Registered No. 3203996

IS Europe Limited

Annual report

For the year ended 31 December 2003

IS Europe LIMITED

Annual report
for the year ended 31 December 2003

Directors and advisers

Directors
J Gleek
I Schrager
J Anderson
D Hamamoto

Secretary and registered office
Patricia Nicholson
20 Thayer Street
London W1M 6DD

Solicitors
MacFarlanes
10 Norwich Street
London EC4A 1BD

Registered auditors
PricewaterhouseCoopers LLP
No 1 Embankment Place
London WC2N 6RH

Bankers
Barclays Bank PLC
1-2 Trinity Way
London E4 8TD

Directors' report
for the year ended 31 December 2003

The directors present their report and the audited financial statements of the company for the year ended 31 December 2003.

Principal activity

The principal activity of the company is that of an investment company. It has exclusive rights to create Ian Schrager Hotels throughout Europe. These hotels trade through a subsidiary company, Ian Schrager London Limited.

Results and dividends

The results for the year are set out in the profit and loss account on page 6.

The directors do not recommend the payment of a dividend for the year (2002: nil). The group's retained loss for the year of £2,266,000 (2002: £2,413,000) has been transferred to reserves.

Directors

The directors of the company at 31 December 2003, all of whom have been directors for the whole of the year ended on that date, are as follows:

J Gleek
I Schrager
J Anderson
D Hamamoto

Directors interests

According to the register of directors' interests, none of the directors who held office at the end of the year had any interest in the shares of group companies, nor were any rights to subscribe for shares in group companies granted to, or exercised by, any of these directors.

Employment of disabled persons.

It is the group's policy to give full consideration to the suitability for employment of disabled persons. Opportunities also exist for employees of the group who become disabled to continue in their employment or be trained for other positions in the group.

Employee involvement

The group's policy is to encourage the involvement of all employees in the group's development and success. This is achieved through its established structure for communicating with employees by means of regular briefings and presentations

Statement of directors' responsibilities

The directors are required by UK company law to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company as at the end of the financial year and of the surplus or deficit of the company for that period. The directors are also responsible for preparing financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently with the exception of the changes arising on the adoption of new accounting standards in the year as explained in the summary of accounting policies. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2003 and that applicable accounting standards have been followed.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditors

A resolution to reappoint PricewaterhouseCoopers LLP as auditors of the group will be proposed at the next annual general meeting.

By order of the board

Patricia Nicholson

Patricia Nicholson
Company secretary

4 January 2005

Independent auditors' report to the members of IS Europe Limited

We have audited the financial statements which comprise the consolidated profit and loss account, the consolidated and company balance sheets, the consolidated cash flow statement and the related notes.

Respective responsibilities of directors and auditors

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

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

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

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the directors' report.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements 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.

Fundamental uncertainty

In forming our opinion, we have considered the adequacy of the disclosures made in the financial statements concerning the future funding of the group for the next 12 months. The financial statements have been prepared on a going concern basis, the validity of which depends on future funding being available. Details of the circumstances relating to the fundamental uncertainty are described in note 1.

The financial statements do not include any adjustments that would result from future funding not being available. Our opinion is not qualified in this respect.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and the group at 31 December 2003 and of the loss and cash flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London

4 January 2005

Consolidated profit and loss account for the year ended 31 December 2003

	Notes	2003	2002
		£000	£000
Turnover	1	**23,234**	24,305
Cost of sales		**(6,443)**	(6,563)
Gross profit		**16,791**	17,742
Administrative expenses		**(11,469)**	(12,666)
Operating profit		**5,322**	5,076
Interest receivable		**152**	242
Interest payable and similar charges	4	**(7,740)**	(8,189)
Interest payable – reduction of prior years' charge	5	**-**	458
Loss on ordinary activities before and after taxation	3	**(2,266)**	(2,413)
Loss for the financial year		**(2,266)**	(2,413)

All income and expenditure arises from continuing operations.

The group has no recognised gains or losses other than the loss for the year.

The historical cost loss and reported loss are the same.

Movements in shareholders funds are shown in note 18 to the financial statements.

Consolidated balance sheet
At 31 December 2003

	Notes	2003	2003	2002	2002
		£000	**£000**	£000	£000
Fixed assets					
Tangible fixed assets	7		**108,844**		111,087
Current assets					
Stocks	8	**358**		380	
Debtors	10	**1,853**		2,454	
Cash (restricted cash £4,217,000 : 2002 £4,237,000)	11	**4,804**		4,896	
		7,015		7,730	
Creditors: amounts falling due within one year	12	**(6,982)**		(6,478)	
Net current assets			**33**		1,252
Total assets less current liabilities			**108,877**		112,339
Creditors: amounts falling due after more than one year	13		**(93,528)**		(96,092)
Net assets			**15,349**		16,247
Capital and reserves					
Called up share capital	15		**5,000**		5,000
Share premium accounts	16		**10,000**		10,000
Other capital reserve	16		**9,460**		8,092
Profit and loss account	16		**(9,111)**		(6,845)
Equity shareholders' funds	18		**15,349**		16,247

The financial statements on pages 6 to 21 were approved by the board of directors on January 4, 2005 and were signed on its behalf by:

J Schrager
Director

J Gleek
Director

Company balance sheet
At 31 December 2003

	Notes	2003	2003	2002	2002
		£000	**£000**	£000	£000
Fixed assets					
Investment in subsidiary	9		**35,000**		35,000
Current assets					
Debtors	10	**400**		400	
Cash	11	**154**		156	
		554		556	
Creditors: amounts falling due within one year	12	**(10,494)**		(13,149)	
Net current liabilities			**(9,940)**		(12,593)
Total assets less current liabilities			**25,060**		22,407
Creditors: amounts falling due after more than one year	13		**(1,275)**		-
Net assets			**23,785**		22,407
Capital and reserves					
Called up share capital	15		**5,000**		5,000
Share premium accounts	17		**10,000**		10,000
Other capital reserve	17		**9,460**		8,092
Profit and loss account	17		**(675)**		(685)
Equity shareholders' funds	18		**23,785**		22,407

The financial statements on pages 6 to 21 were approved by the board of directors on January 4, 2005 and were signed on its behalf by:

T Schrager
Director

J Gleek
Director

Consolidated cash flow statement for the year ended 31 December 2003

	Notes	2003 £000	2002 £000
Net cash inflow from operating activities	21	**9,163**	7,205
Returns on investments and servicing of finance	22	**(7,639)**	(7,428)
Capital expenditure	22	**(739)**	(573)
Financing	22	**(857)**	(2,786)
Decrease in cash and cash equivalents	23	**(72)**	(3,582)

Reconciliation of net cash flow statement for the year ended 31 December 2003

	Notes	2003 £000	2002 £000
Decrease in cash in the year		**(72)**	(3,582)
Cash outflow from decrease in debt	23	**3,500**	3,000
Non cash movements		**(161)**	(117)
Movements in net debt in the year		**3,267**	(699)
Net debt at the start of the year		**(98,933)**	(98,234)
Net debt at the end of the year	23	**(95,666)**	(98,933)

Notes to the financial statements for the year ended 31 December 2003

1 Principal accounting policies

The consolidated financial statements have been prepared under the historical cost convention and in accordance with applicable Accounting Standards in the United Kingdom. A summary of the more important accounting policies, which have been applied consistently, is set out below.

Going concern

Following the breach of loan covenants during the year, the subsidiary Ian Schrager London Limited has signed a waiver agreement with its banks on 12 August 2004 which waives all breaches of the loan agreements up to 31 March 2005 subject to a number of revised clauses which includes the condition that Morgans Hotel Group LLC (formerly Ian Schrager Hotels LLC) and Burford Holdings Limited have agreed to continue to fund Ian Schrager London Limited, if required, to meet loan repayments and interest payments during this period.

In addition, Morgans Hotel Group LLC and Burford Holdings Limited have also agreed to provide on-going support to enable IS Europe Limited to continue to meet its liabilities as and when they fall due for 12 months following the date of the signing of these financial statements or until such time as the shareholders have sold the group which they are currently actively marketing. On this basis the directors believe that it is appropriate for the financial statements to be prepared on the going concern basis.

Basis of consolidation

The consolidated financial statements include financial statements of the company and its subsidiary undertaking made up to 31 December 2003.

Comparative information

The directors have made minor amendments to certain comparative numbers in the notes to the accounts where further information has become available this year.

Investments

Investments are stated at cost or cost less provision where there is a permanent diminution in value.

Fixed assets and depreciation

Tangible fixed assets are stated at cost less depreciation and any provision for impairment. Assets are depreciated to their residual values on a straight line basis over their estimated residual lives as follows:

Freehold buildings	50 years
Building surface finishes	25 years
Plant and machinery	15 years
Fixtures, fittings and equipment	*5 – 10 years*

No depreciation is provided on freehold land or assets under course of construction. No residual values are ascribed to building surface finishes.

Properties in the course of development are included at the lower of cost and net realisable value. The cost includes directly attributable costs together with interest on specific external debts.

Foreign currency transactions

Translations into sterling are made at the average of rates ruling throughout the period for profit and loss items and at the rate ruling at 31 December 2003 for assets and liabilities. Exchange differences arising in the ordinary course of trading are included in the profit and loss account.

Deferred taxation

Deferred taxation is provided in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events have occurred which result in an obligation to pay more or less tax in the future.

Deferred tax is measured at the average tax rates which apply in the period in which the timing differences are expected to reverse. Deferred tax is measured on a non-discounted basis.

Deferred tax assets are regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it is more likely than not that there will be adequate future taxable profits against which to recover carried forward tax losses.

Finance costs

Finance costs are included within the carrying value of the loan and are amortised over the term of the loan.

Stocks

Stocks are stated at the lower of cost and net realisable value. In determining the cost of raw materials and consumables the weighted average purchase price is used.

Turnover

Turnover represents the amounts (excluding value added tax) derived from the provision of goods and services to customers.

2 Staff numbers and costs

	2003	2002
The average number of employees in the year was:		
Hotel operating staff	**162**	162
Management/administration	**25**	24
Sales and marketing	**9**	9
Repair and maintenance	**14**	15
Total	**210**	210

	2003	2002
	£000	£000
The aggregate payroll costs for these persons were as follows:		
Employee costs	**5,002**	4,874
Social security costs	**375**	395
Pension costs	**60**	56
	5,437	5,325

None of the directors received any remuneration during the year or previous year.

Funded defined contribution scheme for employees (group scheme)

Pension costs of £59,000 (2002: £56,000) were charged to the profit and loss account of which £nil (2002: nil) was outstanding at the balance sheet date.

The pension scheme is held with Standard Life and is administered by Inter Alliance.

3 Loss on ordinary activities before taxation

	2003	2002
	£000	£000
Loss on ordinary activities before taxation is stated after charging:		
Auditors' remuneration:		
Group	**84**	82
Company	**12**	12
Non audit – Group	**105**	92
Depreciation and other amounts written off tangible fixed assets:		
Owned	**3,003**	2,894
Loss on disposal of tangible fixed assets	-	105

4 Interest payable and similar charges

	2003	2002
	£000	£000
Amounts payable on bank loans and overdrafts	**7,740**	8,189

5 Interest payable – reduction of prior years' charge

In years prior to 2002, costs pertaining to the design by Phillipe Starck of the London hotels, were deemed to have been payable by Ian Schrager London Limited. During 2002, subsequent to the year in which these costs were incurred, it was decided that these costs would be borne by the company's joint venture owners Morgans Hotel Group LLC and Burford Hotels Limited ('the owners'). Prior to this decision, Ian Schrager London Limited paid £458,000 in relation to this deemed liability. During 2002, the owners paid £458,000 to the company and consequently the interest charge has been credited by that amount in the profit and loss account for the year ended 31 December 2002.

6 Taxation

(a) Analysis of charge in the year

No corporation tax has been provided due to losses incurred in the year (2002: nil)

(b) Factors affecting tax charge for the year

	2003	2002
Loss on ordinary activities before tax	**(2,266)**	(2,413)
Loss on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2002: 30%)	**(680)**	(724)
Effects of:		
Expenses not deductible for tax purposes	**216**	284
Capital items expensed	**-**	20
Capital allowances less than/ (in excess of) depreciation	**432**	(1,235)
Tax losses	**77**	1,864
Utilisation of tax losses	**(45)**	(209)
Tax charge for the period (note 6(a))	**-**	-

(c) Factors affecting future tax charges

In respect of the company's tax losses, no deferred tax asset has been recognised due to uncertainty regarding the group's future trading results (see note 13).

7 Fixed assets - Group

	Assets under course of construction	Freehold land and buildings	Plant and machinery	Fixtures, fittings and equipment	Total
	£000	**£000**	**£000**	**£000**	**£000**
Cost					
At January 2003	-	99,492	7,986	11,483	118,961
Additions	28	390	13	329	760
At 31 December 2003	**28**	**99,882**	**7,999**	**11,812**	**119,721**
Depreciation					
At January 2003	-	2,653	1,573	3,648	7,874
Charge for the year	-	1,028	533	1,442	3,003
At 31 December 2003	**-**	**3,681**	**2,106**	**5,090**	**10,877**
Net book value					
At 31 December 2003	**28**	**96,201**	**5,893**	**6,722**	**108,844**
At 31 December 2002	-	96,839	6,413	7,835	111,087

Included in total net book value of freehold buildings is £4,297,000 (2002: £4,323,000) of capitalised interest (net of accumulated depreciation).

All tangible fixed assets of the group are held by the subsidiary undertaking, Ian Schrager London Limited.

8 Stocks

	Group 2003	Group 2002
	£000	£000
Raw materials and consumables	**358**	380

9 Investment in subsidiary company

	Company £000
At 1 January 2003 and 31 December 2003	**35,000**

The company owns 100% of the ordinary shares of Ian Schrager London Limited, a company incorporated in England and Wales, whose principal activity is the operation of two Ian Schrager hotels in London.

10 Debtors: amounts due within one year

	Group 2003 £000	**Company 2003 £000**	Group 2002 £000	Company 2002 £000
Trade debtors	**954**	**-**	1,326	-
Amounts due from related parties	**524**	**400**	712	400
Prepayments and accrued income	**375**	**-**	416	-
	1,853	**400**	2,454	400

11 Cash

	Group 2003 £000	**Company 2003 £000**	Group 2002 £000	Company 2002 £000
Sundry cash	**587**	**154**	659	156
Restricted cash	**4,217**	**-**	4,237	-
	4,804	**154**	4,896	156

Under the terms of the loan agreement (see note 13), the group was required to set aside cash as a general reserve and an amount to cover outstanding construction liabilities and future fixed asset replacements. At 31 December 2003 this amount totalled £4,217,000 (2002: £4,237,000).

12 Creditors: amounts falling within one year

	Group 2003 £000	**Company 2003 £000**	Group 2002 £000	Company 2002 £000
Bank loans	**4,000**	-	3,500	-
Trade creditors	**674**	-	645	5
Amounts due to group undertakings and related parties	**199**	**10,494**	187	13,140
Other creditors including taxation and social security	**587**	-	468	4
Accruals and deferred income	**1,522**	-	1,678	-
	6,982	**10,494**	6,478	13,149

13 Creditors: amount falling due after more than one year

	Group 2003 £000	Group 2002 £000
Bank loans and overdrafts	**92,253**	96,092
Loans due to group undertakings and related parties	**1,275**	-
	93,528	96,092

Bank loans are repayable as follows:

	Group 2003 £000	Group 2002 £000
Within one year	**4,000**	3,500
Between two and five years	**26,000**	22,000
In five years or more	**66,253**	74,092
	96,253	99,592

Bank loans falling due in five years or more are as follows:

	Group 2003 £000	Group 2002 £000
Sterling bank loans repayable in quarterly instalments, secured on the group's hotels.	**66,253**	74,092
An interest rate swap fixes the interest payable at a rate 7.86% (2002: 8.19%)		
	66,253	74,092

The group has a £105 million loan facility. This is due to be repaid over the next years with the timing of repayments contingent on achieving ratios of EBITDA to net interest.

During the year the Group had a technical breach of its loan covenants. Following discussions the banks have agreed to waive the breach and suspend the covenant conditions until 31 March 2005. Should the covenant conditions be breached after this date, the loan would become payable on demand.

Loans due to group undertakings and related parties

	Company 2003 £000	Company 2002 £000
Amounts due to group undertakings and related parties (see note 20)	**1,275**	-
	1,275	-

These loans are interest free and unsecured. The loans are not payable prior to 1 January 2005.

14 Provision for deferred taxation

	Group 2003 £000	Group 2002 £000
Tax losses carried forward	**5,371**	5,339
Capital allowances in excess of depreciation	**(3,239)**	(3,671)
	2,132	1,668

No deferred taxation asset has been recognised in the financial statements due to uncertainty of its future economic value.

15 Called up share capital

	31 December 2003 £000	31 December 2002 £000
Authorised		
1,000 ordinary shares of £1 each	**1**	1
2,499,999 A ordinary shares of £1 each	**2,500**	2,500
2,499,997 B ordinary shares of £1 each	**2,500**	2,500
2 preferred non-voting ordinary shares of £1 each	**-**	-
	5,001	5,001
Allotted, called up and fully paid		
2 ordinary shares of £1 each		-
2,499,997 B ordinary shares of £1 each	**2,500**	2,500
2,499,997 B ordinary shares of £1 each	**2,500**	2,500
1 preferred non-voting ordinary shares of £1 each	**-**	-
	5,000	5,000

Both the A and B ordinary shares carry equal voting rights and rank pari passu with each other. The preferred ordinary shares carry non-voting rights and rank pari passu with the A and B ordinary shares.

16 Reserves - group

	Share premium £000	Profit and loss account £000	Other capital reserve £000
At 1 January 2003	10,000	(6,845)	8,092
Loss for the financial year	-	(2,266)	-
Other capital reserve	-	-	1,368
At 31 December 2003	**10,000**	**(9,111)**	**9,460**

17 Reserves - company

	Share premium £000	Profit and loss account £000	Other capital reserve £000
At 1 January 2003	10,000	(685)	8,092
Profit for the financial year	-	10	-
Other capital reserve	-	-	1,368
At 31 December 2003	**10,000**	**(675)**	**9,460**

18 Reconciliation of movements in shareholders' funds

	Group 2003 £000	**Company 2003 £000**	Group 2002 £000	Company 2002 £000
Retained (loss) / profit for the financial year	**(2,266)**	**10**	(2,413)	1
Other capital reserve	**1,368**	**1,368**	214	214
Net (decrease) / increase in shareholders' funds	**(898)**	**1,378**	(2,199)	215
Opening shareholders' funds	**16,247**	**22,407**	18,446	22,192
Closing shareholders' funds	**15,349**	**23,785**	16,247	22,407

19 Immediate and ultimate controlling parties

IS Europe Limited is owned 50% by Burford Hotels Limited, whose ultimate holding company is Lehman Brothers Holdings Inc., a company incorporated in the state of Delaware in the USA.

The consolidated accounts of Lehman Brothers Holdings Inc are available to the public from 399, Park Avenue, New York, USA and from One Broadgate, London.

The other 50% is owned by Royalton Europe Holdings LLC (formerly IS Europe Holdings LLC), a wholly owned subsidiary of Morgans Hotel Group LLC, a company incorporated in the USA, whose principal place of business is 475 10th Avenue New York, NY 10018 USA.

20 Related party transactions

Morgans Hotel Group LLC

Morgans Hotel Group LLC recharge staff costs, overheads and any direct costs they incur in support provided to the company. Total costs incurred in the period were £47,000 (2002: £64,000).

Royalton UK Management Limited (formerly IS UK Management Limited)

Royalton UK Management Limited is 100% owned by Morgans Hotel Group LLC.

Royalton UK Management Limited charge IS Europe Limited a management fee and staff costs relating to hotel management, which totalled £2,333,000 (2002: £2,452,000).

SC London Limited

SC London is indirectly owned 50% by Morgans Hotel Group LLC and 50% by Chodorow Ventures LLC.

SC London pays rent and recharged expenditure to IS Europe Limited, which totalled £2,911,000 (2002: £3,006,000).

Related party balances and transactions	**2003**	2002
	£000	£000
Debtors: amounts falling within one year		
SC London Limited	**31**	89
Morgans Hotel Group LLC	**405**	536
Other related parties	**88**	87
	524	712

	2003	2002
	£000	£000
Creditors: amounts falling due within one year		
Royalton UK Management Limited	**199**	187
	199	187

	2003	2002
	£000	£000
Creditors: amounts falling due after more than one year		
Royalton Europe Holdings LLC	**638**	-
Burford Hotels Limited	**637**	-
	1,275	-

The directors confirm that there were no related party transactions other than those disclosed in these financial statements.

21 Reconciliation of operating profit to net cash flow from operating activities

	2003	2002
	£000	£000
Operating profit	**5,322**	5,076
Loss on disposal of fixed assets	**-**	105
Depreciation	**3,003**	2,894
Decrease in stock	**22**	3
Decrease in debtors	**601**	484
Decrease in creditors	**215**	(1,357)
Net cash flow from operating activities	**9,163**	7,205

22 Analysis of cash flows

	2003	2002
	£000	£000
Return on Investment and servicing of finance		
Interest receivable	**152**	241
Interest payable – reduction of prior years	**-**	458
Interest on bank loan	**(7,791)**	(8,127)
	(7,639)	(7,428)
Capital expenditure		
Purchase of tangible fixed assets	**(760)**	(772)
Decrease in restricted cash	**21**	199
	(739)	(573)
Financing		
Repayment of bank loan	**(3,500)**	(3,000)
Draw down of loan (see note 20)	**1,275**	-
Other capital reserve	**1,368**	214
	(857)	(2,786)

23 Analysis of changes in net debt

	At 1 January 2003	Cash flows	Other non-cash movements	**At 31 December 2003**
	£000	£000	£000	**£000**
Cash at bank and in hand	659	(72)	-	**587**
Debt due within one year	(3,500)	3,500	(4,000)	**(4,000)**
Debt due after more than one year	(96,750)	-	4,000	**(92,750)**
Deferred finance costs	658	-	(161)	**497**
Net debt	(98,933)	3,428	(161)	**(95,666)**

24 Post balance sheet events

During 2004, Ian Schrager London Limited, a 100% subsidiary of IS Europe Limited, received a claim of £3.3m from the Inland Revenue for the period to 5 April 2003 in relation to payroll taxes and national insurance contributions. Part of the claim relates to staff employed by SC London limited. Ian Schrager London Limited and SC London Limited are both indirectly 50% owned by Morgans Hotel Group LLC. SC London Limited is contracted to provide the food and beverage services at both the hotels owned and operated by Ian Schrager London Limited. No assessment has been received for the 2003/04 tax year. The directors are contesting the claim for the following reasons:

i) the technical basis for the claim is fundamentally flawed; and
ii) the matter relates mainly to SC London Limited and not Ian Schrager London Limited

No provision has been made for any liabilities that might arise in relation to this matter, as it is not possible to quantify any potential liability given the current state of the ongoing discussions with the Inland Revenue.