loans and overdrafts	10,315	11,105	10,315	11,105
Investment purchases	307	-	307	-
Due to subsidiary undertakings	-	-	10	10
Traded options at fair value	-	48	-	48
Hedge Instruments	-	753	-	753
Other creditors	426	361	426	361
	<u>11,048</u>	<u>12,267</u>	<u>11,058</u>	<u>12,277</u>
Included above are the following amounts owed to <i>Glasgow</i> , the Managers and Secretaries:				
Other creditors	<u>148</u>	<u>115</u>	<u>148</u>	<u>115</u>

Interest on short-term bank loans and overdrafts is at floating rates related to LIBOR and UK base rates respectively.

15. NON CURRENT LIABILITIES

	Group and Company	
	2006 £000	2005 £000
5% Index-Linked Debenture Stock 2008/2010		
- Due in 2-5 years	<u>26,499</u>	<u>25,716</u>

5% Index-Linked Debenture Stock 2008/2010

This Stock is unlisted and is secured by a floating charge over the whole of the assets of the Company and its dealing subsidiary undertakings.

The Directors' opinion of the total fair value of this Stock at 31 March 2006, determined with reference to the current interest profile of similar instruments, was £29,883,000 (2005 - £29,560,000). As there is no intention of redeeming this stock before maturity, this value will not be realised but is given for disclosure purposes only.

Interest on the 5% Stock is paid on 6 March and 6 September each year at an annual rate of 5% as adjusted by the movement in the UK General Index of Retail Prices (RPI) over the period from July 1989 to the month eight months prior to the month in which interest is paid.

The capital amount to be repaid on the 5% Stock on 6 March in each of the years 2008 to 2010 will be one third of the nominal amount as adjusted by the movement in the RPI over the period from July 1989 to the month eight months prior to the month in which repayment is made.

The discount on issue is amortised annually to the share premium account over the life of the Stock.

Notes to the Financial Statements

(continued)

15. NON CURRENT LIABILITIES (continued)

	Group and Company	
	2006	2005
The amounts outstanding at 31 March 2006 comprise:	£000	£000
Nominal amounts	16,000	16,000
Discounts on issue	(979)	(979)
Amortisation of discounts	830	778
	<u>15,851</u>	<u>15,799</u>
Index-linked adjustments	10,648	9,917
	<u>26,499</u>	<u>25,716</u>
The movements during the year were as follows:		
Amounts outstanding at 31 March 2005	25,716	24,897
Amortisation of discounts (note 17)	51	51
Index-linked adjustments	732	768
	<u>26,499</u>	<u>25,716</u>

16. CALLED UP SHARE CAPITAL

	Number	Authorised	
		2006	2005
		£000	£000
Ordinary shares of 50p each	39,800,000	19,900	39,800,000
3.5% cumulative preference shares of £1 each	100,000	100	100,000
		<u>20,000</u>	<u>20,000</u>
		Allotted, called up and fully paid	
		2006	2005
		£000	£000
Ordinary shares of 50p each	29,676,982	14,838	29,676,982
3.5% cumulative preference shares of £1 each	50,000	50	50,000
		<u>14,888</u>	<u>14,888</u>

17. SHARE PREMIUM ACCOUNT

	2006	2005
	£000	£000
At 31 March 2005	18,987	19,038
Amortisation of expenses and discounts on issue of Debenture Stocks (note 15)	(51)	(51)
At 31 March 2006	<u>18,936</u>	<u>18,987</u>

Notes to the Financial Statements

(continued)

18. RETAINED EARNINGS

Realised capital reserve	2006		2005	
	Group £000	Company £000	Group £000	Company £000
At 31 March 2005	27,714	27,586	27,871	27,743
Net gains on sales of investments during year	9,286	9,286	1,001	1,001
Net (losses)/gains on hedge positions closed in year	(2,793)	(2,793)	242	242
Management fee	(246)	(246)	(202)	(202)
Finance costs of borrowings:				
<i>Bank loans and overdrafts repayable within five years</i>	(268)	(268)	(173)	(173)
Index-Linked Debenture costs	(1,026)	(1,026)	(1,025)	(1,025)
At 31 March 2006	<u>32,667</u>	<u>32,539</u>	<u>27,714</u>	<u>27,586</u>
Unrealised capital reserve				
	2006		2005	
	Group £000	Company £000	Group £000	Company £000
At 31 March 2005	12,122	12,241	2,111	2,230
Movements during the year:				
Fixed asset investments	11,264	11,264	11,618	11,618
Hedge instruments	343	343	(1,538)	(1,538)
Traded options	(12)	(12)	29	29
Amortised cost adjustment charged to capital	(102)	(102)	(98)	(98)
At 31 March 2006	<u>23,615</u>	<u>23,734</u>	<u>12,122</u>	<u>12,241</u>

The capital reserves are not distributable.

Revenue reserve

	2006		2005	
	Group Realised £000	Company Realised £000	Group Unrealised £000	Company Realised £000
At 31 March 2005	7,065		276	7,075
Transfer from revenue account	77		-	(97)
At 31 March 2006	<u>7,142</u>		<u>276</u>	<u>6,978</u>
	2006		2005	
	Group Realised £000	Company Realised £000	Group Unrealised £000	Company Realised £000
At 31 March 2004	6,970		276	6,936
Transfer from revenue account	95		-	139
At 31 March 2005	<u>7,065</u>		<u>276</u>	<u>7,075</u>

Notes to the Financial Statements

(continued)

19. RISK MANAGEMENT, FINANCIAL ASSETS AND LIABILITIES

Risk Management

The Company's objective is addressed by investing in mainly quoted UK equities to provide growth in capital and income and in fixed income securities to provide a high level of income. Additional income is generated from premiums earned by writing covered out-of-the-money traded options against assets held in the portfolio. Liquidity risk is minimised by virtue of the majority of the equities held being tradeable on the London Stock Exchange.

Long and short-term borrowings are employed to augment the portfolio of investments, so that greater returns to shareholders may be generated from the capital stock thus enlarged. The Company has in issue an Index-Linked Debenture on which the interest payable and the capital sums to be repaid on maturity are linked to the Retail Price Index. The Group's short-term borrowings and cash resources carry interest at floating rates. The Company also invests in fixed interest securities the value of which will be linked to underlying bank rates or equivalents. The interest rate profile and risk is managed as part of the overall investment strategy of the Group. The estimated fair value of the Group's debt is given in note 15 to the financial statements.

The value of the portfolio is exposed to the risk of volatility in the prices of its constituent investments and the risk that a capital profit may be foregone if a traded option position moves "into the money" (i.e. a share price rises above the strike price of a call option or falls below that of a put option). A measure of the capital profit foregone in respect of traded options exercised in the course of the year is included in note 11 to the financial statements.

The impact of security price volatility and credit risk in connection to any individual investment is reduced by diversification and by writing covered traded options. Diversification is by type of security: ordinary shares, preference shares and convertibles, corporate fixed interest and gilt-edged securities, and by investment in the stocks and shares of companies in a range of industrial, commercial and financial sectors.

The management of the portfolio is conducted according to investment guidelines, established by the Board after discussion with the Managers, which specify the limits within which the Managers are authorised to act.

Financial Assets and Liabilities

The Group's financial assets include investments, cash at bank and short-term debtors. Financial liabilities consist of bank loans and overdrafts, index-linked debenture stock, preference shares and other short-term creditors.

The book value of cash at bank and bank loans and overdrafts included in these financial statements approximate to fair value because of their short-term maturity. Investments held as dealing investments are valued at the lower of cost and market value. The carrying values of fixed asset investments are stated at their fair values, which have been determined in accordance with accounting policy note 1(c). The estimated total fair value of the Index-Linked Debenture Stock has been determined with reference to the current interest profile of similar instruments (see note 15). For all other short-term debtors and creditors, their book values approximate to fair value because of their short-term maturity.

Gearing

The Group's gearing comprises both long and short-term borrowings. It has in issue an Index-Linked Debenture on which the interest payable and the capital sum to be repaid on maturity are linked to the Retail Prices Index. Short-term borrowing from banking institutions is also used and bears interest at floating rates. The profile of financing costs is managed as part of overall investment strategy. The employment of gearing magnifies the impact on net assets of both positive and negative changes in the value of the Group's portfolio of investments.

Gearing is, however, restricted by the various covenants applicable to different borrowings. The Index-Linked Debenture Stock contains a clause which stipulates that borrowings must not exceed shareholders' funds. As at 31 March 2006 total borrowings, comprising the Index-Linked Debenture Stock and bank loans and overdrafts, amounted to £36.8 million, significantly below shareholders' funds of £97.5 million. A second clause stipulates that the market value of total assets must be at least three times greater than Group secured indebtedness. The only secured debt within the Group is the Index-Linked Debenture Stock and therefore three times the value of this stock is £79.5 million, significantly below the market value of total assets of £135.1 million.

Borrowings are augmented by short term bank facilities, provided by two major banks. In respect of one lender, the Company's net asset value must not fall below £50 million. As at 31 March 2006 the net asset value stood at £97.5 million, considerably in excess of this covenant. The other short term facility provides for quarterly covenant reporting, based upon gross borrowings as a proportion of adjusted gross assets. This ratio should not exceed 50%. As at 31 March 2006, the reported ratio was 26%.

Portfolio Hedging Instruments

During the year, the Company maintained partial hedging of the ordinary share portfolio to limit any possible major erosion of asset value and attendant rise in gearing which could result from significant weakness of ordinary share prices on the UK stockmarket. Half of the FTSE 100 Call Option (expiry – December 2005) was closed out in September 2005 with the remainder expiring in December 2005. This

Notes to the Financial Statements

(continued)

19. RISK MANAGEMENT, FINANCIAL ASSETS AND LIABILITIES (continued)

resulted in a realised loss of £2.1 million. The FTSE 100 Combination Put Spread expired in December 2005 resulting in a realised loss of £714,000. As at 31 March 2006 the Company continued to hold a FTSE 100 Put Spread (expiry – September 2008) which was originally opened in September 2003. This five year Put Spread comprises two put options. The strike price of the put option purchased was 3818 and that of the put option sold 2545. Due to the rise in the UK stockmarket, at 31 March 2006 there was an unrealised loss of £1,694,000 on this open hedge position (2005 – unrealised loss on all positions of £2,037,000).

20. COMMITMENTS AND CONTINGENCIES

At 31 March 2006 there were no contingent liabilities in respect of outstanding underwriting commitments or uncalled capital (2005 – £Nil).

Notes to the Financial Statements

(continued)

21. EXPLANATION OF TRANSITION TO IFRS

Reconciliation of Equity

The following tables reconcile the Group's equity from the figures previously reported under UK GAAP to IFRS as at the following dates:

- 1 April 2004, the date of transition to IFRS;
- 31 March 2005, the Group's comparative year end.

The table on page 47 reconciles the Group's profit from the figures previously reported under UK GAAP to IFRS for the year ended 31 March 2005.

Reconciliation of Equity at 1 April 2004

	Note	UK GAAP £000	1 April 2004 Effect of transition to IFRS £000	IFRS £000
NON CURRENT ASSETS				
Ordinary shares	21(a)	74,536	(47)	74,489
Convertibles	21(a)	6,970	(52)	6,918
Other fixed interest	21(a)	11,280	(58)	11,222
Hedge Instruments	21(b)	1,414	(4)	1,410
Unlisted Investments		3,556	–	3,556
		<u>97,756</u>	<u>(161)</u>	<u>97,595</u>
CURRENT ASSETS				
Trade and other receivables		343	–	343
Accrued income and prepayments	21(c)	1,865	62	1,927
Investments of dealing subsidiary	21(a)	205	–	205
Cash and cash equivalents		732	–	732
Hedge Instruments	21(b)	–	263	263
		<u>3,145</u>	<u>325</u>	<u>3,470</u>
CURRENT LIABILITIES				
Trade and other payables		(3,105)	–	(3,105)
Proposed dividend	21(d)	(3,101)	3,101	–
Bank loans and overdrafts		(1,650)	–	(1,650)
Hedge Instruments	21(b)	–	(259)	(259)
		<u>(7,856)</u>	<u>2,842</u>	<u>(5,014)</u>
NON CURRENT LIABILITIES				
Index Linked Debenture Stock	21(e)	(24,897)	–	(24,897)
		<u>(24,897)</u>	<u>–</u>	<u>(24,897)</u>
NET ASSETS		<u>68,148</u>	<u>3,006</u>	<u>71,154</u>
ISSUED CAPITAL AND RESERVES ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT				
Called up share capital		14,888	–	14,888
Share premium account		19,039	(1)	19,038
Retained Earnings				
Realised capital reserve		27,898	(27)	27,871
Unrealised capital reserve		2,268	(157)	2,111
Revenue reserve		4,055	3,191	7,246
		<u>68,148</u>	<u>3,006</u>	<u>71,154</u>

Notes to the Financial Statements

(continued)

21. EXPLANATION OF TRANSITION TO IFRS (continued)

Reconciliation of Equity at 31 March 2005

		UK GAAP £'000	31 March 2005 Effect of transition to IFRS £'000	IFRS £'000
	Note			
NON CURRENT ASSETS				
Ordinary shares	21(a)	81,948	(51)	81,897
Convertibles	21(a)	7,596	(58)	7,538
Other fixed interest	21(a)	22,809	(61)	22,748
Hedge Instruments	21(b)	90	626	716
Unlisted Investments		3,213	-	3,213
		<u>115,656</u>	<u>456</u>	<u>116,112</u>
CURRENT ASSETS				
Trade and other receivables		-	30	30
Accrued income and prepayments	21(c)	1,783	(13)	1,770
Investments of dealing subsidiary	21(a)	922	73	995
Cash and cash equivalents		2	-	2
Hedge Instruments	21(b)	-	126	126
		<u>2,707</u>	<u>216</u>	<u>2,923</u>
CURRENT LIABILITIES				
Trade and other payables		(421)	12	(409)
Proposed dividend	21(d)	(3,101)	3,101	-
Bank loans and overdrafts		(11,105)	-	(11,105)
Hedge Instruments	21(b)	-	(753)	(753)
		<u>(14,627)</u>	<u>2,360</u>	<u>(12,267)</u>
NON CURRENT LIABILITIES				
Index Linked Debenture Stock	21(e)	(25,716)	-	(25,716)
		<u>(25,716)</u>	<u>-</u>	<u>(25,716)</u>
NET ASSETS				
		<u>78,020</u>	<u>3,032</u>	<u>81,052</u>
ISSUED CAPITAL AND RESERVES ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT				
Called up share capital		14,888	-	14,888
Share premium account		18,987	-	18,987
<i>Retained Earnings</i>				
Realised capital reserve		27,699	15	27,714
Unrealised capital reserve		12,334	(212)	12,122
Revenue reserve		4,112	3,229	7,341
		<u>78,020</u>	<u>3,032</u>	<u>81,052</u>

Notes to the Financial Statements

(continued)

21. EXPLANATION OF TRANSITION TO IFRS (continued)

Reconciliation of Profit for the year to 31 March 2005

		Year to 31 March 2005		
	Note	UK GAAP £000	Effect of transition to IFRS £000	IFRS £000
GAINS				
Gains on investment	21(a)	11,240	113	11,353
		<u>11,240</u>	<u>113</u>	<u>11,353</u>
REVENUE				
Dividend income	21(c)	6,862	(108)	6,754
Traded option premiums		734	-	734
Interest income		107	(48)	59
Deposit interest		8	-	8
Net gain on financial assets held for trading		(117)	73	(44)
Other revenue		2	-	2
		<u>7,596</u>	<u>(83)</u>	<u>7,513</u>
EXPENSES				
Investment management fee		(402)	(2)	(404)
Other administrative expenses		(399)	(2)	(401)
Finance costs of borrowings	21(e)	(2,448)	1	(2,447)
		<u>(3,249)</u>	<u>(3)</u>	<u>(3,252)</u>
PROFIT BEFORE TAX				
Tax expense		15,587	27	15,614
		<u>-</u>	<u>-</u>	<u>-</u>
PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY				
		<u>15,587</u>	<u>27</u>	<u>15,614</u>

(a) Investments

The Group's investments are defined by IFRS as investments designated at fair value through profit and loss. All investments are designated upon initial recognition as held at fair value and are measured at subsequent reporting dates at their fair value, which is the bid price as at close of business on the balance sheet date. Under previous GAAP, investments were valued at middle market prices as at close of business on the balance sheet date.

Gains on investments disclosed within the Income Statement have been affected by the move to bid price and by the implementation of the amortised cost/effective interest rate method of accounting for relevant fixed interest securities (see note (c) below). The amortisation of these investments has been charged to capital.

(b) Hedging Instruments

Under previous GAAP the hedging contracts taken out to achieve the Company's hedging structure, were grouped together and shown as one figure. Under IFRS the hedging contracts are accounted for as separate contracts under IAS 39 and therefore are individually shown on the balance sheet at their fair, i.e. market value.

(c) Income

Income from relevant fixed interest securities was previously accounted for on an accruals basis, however under IFRS income from these investments is now accounted for using an effective interest rate method. This method exactly discounts the expected stream of future cash receipts through to maturity of fixed interest investment. Interest income includes the amortisation of any premium or discount represented by the difference between the initial carrying amount of the investment and its amount at maturity.

Notes to the Financial Statements

(continued)

(d) Dividends payable

Under previous GAAP, dividends proposed after the period end were recognised in that accounting period as an adjusting post balance sheet event. However, under IFRS, dividends payable are only recorded as a liability on an irrevocable declaration. Furthermore, dividends are no longer shown on the face of the Income Statement (previously called the Statement of Total Return). They are now shown in the Statement of Changes in Equity.

(e) Index Linked Debenture Stock

Under previous GAAP the amortisation of the discount on the issue of the Debenture stock was charged 50:50 between Revenue and Capital and charged to Finance Cost of Borrowings. Under IFRS the amortisation is now completely charged to capital and is included in finance cost of borrowings allocated to capital.

(f) Cash Flow Statement

Interest paid, which was disclosed within Servicing of Finance under UK GAAP, and taxation, which was separately disclosed under UK GAAP, are now analysed within operating activities. Equity dividends paid are now shown within Financing Activities.

(g) Transition to IFRS – Company

The transition to IFRS for the Company results in the same adjustments as detailed above excluding those referring to Investments of Dealing subsidiary in the Reconciliation of Equity at 1 April 2004 and 31 March 2005. The Reconciliation of Profit for the year ended 31 March 2005 will exclude the net gain of the dealing subsidiary.

Glasgow Investment Managers Limited

(Authorised and regulated by the Financial Services Authority)

Glasgow Investment Managers ("Glasgow"), the company which manages Shires Income plc, is principally owned by its staff and retired founder with Shires Income plc holding the remaining interest.

Glasgow also manages two other investment trust companies:

- **Shires Smaller Companies plc**
- **Glasgow Income Trust plc**

Shares in Shires Income plc, Shires Smaller Companies plc and Glasgow Income Trust plc are also available within the Glasgow Investment Collection as detailed on page 16.

This page and page 16 are issued and approved by Glasgow Investment Managers Limited, authorised and regulated by the Financial Services Authority. Past performance is not indicative of future performance. The price of shares and the income from them may go down as well as up and it is possible that investors may not get back the full amount invested on disposal of the shares. Changes in the rates of exchange may cause the value of overseas investments to go down or up. High income investments, in order to meet their income objectives, may charge expenses to capital which in turn may erode the capital value of the investment to less than the amount invested. Funds that invest in the securities of smaller companies are likely to carry a higher degree of risk than most funds. In certain circumstances, the Managers may enter into derivatives transactions in order to manage risk in the portfolio and generate income. The market in these instruments can be highly volatile and there is a high risk of loss. Derivatives may only be used subject to the restrictions set out for the Trust.

Shires Income plc invests a significant proportion of its portfolio in another highly geared Investment Trust, Shires Smaller Companies plc. Due to the level of this holding, changes in the value of this investment may give rise to significant fluctuations in the value of Shires Income plc.

Gearing

Investment Trusts have the facility to borrow, which is known as "gearing". Shires Income plc uses gearing. Normally, gearing is measured as a percentage. A gearing percentage of 10% means that an Investment Trust with net assets of £100 million, has £10 million of borrowing(s). The level of gearing can change quite significantly depending on fluctuations in market levels. When there is a change in value of the Investment Trust's underlying portfolio the use of gearing may result in exaggerated movements in the Trust's net asset value. Gearing may also result in Investment Trust price movements being more volatile than the price movements in the Trust's underlying investment portfolio.

The favourable tax treatment of PEPs and ISAs is subject to government legislation and, as such, may be changed. The value of tax relief will depend upon your individual circumstances.

Glossary of Technical Terms

Benchmark

A market index, which averages the performance of the share prices of companies in any given sector, thus providing an indication of movements in the stockmarket. The benchmark used in this Annual Report is the FTSE All-Share Index, a recognised and respected index, which measures the performance of the largest 750 quoted UK companies.

Convertibles

Fixed interest securities, which can be converted into equity shares at a future date.

Discount

The amount by which the market price per ordinary share of an investment trust is lower than the net asset value per ordinary share. The discount is normally expressed as a percentage of the net asset value per ordinary share.

Gearing

Total gearing is the proportion of the Group's net assets financed by borrowings. It is used to increase exposure to securities, with the aim of magnifying the impact on net assets of rises in the value of the portfolio, and to augment the investment base from which income is received. The employment of gearing magnifies the impact on net assets of both positive and negative changes in the value of the portfolio of investments. A level expressed either as 100 or 0% indicates there is no gearing.

Equity gearing is the sum of the investments in ordinary shares, both listed and unlisted, convertibles and hedge instruments expressed as a proportion of the Group's net assets.

Net Asset Value

Also described as ordinary shareholders' funds, Net Asset Value per ordinary share is the value of total assets less liabilities. Liabilities for this purpose include borrowings and preference share capital as well as current liabilities. The Net Asset Value per ordinary share is calculated by dividing this amount by the number of ordinary shares in issue.

Preference Shares

These entitle the holder to a fixed rate of dividend out of the profits of the Company, to be paid in priority to other classes of shareholder.

Premium

The amount by which the market price per ordinary share of an investment trust is higher than the net asset value per ordinary share. The premium is normally expressed as a percentage of the net asset value per ordinary share.

Total Assets

Total assets less current liabilities.

Total Expense Ratio

Total annual operating costs, excluding interest costs, divided by average shareholders' funds (calculated according to AITC guidelines).

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the seventy-eighth Annual General Meeting of the Members of the Company will be held at Trinity House, Tower Hill, London EC3N 4DH on 7 July 2006 at 12 noon to transact the following business:

Ordinary Business

1. To receive and adopt the Directors' Report and audited financial statements for the year ended 31 March 2006.
2. To receive and adopt the Directors' Remuneration Report for the year ended 31 March 2006.
3. To declare a final dividend.
4. To re-elect J. M. Haldane as a Director.
5. To re-elect J. R. Davidson as a Director.
6. To re-appoint KPMG Audit Plc as auditors of the Company and to authorise the Directors to determine their remuneration.

Special Business

To consider and, if thought fit, pass the following resolution which will be proposed as an ordinary resolution:

7. That with effect from the time of the passing of this resolution the Directors be and are hereby generally and unconditionally authorised, pursuant to section 80 of the Companies Act 1985 as amended ("the Act"), to exercise all the powers of the Company to allot relevant securities (as defined in said section 80 of the Act) up to a maximum nominal amount of £4,946,163, being equal to approximately one third of the ordinary shares in issue, to such persons and at such times and on such terms as they think proper during the period of five years from the date of the passing of this resolution and at any time thereafter pursuant to any offer or agreement made by the Company before the expiry of this authority so that all previous authorities of the Directors pursuant to the said section 80 be and they are hereby revoked.

To consider and, if thought fit, pass the following resolutions which will be proposed as special resolutions.

8. That the Directors be and are hereby empowered pursuant to Section 95 of the Companies Act 1985 ("the Act") to allot equity securities as if Subsection 89(1) of the Act did not apply to any such allotment, provided that this power shall be limited:
 - (i) to the allotment of equity securities in connection with a rights issue where it is, in the opinion of the Directors, necessary or expedient to deal with problems under the laws of any overseas territory or the requirements of any regulatory body or any Stock Exchange in any overseas territory or in connection with fractional entitlements; and
 - (ii) to the allotment (otherwise than pursuant to (i) above) of ordinary shares up to an aggregate nominal amount of £741,924 at a price per share not less than the fully diluted net asset value of an ordinary share in the Company calculated as at the close of business on the immediately preceding business day

and shall expire at the conclusion of the Annual General Meeting of the Company in 2007 but so that this power shall enable the Company to make offers or agreements before the expiry of this power which would or might require equity securities to be allotted after the expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired and for this purpose words and expressions defined in or for the purpose of Part IV of the Act shall bear the same meanings in this resolution.

9. That the Company be and it is hereby generally and unconditionally authorised to make market purchases of any of its own ordinary shares in such manner and upon such terms as the Directors of the Company may from time to time determine, provided that:
 - (i) the maximum aggregate nominal value of the ordinary shares hereby authorised to be acquired shall be limited to £2,224,290;
 - (ii) the maximum price which may be paid for any ordinary shares shall not exceed an amount equal to 105% of the average of the market values of such ordinary shares, as defined in the Listing Rules of the Financial Services Authority, for the five business days before the purchase is made and the minimum price shall be 50p per ordinary share (in each case exclusive of expenses); and

Notice of Annual General Meeting

(iii) the authority hereby conferred shall expire (unless previously revoked or renewed) on 7 July 2007 or at the conclusion of the next Annual General Meeting of the Company held after the passing of this resolution, whichever is the later, provided that the Company may before such expiry make any contract for purchase of ordinary shares which would or might be executed wholly or partly after the expiry of such authority and the Company may make such a purchase in pursuance of such contract as if the authority hereby conferred had not expired.

By Order of the Board

Glasgow Investment Managers Limited

Secretaries

26 May 2006

Note:

A member of the Company entitled to attend and vote at the Meeting may appoint a proxy to attend and, on a poll, vote in place of him. A proxy need not be a member of the Company. A form of proxy is enclosed which, if required, should be completed in accordance with the instructions thereon.

Completion and return of the proxy will not preclude a member from attending and voting in person.

The Company, pursuant to regulation 41 of the Uncertificated Securities Regulations 2001, specifies that only those members of the Company entered on the register of members of the Company as at 12 noon on 5 July 2006 shall be entitled to attend or vote at the meeting in respect of the number of shares registered in their name at that date. Changes to entries in the register of members after that time will be disregarded in determining the rights of any person to attend or vote at the Meeting.

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Authorised and regulated by the Financial Services Authority