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**REPORT OF THE DIRECTORS AND
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006
FOR
MERCHANT INNS PLC**

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MERCHANT INNS PLC

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for the year ended 30 June 2006

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MERCHANT INNS PLC
COMPANY INFORMATION
for the year ended 30 June 2006

DIRECTORS.

R R A Breare
M J Chicken
A Taraz

SECRETARIES

Property Secretaries Limited

REGISTERED OFFICE

35 Vine Street
LONDON
EC3N 2AA

REGISTERED NUMBER.

03872646 (England and Wales)

AUDITORS:

Griffins
Chartered Accountants & Registered Auditor
Griffins Court
24-32 London Road
NEWBURY
Berkshire
RG14 1JX

MERCHANT INNS PLC

REPORT OF THE DIRECTORS for the year ended 30 June 2006

The directors present their report with the financial statements of the company for the year ended 30 June 2006

PRINCIPAL ACTIVITY

The principal activity of the company in the year under review was that of the acquisition, development and operation of freehold pubs in strategic locations

REVIEW OF BUSINESS

The results for the year and financial position of the company are as shown in the annexed financial statements

The results reflect a year of considerable development for the company as set out below and the increased trading loss was the inevitable outcome of the company's principal asset, The Carnarvon Arms, being shut for refurbishment and redevelopment for almost five of the first six months of the year, together with the need to establish a firm operating platform at each of the three acquisitions in order for them to generate material earnings

In July 2005 the company acquired Black Boy Inn at Milton, Oxfordshire. The acquisition was funded from the company's resources and a new bank loan together with the proceeds from the issue of new shares

In April 2006 the company purchased the Horse and Groom pub near Malmesbury. The acquisition was funded from the company's resources and a new bank loan

Since the balance sheet date, major developments with a total cost of around £1.4 million have taken place at three of the company's four pubs

The refurbishment of the Horse and Groom with the addition of five bedrooms and the Black Boy with a new conservatory style extension have both been completed on time and on budget. These pubs reopened in March and April respectively after the closures that these works necessitated and have since traded above our projections

The works at the Carnarvon, which comprised the addition of an adjacent 12 bedroom block, was completed during July - on budget and just a few days later than originally planned. The forward bookings for these rooms give us considerable confidence that our expectations of trading will be met. In the meantime, the pub (which includes 11 existing bedrooms) has continued to trade well ahead of budget

The Carnarvon Arms was valued by external valuers on 9 March 2006, following its successful refurbishment and relaunch post completion of the Phase I works. This has made it possible not only to reverse the previous 2003 impairment adjustment but also to recognise a further increase of £77,000 as a revaluation uplift in these accounts. Whilst under current accounting rules it is a requirement that all properties are revalued at the same time the Board has decided to accept a technical qualification by the auditors in their report rather than incur the additional costs of full external valuations on all the other properties. Thus, despite the directors' confidence that the full value of the company's assets is significantly higher, these accounts do not reflect that increase in shareholders' funds

We believe that the trading being achieved or expected shortly by these pubs will generate a further increased valuation for the pubs which will be the subject of external valuations shortly for the purpose of the 30 June 2007 accounts and that the increases will be greater than the capital expenditure incurred

BUSINESS KEY PERFORMANCE INDICATORS

The directors continually review the company's results to measure if results have achieved the company's strategies and objectives. Turnover, gross margin and net profit contribute towards this review and measurement of results

FUTURE DEVELOPMENTS

MERCHANT INNS PLC

REPORT OF THE DIRECTORS for the year ended 30 June 2006

On 25 June 2007 the company completed the purchase of the Talbot Hotel near Ripley, Surrey for consideration of £3.8 million. This coaching inn, which currently has ten rooms and planning permission for a further 30 bedrooms, is situated close to the strategic M25/A3 interchange and has significant all round potential for growth. The acquisition was funded in full by a loan from a potential investor.

On 11 May 2007 the Mermaid was let under a tenancy agreement for a premium of £45,000, the board having concluded that it could not be developed as anticipated due to planning restrictions and was unlikely to be capable of profitable operation in the Merchant Inns style.

In August 2007 the company entered into an exclusivity agreement to purchase the entire share capital of Azilake Ltd whose sole asset is the Lambert Arms, near Thame, Oxfordshire.

At 30 June 2006 the company had net current liabilities as in previous years and as is normal for companies trading with high fixed assets values such as freehold pub companies. The increase in the net current liabilities was due to the existing borrowings being refinanced in August 2006 plus further borrowings to purchase the additional pubs and to finance the refurbishment of the Carnarvon.

The company has arranged additional financing from a potential investor, secured on its freehold properties. On this basis, as well as a letter of support from Robert Breare, the directors consider it appropriate to prepare the financial statements on the going concern basis.

DIVIDENDS

The directors do not recommend a dividend for the year ended 30 June 2006.

EVENTS SINCE THE END OF THE YEAR

Information relating to events since the end of the year is given in the notes to the financial statements.

MERCHANT INNS PLC

REPORT OF THE DIRECTORS for the year ended 30 June 2006

DIRECTORS

The directors during the year under review were

R R A Breare
M J Chicken
A Taraz

The beneficial interests of the directors holding office in the issued share capital of the company were as follows

At 30 June 2006

	Ordinary £0 05	Ordinary £0 50	'A' Ordinary £0 50	'B' Ordinary £0 05	Deferred £0 05
R R A Breare	2,128,225	-	-	-	126
M J Chicken	30	-	-	-	135
A Taraz	28	-	-	-	126

At 30 June 2005

	Ordinary £0 05	Ordinary £0 50	'A' Ordinary £0 50	'B' Ordinary £0 05	Deferred £0 05
R R A Breare	-	14	-	2,128,211	-
M J Chicken	-	14	1	15	-
A Taraz	-	14	-	14	-

As permitted by s310 (3) of the Companies Act 1985, the company has maintained insurance cover on behalf of the officers of the company indemnifying them against certain liabilities that may be incurred by them in relation to the company

COMPANY'S POLICY ON PAYMENT OF CREDITORS

It is the company's policy to negotiate terms with suppliers and to adhere to those terms. At the balance sheet date the number of days purchases of the company represented by trade creditors was 41

SUBSTANTIAL SHAREHOLDINGS

The following shareholders had beneficial interests in the issued voting shares of the company

	2006	2005
RRA Breare	39.8%	49.4%
M Horton	19.5%	0.0%
Giltspur Nominees Limited	5.4%	0.0%
MC Leslie	3.7%	2.3%

The directors are not aware of any other shareholdings in the company representing 3% or more of the company's issued voting share capital

MERCHANT INNS PLC

REPORT OF THE DIRECTORS for the year ended 30 June 2006

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They 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.

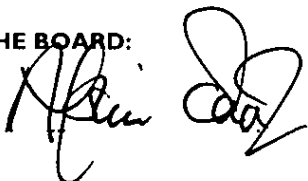
STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

So far as the directors are aware, there is no relevant audit information (as defined by Section 234ZA of the Companies Act 1985) of which the company's auditors are unaware, and each director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

AUDITORS

The auditors, Griffins, will be proposed for re-appointment in accordance with Section 385 of the Companies Act 1985.

ON BEHALF OF THE BOARD:



A Taraz - Director

Date

8/10/07

REPORT OF THE INDEPENDENT AUDITORS TO THE SHAREHOLDERS OF MERCHANT INNS PLC

We have audited the financial statements of Merchant Inns PLC for the year ended 30 June 2006 on pages eight to twenty two. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out on page five.

Our responsibility is to audit the financial statements 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 are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Report of the Directors is consistent with the financial statements.

In addition, we 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 read the Report of the Directors and consider the implications for our report if we become aware of any apparent misstatements within it.

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. 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.

**REPORT OF THE INDEPENDENT AUDITORS TO THE SHAREHOLDERS OF
MERCHANT INNS PLC**

Qualified opinion arising from disagreement about accounting treatment in respect of revaluation policy

In accordance with FRS15, if a company adopts a revaluation policy it should be applied to the whole class of assets. Merchant Inns PLC has only revalued one of the four properties in the class of freehold properties, on the basis that it was the only property on which major capital expenditure had been carried out during the year.

Except for the absence of any revaluation attributable to the other three properties, in our opinion the financial statements give a true and fair view of the state of the company's affairs as at 30 June 2006 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act.

In our opinion the information given in the Report of the Directors is consistent with the financial statements.



Griffins
Chartered Accountants & Registered Auditor
Griffins Court
24-32 London Road
NEWBURY
Berkshire
RG14 1JX

Date

8/12/07.

MERCHANT INNS PLC

PROFIT AND LOSS ACCOUNT
for the year ended 30 June 2006

	Notes	2006 £	2005 £
TURNOVER		879,313	300,464
Cost of sales		<u>(305,161)</u>	<u>(97,683)</u>
GROSS PROFIT		574,152	202,781
Administrative expenses		<u>(1,416,707)</u>	<u>(458,135)</u>
		(842,555)	(255,354)
Other operating income		<u>5,000</u>	<u>-</u>
OPERATING LOSS	3	(837,555)	(255,354)
Exceptional items	4	<u>449,382</u>	<u>-</u>
		(388,173)	(255,354)
Interest receivable and similar income		<u>-</u>	<u>232</u>
		(388,173)	(255,122)
Interest payable and similar charges	5	<u>(142,577)</u>	<u>(24,935)</u>
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION		(530,750)	(280,057)
Tax on loss on ordinary activities	6	<u>-</u>	<u>-</u>
LOSS FOR THE FINANCIAL YEAR AFTER TAXATION		<u>(530,750)</u>	<u>(280,057)</u>

CONTINUING OPERATIONS

None of the company's activities were acquired or discontinued during the current year or previous year

MERCHANT INNS PLC

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 30 June 2006

	2006	2005
	£	£
LOSS FOR THE FINANCIAL YEAR	(530,750)	(280,057)
Gains on revaluation of property	<u>77,409</u>	<u>-</u>
TOTAL RECOGNISED GAINS AND LOSSES		
RELATING TO THE YEAR	<u>(453,341)</u>	<u>(280,057)</u>

NOTE OF HISTORICAL COST PROFITS AND LOSSES

The difference between the results as disclosed in the profit and loss account and the results on an unmodified historical cost basis is not material

MERCHANT INNS PLC

BALANCE SHEET
30 June 2006

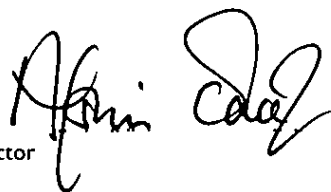
	Notes	2006 £	2005 £
FIXED ASSETS			
Tangible assets	10	3,768,667	1,271,723
CURRENT ASSETS			
Stocks	11	30,261	7,647
Debtors	12	68,502	100,138
Cash in hand		3,775	800
		<u>102,538</u>	<u>108,585</u>
CREDITORS			
Amounts falling due within one year	13	<u>(4,007,378)</u>	<u>(713,164)</u>
NET CURRENT LIABILITIES		<u>(3,904,840)</u>	<u>(604,579)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>(136,173)</u>	<u>667,144</u>
CREDITORS			
Amounts falling due after more than one year	14	-	<u>(474,976)</u>
NET (LIABILITIES)/ASSETS		<u>(136,173)</u>	<u>192,168</u>
CAPITAL AND RESERVES			
Called up share capital	17	1,019,154	967,071
Share premium	18	884,960	812,043
Revaluation reserve	18	77,409	-
Capital redemption reserve	18	332,714	332,714
Profit and loss account	18	<u>(2,450,410)</u>	<u>(1,919,660)</u>
SHAREHOLDERS' FUNDS	22	<u>(136,173)</u>	<u>192,168</u>

The financial statements were approved by the Board of Directors on

8/10/07

and were signed on its behalf by

A Taraz - Director



MERCHANT INNS PLC

CASH FLOW STATEMENT
for the year ended 30 June 2006

	Notes	2006 £	2005 £
Net cash outflow from operating activities	1	(245,577)	(22,416)
Returns on investments and servicing of finance	2	(142,577)	(19,904)
Capital expenditure	2	(2,128,567)	(617,349)
		(2,516,721)	(659,669)
Financing	2	2,378,334	574,865
Decrease in cash in the period		(138,387)	(84,804)
<hr/>			
Reconciliation of net cash flow to movement in net debt	3		
Decrease in cash in the period		(138,387)	(84,804)
Cash inflow from increase in debt		(2,253,334)	(354,002)
Change in net debt resulting from cash flows		(2,391,721)	(438,806)
Non cash movement in net debt		-	(132,063)
Movement in net debt in the period		(2,391,721)	(570,869)
Net debt at 1 July		(910,188)	(339,319)
Net debt at 30 June		(3,301,909)	(910,188)

The notes form part of these financial statements

MERCHANT INNS PLC

NOTES TO THE CASH FLOW STATEMENT
for the year ended 30 June 2006

1 RECONCILIATION OF OPERATING LOSS TO NET CASH OUTFLOW FROM OPERATING ACTIVITIES

	2006	2005
	£	£
Operating loss	(837,555)	(255,354)
Depreciation charges	158,418	79,862
Increase in stocks	(22,614)	(25)
Decrease/(Increase) in debtors	31,632	(30,298)
Increase in creditors	<u>424,542</u>	<u>183,399</u>
Net cash outflow from operating activities	<u>(245,577)</u>	<u>(22,416)</u>

2 ANALYSIS OF CASH FLOWS FOR HEADINGS NETTED IN THE CASH FLOW STATEMENT

	2006	2005
	£	£
Returns on investments and servicing of finance		
Interest received	-	232
Interest paid	<u>(142,577)</u>	<u>(20,136)</u>
Net cash outflow for returns on investments and servicing of finance	<u>(142,577)</u>	<u>(19,904)</u>
 Capital expenditure		
Purchase of tangible fixed assets	<u>(2,128,567)</u>	<u>(617,349)</u>
Net cash outflow for capital expenditure	<u>(2,128,567)</u>	<u>(617,349)</u>
 Financing		
Increase in bank loans	1,239,633	347,371
Increase in other loans	1,013,701	5,000
Share issue	52,083	267,864
Share buyback	-	(45,370)
Share premium on issue	<u>72,917</u>	<u>-</u>
Net cash inflow from financing	<u>2,378,334</u>	<u>574,865</u>

MERCHANT INNS PLC

NOTES TO THE CASH FLOW STATEMENT
for the year ended 30 June 2006

3 ANALYSIS OF CHANGES IN NET DEBT

	At 1/7/05 £	Cash flow £	At 30/6/06 £
Net cash			
Cash at bank and in hand	800	2,975	3,775
Bank overdraft	<u>(156,263)</u>	<u>(141,362)</u>	<u>(297,625)</u>
	<u>(155,463)</u>	<u>(138,387)</u>	<u>(293,850)</u>
 Debt:			
Debts falling due within one year	(279,749)	(2,728,310)	(3,008,059)
Debts falling due after one year	<u>(474,976)</u>	<u>474,976</u>	<u>-</u>
	<u>(754,725)</u>	<u>(2,253,334)</u>	<u>(3,008,059)</u>
 Total	<u>(910,188)</u>	<u>(2,391,721)</u>	<u>(3,301,909)</u>

The notes form part of these financial statements

MERCHANT INNS PLC

NOTES TO THE FINANCIAL STATEMENTS for the year ended 30 June 2006

ACCOUNTING POLICIES

Accounting convention

The financial statements have been prepared under the historical cost convention as modified by the revaluation of certain assets and are in accordance with applicable accounting standards

Turnover

Turnover represents net invoiced sales of goods and services, excluding value added tax

Tangible fixed assets

Depreciation is calculated so as to write off the cost of an asset, less its residual value, over the useful economic life of that asset as follows

Freehold buildings	- 2%
Freehold land	- Not provided
Fixtures & fittings	- 20%

Stocks

Stocks are valued at the lower of cost and net realisable value, after making due allowance for obsolete and slow moving items

Deferred tax

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or right to pay less or to receive more tax. The exception to this is that deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Hire purchase and leasing commitments

Rentals paid under operating leases are charged to the profit and loss account on a straight line basis over the period of the lease.

Going concern

The financial statements are prepared under a going concern basis. At 30 June 2006 the company had net current liabilities of £3.9m. The majority of these current liabilities represent loans from directors or parties connected with them (in respect of which the Company has received letters of support) and bank loans. The Company is in discussions with an investor for further investment which if successful would resolve this position and provide a solid platform from which the Company can develop. Whilst it is not possible for the directors to be certain as to the outcome of the matter mentioned above, nonetheless they believe it is appropriate for the financial statements to be prepared on a going concern basis.

Operating lease agreements

Rentals applicable to operating leases where substantially all of the benefits and risks of ownership remain with the lessor are charged against profits on a straight line basis over the period of the lease.

MERCHANT INNS PLC

NOTES TO THE FINANCIAL STATEMENTS - continued for the year ended 30 June 2006

2 STAFF COSTS

	2006	2005
	£	£
Wages and salaries	516,430	140,213
Social security costs	37,323	9,750
Other pension costs	8,197	-
	<u>561,950</u>	<u>149,963</u>

The average monthly number of employees during the year was as follows

	2006	2005
Administrative staff - directors	3	3
Other staff	<u>41</u>	<u>9</u>
	<u>44</u>	<u>12</u>

3 OPERATING LOSS

The operating loss is stated after charging

	2006	2005
	£	£
Hire of plant and machinery	7,056	-
Depreciation - owned assets	158,417	79,862
Auditors' remuneration	<u>12,000</u>	<u>23,526</u>
Directors' emoluments	<u>-</u>	<u>1,500</u>

4 EXCEPTIONAL ITEMS

As a result of the valuation of the Carnarvon on 9 March 2006, existing impairment on this property was reversed

5 INTEREST PAYABLE AND SIMILAR CHARGES

	2006	2005
	£	£
Bank interest	88,197	24,906
Other loan interest	-	(890)
Amortisation of finance fees	7,227	919
Interest payable	<u>47,153</u>	<u>-</u>
	<u>142,577</u>	<u>24,935</u>

6 TAXATION

Analysis of the tax charge

No liability to UK corporation tax arose on ordinary activities for the year ended 30 June 2006 nor for the year ended 30 June 2005

MERCHANT INNS PLC

NOTES TO THE FINANCIAL STATEMENTS - continued for the year ended 30 June 2006

7 OPERATING LEASE RENTALS

During the year the company paid operating lease rentals of £13,900 (2005 £6,742) for accommodation for certain employees

8 DIRECTORS' EMOLUMENTS

The directors' aggregate emoluments in respect of qualifying services were

	2006 £	2005 £
Emoluments receivable	-	1,500

In addition to the above the following costs were incurred for services provided by entities in which the directors had an interest

Fees for consultancy services totalling £90,815 (2005 £ 6,815) were charged by Talisman Management and Investment Limited, a company in which R R A Breare had a direct interest Management and administration fees of £190,822 (2005 £38,888) were charged by Noble House Leisure Limited, a company in which R R A Breare had a direct interest

Monitoring and administration fees of £9,554 (2005 £9,554) were charged by Merchant Place Corporate Finance Limited, a company controlled by M J Chicken

Financial consultancy fees of £4,415 (2005 £4,415) were charged by Thompson Taraz LLP, Chartered Accountants, of which A Taraz is a partner

9 DEFERRED TAXATION

No deferred taxation has been charged or credited to the profit and loss account during the current and previous years The deferred taxation provided in the financial statements and the amounts not provided are as follows

	Provided		Not Provided	
	2006 £	2005 £	2006 £	2005 £
Depreciation in excess of capital allowances	-	-	(63,407)	(36,700)
Excess tax losses	-	-	(301,320)	(186,258)
	-	-	(364,727)	(222,958)

The deferred tax asset has not been recognised as there is insufficient evidence that the assets will be recovered The asset would be recovered if the company considered that sufficient taxable profits would arise in the future

MERCHANT INNS PLC

NOTES TO THE FINANCIAL STATEMENTS - continued
for the year ended 30 June 2006

10 TANGIBLE FIXED ASSETS

	Freehold property £	Fixtures and fittings £	Totals £
COST OR VALUATION			
At 1 July 2005	1,640,894	342,683	1,983,577
Additions	1,887,882	240,685	2,128,567
Revaluations	<u>(18,764)</u>	<u>-</u>	<u>(18,764)</u>
At 30 June 2006	<u>3,510,012</u>	<u>583,368</u>	<u>4,093,380</u>
DEPRECIATION			
At 1 July 2005	520,453	191,398	711,851
Charge for year	56,295	102,122	158,417
Revaluation adjustments	<u>(96,173)</u>	<u>-</u>	<u>(96,173)</u>
Reversal of impairments	<u>(449,382)</u>	<u>-</u>	<u>(449,382)</u>
At 30 June 2006	<u>31,193</u>	<u>293,520</u>	<u>324,713</u>
NET BOOK VALUE			
At 30 June 2006	<u>3,478,819</u>	<u>289,848</u>	<u>3,768,667</u>
At 30 June 2005	<u>1,120,441</u>	<u>151,285</u>	<u>1,271,726</u>

Included in cost or valuation of land and buildings is freehold land of £253,400 (2005 - £253,400) which is not depreciated

Freehold property also includes incidental costs of acquisition of £32,515

Cost or valuation at 30 June 2006 is represented by

	Freehold property £	Fixtures and fittings £	Totals £
Valuation in 2006	<u>(18,764)</u>	<u>-</u>	<u>(18,764)</u>
Cost	<u>3,528,776</u>	<u>583,368</u>	<u>4,112,144</u>
	<u>3,510,012</u>	<u>583,368</u>	<u>4,093,380</u>

If freehold property had not been revalued it would have been included at the following historical cost.

	2006 £	2005 £
Cost	<u>3,528,776</u>	<u>-</u>
Aggregate depreciation	<u>576,748</u>	<u>-</u>

The Carnarvon Arms was externally valued at £1,825,000 on 9 March 2006 by Christie & Co. valuers and surveyors. The property was valued on an open market basis, as a fully-operational entity, having regard to its trading potential.

The other freehold properties have not been valued and are being held at cost.

MERCHANT INNS PLC

NOTES TO THE FINANCIAL STATEMENTS - continued
for the year ended 30 June 2006

11 STOCKS

	2006	2005
	£	£
Finished goods and goods for resale	<u>30,261</u>	<u>7,647</u>

12 DEBTORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2006	2005
	£	£
Trade debtors	3,629	6,986
Other debtors	11,065	700
Prepayments and accrued income	<u>53,808</u>	<u>92,452</u>
	<u>68,502</u>	<u>100,138</u>

13 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2006	2005
	£	£
Bank loans and overdrafts (see note 15)	2,074,208	218,237
Other loans (see note 15)	1,231,476	217,775
Trade creditors	252,148	147,000
Social security and other taxes	91,020	10,517
Other creditors	3,370	1,232
Amounts due to related parties	72,995	77,929
Accruals and deferred income	<u>282,161</u>	<u>40,474</u>
	<u>4,007,378</u>	<u>713,164</u>

The bank overdrafts and bank loans falling due within one year are secured by charges on The Carnarvon Arms, The Mermaid Inn, The Black Boy Inn and The Horse & Groom and by a fixed and floating charge over the assets of the company

In August 2006 the company refinanced its existing loans and took out further loans to provide additional working capital. A total loan of up to £2,968,000 was agreed, to be paid over 16 years.

14 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	2006	2005
	£	£
Bank loans (see note 15)	<u>-</u>	<u>474,976</u>

MERCHANT INNS PLC

NOTES TO THE FINANCIAL STATEMENTS - continued
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15 LOANS

An analysis of the maturity of loans is given below

	2006	2005
	£	£
Amounts falling due within one year or on demand		
Bank overdrafts	297,625	156,263
Bank loans	1,789,076	61,974
Deferred finance issue costs	(19,720)	-
Amortisation	7,227	-
Other loans	<u>1,231,476</u>	<u>217,775</u>
	<u>3,305,684</u>	<u>436,012</u>
 Amounts falling due between one and two years		
Bank loans - 1-2 years	<u>-</u>	<u>79,113</u>
 Amounts falling due between two and five years		
Bank loans - 2-5 years	<u>-</u>	<u>237,339</u>
 Amounts falling due in more than five years		
Repayable by instalments		
Bank loans more than 5 years by instalments	-	162,199
Deferred finance issue costs	-	(4,594)
Amortisation	<u>-</u>	<u>919</u>
	<u>-</u>	<u>158,524</u>

16 OPERATING LEASE COMMITMENTS

The following operating lease payments are committed to be paid within one year

	Land and buildings
	2006
	£
Expiring	
Within one year	<u>-</u>
	<u>8,400</u>

MERCHANT INNS PLC

NOTES TO THE FINANCIAL STATEMENTS - continued for the year ended 30 June 2006

17 CALLED UP SHARE CAPITAL

	2006		2005	
	Number	£	Number	£
Authorised				
Ordinary shares of £0.05 (2005 £0.50) each	55,100,105	2,755,005	10,100,000	5,050,000
'A' Ordinary shares of £0.50 each	-	-	105	53
'B' Ordinary shares of £0.05 each	-	-	5,000,000	250,000
Deferred shares of £0.05 each	90,900,945	4,545,047	-	-
	<u>46,001,050</u>	<u>7,300,053</u>	<u>15,100,105</u>	<u>5,300,053</u>
Alotted, called up and fully paid				
Ordinary shares of £0.05 (2005 £0.50) each	5,352,880	267,644	1,669,918	834,959
'A' Ordinary shares of £0.50 each	-	-	105	53
'B' Ordinary shares of £0.05 each	-	-	2,641,191	132,059
Deferred shares of £0.05 each	15,030,207	751,510	-	-
	<u>20,383,087</u>	<u>1,019,154</u>	<u>4,311,214</u>	<u>967,071</u>

On 25th July 2005, the company's shareholders approved a reconstruction of the company's share capital as a result of which one class of new ordinary shares of 5p each and one class of deferred shares of 5p each were issued to replace the three existing classes of shares

Deferred shares do not entitle their holder to receive any dividend or distribution, nor to receive notice of or attend, speak or vote at any general meeting. On the winding up of the company the holders are entitled to receive a maximum of the amount of capital paid up on each deferred share, only after the repayment of the capital paid up on each ordinary share in the capital of the company and the payment of a further £100,000 on each such ordinary share.

Full details of the rights attaching to shares are contained in the Memorandum and Articles of the company. Copies can be obtained from Companies House, Crown Way, Maindy, Cardiff.

18 RESERVES

	Profit and loss account £	Share premium £	Revaluation reserve £	Capital redemption reserve £	Totals £
At 1 July 2005	(1,919,660)	812,043	-	332,714	(774,903)
Deficit for the year	(530,750)	-	-	-	(530,750)
Cash share issue	-	72,917	-	-	72,917
Property revaluation	-	-	77,409	-	77,409
At 30 June 2006	<u>(2,450,410)</u>	<u>884,960</u>	<u>77,409</u>	<u>332,714</u>	<u>(1,155,327)</u>

19 CAPITAL COMMITMENTS

At the balance sheet date the company had authorised capital expenditure of £nil (2005 £508,500) which is not provided for in these financial statements.

MERCHANT INNS PLC

NOTES TO THE FINANCIAL STATEMENTS - continued for the year ended 30 June 2006

20 RELATED PARTY DISCLOSURES

The company has no controlling party

The company enters into transactions in the ordinary course of business with various related parties, as disclosed below

Merchant Place Corporate Finance Limited ("MPCF"), a company controlled by M J Chicken the unsecured loan of £80,000, which had been advanced to the company by MPCF during the year ended 30 June 2004, was repaid in full during the year ended 30 June 2005 together with accrued interest. In addition, the company was charged £9,555 (2005 £9,555) by MPCF in respect of monitoring and administration fees. The total amount due to MPCF at 30 June 2006 in respect of these services was £35,850 (2005 £23,855). It also provided a loan of £268,000, which is included in creditors due within one year.

Noble House Leisure Limited ("NHLL"), a company in which R R A Breare had a direct interest during the year the company was charged £190,821 (2005 £38,888) for management and other services provided by NHLL. At 30 June 2006 the company owed NHLL £78,332 (2005 £24,737).

Talisman Management and Investment Limited ("Talisman"), a company in which R R A Breare had a direct interest during the year the company was charged £90,815 (2005 £6,815) for consultancy services provided by Talisman. At 30 June 2006 the company owed Talisman £21,878 (2005 £15,672). In addition Talisman loaned the company £126,000, which is owed to Talisman in respect of this loan at the balance sheet date. A further £84,000 is owed at the year end and is included within accruals.

Thompson Taraz LLP, Chartered Accountants, of which A Taraz is a partner during the year the company incurred financial consultancy fees from Thompson Taraz LLP of £4,415 (2005 £4,415). At 30 June 2006 the company owed Thompson Taraz LLP £16,440 (2005 £13,664).

At the balance sheet date the company owed R R A Breare £622,632 (2005 £217,775) in the form of an unsecured loan.

21 POST BALANCE SHEET EVENTS

In August 2006 the company refinanced its existing loans and took out further loans to provide additional working capital. A total loan of up to £2,968,000 was agreed, to be paid over 16 years.

Since the balance sheet date, major developments with a total cost of around £1.4 million have taken place at three of the company's four pubs.

On 5 June 2007 the company exchanged contracts on the Talbot Hotel near Ripley, Surrey for consideration of £3.8 million. This coaching inn, which currently has ten rooms and planning permission for a further 30 bedrooms, is situated close to the strategic M25/A3 interchange and has significant all round potential for growth. Completion occurred on Monday 25 June and the acquisition was funded by a loan from a potential investor.

After the year end, the Mermaid has been let under a tenancy agreement, the board having concluded that it could not be developed as anticipated due to planning restrictions and was unlikely to be capable of profitable operation in the Merchant Inns style.

On 6th August 2007 the company entered into an exclusivity agreement to purchase The Lambert Arms, near Watlington, Oxfordshire. The pub currently has 10 letting bedrooms and significant development potential.

In August 2007 the company entered into a further loan agreement with a potential investor to borrow up to £400,000 for capital expenditure and working capital purposes.

The company is currently in negotiations with an investor to raise further finance.

MERCHANT INNS PLC

NOTES TO THE FINANCIAL STATEMENTS - continued
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22 RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	2006	2005
	£	£
Loss for the financial year	(530,750)	(280,057)
Other recognised gains and losses relating to the year (net)	77,409	-
Issue of shares (net)	<u>125,000</u>	<u>222,494</u>
Net reduction of shareholders' funds	(328,341)	(57,563)
Opening shareholders' funds	<u>192,168</u>	<u>249,731</u>
Closing shareholders' funds	<u>(136,173)</u>	<u>192,168</u>
 Equity interests	 <u>(136,173)</u>	 <u>192,168</u>