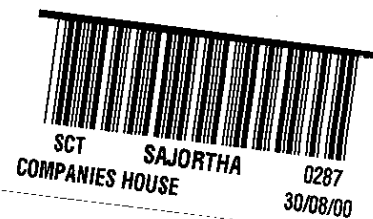


# Ivory & Sime Optimum Income Trust plc

Annual Report and Accounts

Report to May 2000

## 2000



Managed by



**FRIENDS**  
IVORY & SIME

### **Investment Objective**

The Company will invest in UK equities and equity-related securities, predominantly selected from a universe of the UK's largest companies, with the objectives, over the life of the Company, of:

- achieving a high and growing level of income for its ordinary shareholders; and
- increasing dividends ahead of inflation and at least in line with the dividend growth on the FTSE All-Share Index.

### **Capital Structure**

The Company has a split capital structure comprised of Ordinary Shares and Zero Dividend Preference Shares. The interaction of the rights attributable to these two different share classes has important implications for the risks and returns to shareholders in the Company.

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Dividends increased by 3.4 per cent, ahead of both inflation and the dividend growth on the FTSE All-Share Index.

**Ivory & Sime Optimum Income Trust plc**  
**Total assets less current liabilities v FTSE All-Share and TOPSI 100 indices**

**Performance Summary**

	31 May 2000	31 May 1999	% change
<b>Ordinary Share – Capital Values</b>			
Net asset value per share	133.20p	139.35p	(4.4)
Share price (mid market)	109.5p	126.5p	(13.4)
Discount	17.8%	9.2%	N/A
<b>Zero Dividend Preference Shares</b>			
Accumulated value per share	165.44p	152.09p	8.8
Share price (mid market)	169.25p	164.25p	3.0
Final cover*	1.31x	1.28x	2.3
Premium	2.3%	8.0%	N/A
<b>Total assets less current liabilities</b>	<b>£105.2m</b>	<b>£102.7m</b>	<b>2.5</b>
Package discount†	6.7%	0.2%	N/A
<b>Benchmark Indices</b>			
FTSE All-Share Index	3,017.2	2,889.7	4.4
TOPSI 100 Index	4,853.1	5,255.1	(7.6)
	<b>Year to 31 May 2000</b>	<b>Year to 31 May 1999</b>	
<b>Ordinary Shares – Revenue</b>			
Earnings per Ordinary Share	7.71p	8.18p	
Dividends per Ordinary Share	7.70p	7.45p	
<b>Expense ratio (% of total assets)</b>	<b>1.1%</b>	<b>1.1%</b>	

\* The ratio of total assets to the final redemption value of Zero Dividend Preference Shares

† The difference between total assets less current liabilities, and the total of Ordinary and Zero Dividend Preference Shares in issue, multiplied by their respective Share prices

## Corporate earnings growth for UK Companies should be robust in the year ahead.

**Growth of Earnings and Dividend Performance** | The past year has proven to be a difficult one for those investors seeking high and growing dividend income from their portfolios. Nevertheless, your Company was able to declare four quarterly dividend payments totalling 7.70p per Ordinary Share. Last year's payments totalled 7.45p, meaning that the 3.4 per cent increase was better than that of inflation (3.1 per cent). The final payment of 1.975p means that the annualised rate is now 7.90p per share (2.6 per cent higher than last year's dividend level) and, something unexpected notwithstanding, that is the very least shareholders should expect in the coming year. Indeed as I mention later, corporate profits growth is picking up again and we would expect to declare higher quarterly dividends in order to fulfil our stated objective of "providing a high and growing level of income for its ordinary shareholders".

This year's dividends were paid out of current earnings (7.71p per Ordinary Share), allowing a small transfer to our Revenue Reserve. At the end of the year this stood at 2.36p per Ordinary Share, which is available for distribution in the future. Your Board believes the year's performance to be reasonable against the backdrop of a changing dividend culture aggravated by the abolition of advance corporation tax in April 1999.

**Capital Performance** | In an environment of moderate economic growth accompanied by low inflation and low interest rates, investors favoured low yielding, capital growth shares over those providing higher dividend yields. Indeed, as we know, until the middle of March the market's focus was almost entirely on the low yielding Telecoms, Media and Information Technology sectors. The FTSE All-Share Index, driven primarily by them, rose by 4.4 per cent during the year, while the higher yielding TOPSI 100 Index fell by 7.6 per cent. Our total assets rose by what I believe, in the circumstances, was a creditable 2.5 per cent, as the Managers' commitment to stocks which appeared fundamentally undervalued began to find favour with the market towards the end of our year.

The gearing inherent in the Company's capital structure meant that the 2.5 per cent increase in total assets resulted in a 4.4 per cent fall in the net asset value of the Ordinary Shares. Zero Dividend Preference ("ZDP") shareholders' funds increased at the pre-determined rate of 8.78 per cent to £58.3 million. Their capital cover (the ratio of total assets to the final redemption value) rose to 131 per cent. The gearing provided by the ZDP shares and its effect on the net asset value is explained later in the Report and Accounts on pages 10 and 11.

**Indices** | Any comparison of both our income and capital performances against our two benchmark indices is becoming less relevant. These two indices are regularly rebased, resulting in the portfolio of companies making up the indices continually changing. By definition the indices can no longer perform the role of benchmarks because they themselves are no longer "fixed points for reference purposes".

Alex Hammond-Chambers  
Chairman

During February 2000 Vodafone AirTouch consummated its merger with the German company Mannesmann, thereby doubling its market capitalisation and therefore its weighting in the FTSE All-Share Index. This single event meant that the reported income growth of the Index went from positive to negative (minus 3.5 per cent for our year). This was not representative of the market as a whole, and the statistic is at the very least misleading. The facts are however that a large number of institutional investors make decisions based on what can reasonably be regarded as flawed benchmarks. It is frankly a worrying state of affairs and one that it is to be hoped will be addressed by the Myners' Committee's report on institutional investing.

Having said that, we do show the FTSE All-Share Index and the TOPSI 100 Index as benchmarks against which we compare our income and capital performances and we will continue to do so. As it happens in both areas, income and capital, we performed satisfactorily last year. But I am afraid that we no longer have much regard for this as a measurement standard.

**The Annual General Meeting** | We do urge shareholders to attend the AGM, which will be held at 12 noon on 24 August 2000 at One Charlotte Square, Edinburgh. At it there will be a presentation by the Managers of the year's results, together with an assessment of the future prospects. The AGM is the shareholders meeting at which you have the opportunity to meet all of the Directors and the Managers, to ask questions or make comments in front of all other shareholders and indeed to meet them.

**Outlook** | The current economic environment in the UK is relatively favourable with the prospect of further economic expansion combined with a low inflationary background. While there may be scope for some further tightening of monetary policy, UK interest rates look to be near their peak. In this environment UK equities seem likely to trade within a narrow range in the short-term. In addition, concerns remain over the high valuation of the American stock market and over the likelihood of the Federal Reserve being able to achieve a controlled slowdown of the US economy without precipitating a collapse on Wall Street.

Over the balance of the coming year, however, corporate earnings growth for UK companies should be relatively robust and we remain confident that this background will allow the Company to continue to achieve the objective of a high and growing level of income for Ordinary Shareholders.

Alex Hammond-Chambers  
Chairman  
24 July 2000

**Rodger McNair**  
Investment Manager

## Managers' Review

### **"The Company's investment portfolio remains well positioned to deliver a high and growing income for Ordinary Shareholders."**

As the Company's year progressed, upwards revisions to global growth forecasts were a reflection of buoyant economic conditions worldwide. In particular, the US economy forged ahead, growing significantly above the long-term trend rate, while on the domestic front, initial expectations for UK economic growth were surpassed. Against that background the monetary authorities in the UK, Europe and the US responded by tightening interest rates in order to restrain inflationary pressures. This was reflected in a series of interest rate rises in all three regions during the Company's year. June 1999 marked the last in a series of cuts in UK base rates to 5.0 per cent before they were raised on four separate occasions to their current level of 6.0 per cent.

Uncertainty regarding the ability of the Federal Reserve to slow the US economy and engineer an economic "soft landing" contributed towards a turbulent year for global equity markets. Volatility was a pre-eminent feature of the UK equity market during the Company's year. The inclusion of several companies with limited free-floats into the FTSE 100 Index certainly contributed to this. Examples of these include Freeserve, Thus and Kingston Communications. Furthermore, large-scale corporate activity, most notably the takeover of the German group Mannesmann by Vodafone AirTouch, added to equity market volatility due to the sheer scale of the equity flows involved.

One feature which has remained remarkably consistent in recent years is the twin track nature of the UK economy. The service sector continued to exhibit strong growth, whereas UK manufacturing struggled to make much progress by comparison. The magnitude of Sterling's strength against the Euro surprised many and certainly did little to help the plight of UK manufacturing, reducing the competitiveness of UK exports to Western Europe.

Although limited progress was made by the UK equity market over the year as a whole, this disguised significant underlying trends. After a somewhat subdued start to the year the UK equity market rallied strongly during the final three months of 1999 to reach its all-time high on 30 December, only to fall back over the first few

months of the new Millennium. Medium-sized companies easily outperformed their larger "blue chip" peers in the FTSE 100 whilst smaller companies were the best performing equity asset class over the year.

Perhaps the most notable feature during the year was the emergence of a grouping commonly labelled as "TMT" stocks – encompassing all Telecoms, Media and Technology companies. From October 1999 to March 2000 there was a dramatic rise in the equity valuations of those companies, which were perceived to be beneficiaries of the internet revolution. The extreme valuations attributed to those shares contrasted with much of the rest of the market and subsequently proved to be unsustainable. "TMT" stocks suffered a significant setback, virtually across the board, during the final three months of the Company's year. At the same time there was a marked recovery in many of those sectors which had been left behind during the rally in "TMT" stock prices.

In our report last year we highlighted the trend towards companies opting to return surplus capital to shareholders through share buy-backs and other forms of capital distribution rather than through special dividend distributions. This remained very much the case during the past year. Indeed, the Company received no special dividends at all during the year under review.

#### **Relative Performance of "TMT" Sectors**

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**Portfolio** | The Company's equity portfolio performed particularly well over the final three months of the year as the out-performance from the "TMT" stocks reversed sharply. The Company has a relatively low exposure to these stocks given their predisposition towards low absolute levels of dividend distribution and also due to the cash consumptive nature of many of their business models, especially in the early stages. The Company's portfolio has significant investments in the Oil, Pharmaceutical, Bank and Insurance sectors which generally exhibit characteristics of surplus cash generation, robust balance sheets and real dividend growth.

However, despite the recent setback in "TMT" stocks, over the course of the year UK equity market performance was still highly polarised towards those companies as a result of the strong gains registered in the preceding nine months. The Telecoms sector was the largest contributor to UK equity market performance over the year, followed by the Media sector. While Optimum does have significant investments in both sectors the portfolio is underweight relative to the broader market, especially in those shares which appear to be most speculatively valued. Technology shares were the best performers during the year and the Company's sole representation in that area is Marconi.

**Outlook** | Prospects for further economic expansion accompanied by moderate to low inflation generally look encouraging, although it is likely that the UK economy will slow as we move into next year. With regard to UK equity valuations these look reasonably well underpinned on most valuation measures and also when viewed in an international context. The major caveat remains the risk that a controlled slowdown of the US economy is not achieved. This would clearly have a negative knock-on effect for global equity markets. In spite of the recent recovery in share valuations outwith the "TMT" sectors, the valuation gap remains large and we feel the more traditional areas currently offer the most attractive opportunities for investment. Despite a slowdown in the dividend growth rate for the UK equity market over the past year we remain confident that the Company's underlying investment portfolio is well positioned to meet its objectives.

Friends Ivory & Sime plc  
24 July 2000



## Classification of Investments

Sector	2000 £'000	2000 % Total assets less current liabilities	1999 % Total assets less current liabilities
<b>Resources</b>	<b>12,507</b>	<b>11.9</b>	<b>9.4</b>
Oil & Gas	11,651	11.1	9.4
Mining	856	0.8	—
<b>Basic Industries</b>	<b>5,773</b>	<b>5.5</b>	<b>6.8</b>
Chemicals	2,703	2.6	3.7
Construction & Building Materials	2,563	2.4	2.9
Steel & Other Metals	507	0.5	—
<b>General Industrials</b>	<b>4,402</b>	<b>4.2</b>	<b>4.7</b>
Electronic & Electrical Equipment	—	—	1.9
Engineering & Machinery	2,851	2.7	1.8
Aerospace & Defence	1,551	1.5	1.0
<b>Non-Cyclical Consumer Goods</b>	<b>14,913</b>	<b>14.2</b>	<b>13.8</b>
Beverages	1,441	1.4	1.4
Food Producers & Processors	276	0.3	0.3
Packaging	714	0.7	—
Personal Care & Household Products	841	0.8	0.8
Pharmaceuticals	10,156	9.6	9.1
Tobacco	1,485	1.4	2.2
<b>Cyclical Services</b>	<b>16,073</b>	<b>15.3</b>	<b>17.2</b>
Restaurants, Pubs & Breweries	2,446	2.3	2.2
Leisure, Entertainment & Hotels	1,340	1.3	1.6
Media & Photography	3,672	3.5	3.5
General Retailers	3,715	3.5	4.4
Support Services	2,077	2.0	1.0
Transport	2,823	2.7	4.5
<b>Non-Cyclical Services</b>	<b>12,785</b>	<b>12.1</b>	<b>9.6</b>
Food & Drug Retailer	575	0.5	—
Telecommunication Services	12,210	11.6	9.6
<b>Utilities</b>	<b>7,047</b>	<b>6.7</b>	<b>7.0</b>
Electricity	2,576	2.4	1.7
Gas Distribution	1,039	1.0	0.9
Water	3,432	3.3	4.4
<b>Financials</b>	<b>26,109</b>	<b>24.8</b>	<b>27.2</b>
Banks	15,472	14.7	17.1
Insurance	4,403	4.2	4.1
Life Assurance	3,781	3.6	3.9
Real Estate	1,466	1.4	1.6
Speciality & Other Finance	987	0.9	0.5
<b>Information Technology</b>	<b>982</b>	<b>0.9</b>	<b>—</b>
Information Technology Hardware	982	0.9	—
<b>Total Equity</b>	<b>100,591</b>	<b>95.6</b>	<b>95.5</b>
<b>Convertible Fixed Interest</b>	<b>875</b>	<b>0.8</b>	<b>0.9</b>
<b>Convertible Preference Shares</b>	<b>1,147</b>	<b>1.1</b>	<b>1.2</b>
<b>Total Investments</b>	<b>102,613</b>	<b>97.5</b>	<b>97.6</b>
<b>Net Current Assets</b>	<b>2,578</b>	<b>2.5</b>	<b>2.4</b>
<b>Total Assets less Current Liabilities</b>	<b>105,191</b>	<b>100.0</b>	<b>100.0</b>

## Investment Portfolio

Company	Valuation £'000	% of Total assets less current liabilities	% of Portfolio income
<b>BP Amoco</b> The company is one of the world's largest integrated oil and gas companies.	6,083	5.8	3.9
<b>British Telecom</b> BT is the dominant supplier of telecommunications services and equipment in the UK.	5,712	5.4	4.1
<b>Shell Transport &amp; Trading</b> The company is one of the world's largest integrated oil and gas companies.	5,569	5.3	4.4
<b>Glaxo Wellcome</b> A global manufacturer and marketer of pharmaceutical products.	5,365	5.1	3.3
<b>Vodafone AirTouch</b> The group is one of the world's largest providers of mobile telecommunications services and products.	4,274	4.1	0.6
<b>Lloyds TSB Group</b> The company provides retail and commercial banking services through its branch network and offices in the UK and overseas.	3,687	3.5	4.3
<b>HSBC Holdings</b> The group provides a comprehensive range of banking and financial services through an international network of offices throughout Europe, the Asia Pacific region, the Middle East and the Americas.	2,877	2.7	2.3
<b>CGNU</b> The group provides a wide range of insurance and life assurance services in the UK and overseas.	2,846	2.7	3.0
<b>Barclays</b> The company is a UK based financial services group with primary interests in retail and investment banking.	2,603	2.5	2.4
<b>Astrazeneca</b> The company is involved in the global manufacture and marketing of prescription pharmaceuticals, agricultural chemicals and speciality chemicals.	2,534	2.4	2.0
<b>Ten Largest Investments</b>	<b>41,550</b>	<b>39.5</b>	<b>30.3</b>

Company	Nature of Business	Valuation £'000	% of Total assets less current liabilities	% of Portfolio Income
Abbey National	Banking	2,262	2.2	3.2
Smithkline Beecham	Pharmaceuticals	2,258	2.2	1.0
Prudential	Life Assurance	2,252	2.1	1.6
Cable & Wireless	Telecommunications Services	2,224	2.1	0.9
Burmah Castrol	Specialty Chemicals and Lubricants	1,819	1.7	1.6
Land Securities	Property Investments and Development	1,466	1.4	1.8
Diageo	Food and Beverages	1,441	1.4	1.6
Scottish & Newcastle	Restaurants, Pubs and Breweries	1,394	1.3	2.0
United News & Media	Media and Publishing	1,336	1.3	1.1
Kelda Group	Water Utility	1,284	1.2	2.9
<b>Twenty Largest Investments</b>		<b>59,286</b>	<b>56.4</b>	<b>48.0</b>
Royal Bank of Scotland	Banking	1,203	1.1	1.0
Next	Clothing Retailer	1,190	1.1	1.3
United Utilities	Multi-Utility	1,168	1.1	2.6
Williams 8% CCRP	Diversified Manufacturer	1,147	1.1	2.3
Bunzl	Outsourcing and Distribution	1,120	1.1	0.9
Imperial Tobacco Group	Tobacco Manufacturer	1,114	1.1	1.7
Royal & Sun Alliance Ins	Composite Insurance	1,069	1.0	2.1
BG	Gas Distribution	1,039	1.0	0.8
Provident Financial	Home Credit and Insurance	987	1.0	1.1
Marconi	Communications Equipment Manufacturer	982	0.9	0.2
<b>Thirty Largest Investments</b>		<b>70,305</b>	<b>66.9</b>	<b>62.0</b>
Thames Water	Water Utility	980	0.9	1.8
Hilton Group	Leisure and Hotels	976	0.9	1.0
Bank of Scotland	Banking	971	0.9	0.7
Smiths Industries	Aerospace & Medical Equipment Manufacturer	960	0.9	0.8
Davis Services	Textile Rentals and Plant Hire	958	0.9	1.3
BAA	Airport Operator	935	0.9	0.9
Scottish Power	Electricity Generator	904	0.9	1.3
BOC Group	Industrial Gases	884	0.9	1.0
De Vere Group 7% Cnv Bonds	Hotels and Leisure	875	0.8	2.0
Halifax	Banking	872	0.8	1.0
<b>Forty Largest Investments</b>		<b>79,620</b>	<b>75.7</b>	<b>73.8</b>
Hanson	Building Materials	871	0.8	0.8
IMI	Industrial Controls and Drinks Dispenser Manufacturer	870	0.8	1.5
Bass	International Hotels and UK Pub Operator	856	0.8	1.2
Anglo American	Mining	856	0.8	0.9
Reckitt Benckiser	Household Goods Manufacturer	841	0.8	0.9
BPB	Building Materials	838	0.8	0.9
GKN	Automotive Components Manufacturer	808	0.8	0.5
Kingfisher Group	General Retailer	803	0.8	0.6
Benisford	Food Service Equipment Manufacturer	771	0.7	1.0
National Grid Group	Electricity Generator	768	0.7	0.7
<b>Fifty Largest Investments</b>		<b>87,902</b>	<b>83.5</b>	<b>82.8</b>
<b>Other Investments (29)</b>		<b>14,711</b>	<b>14.0</b>	<b>17.2</b>
<b>Total Investments</b>		<b>102,613</b>	<b>97.5</b>	<b>100.0</b>
<b>Net Current Assets</b>		<b>2,578</b>	<b>2.5</b>	
<b>Total Assets less Current Liabilities</b>		<b>105,191</b>	<b>100.0</b>	

Ivory & Sime Optimum has a split capital structure comprised of two different classes of shares, Ordinary Shares and Zero Dividend Preference Shares. The interaction of the rights attributable to these two different share classes has important implications for the risks and returns to shareholders in the Company.

### Gearing

#### *What is gearing?*

Gearing results when a company raises or borrows money (usually fixed interest) in seeking to add to shareholders' returns. In a similar way that a mechanical gear wheel within an engine increases output, so gearing within an investment trust provides the potential for enhanced financial performance. An investment trust, in common with other limited liability companies, is able to borrow monies and thereby create gearing. This ability gives an investment trust a distinct advantage over other forms of investment vehicles, although in time of market weakness the gearing can work to the ordinary shareholders' disadvantage. In the case of Ivory & Sime Optimum, the Zero Dividend Preference Shares provide gearing to the holders of Ordinary Shares.

#### *Income Gearing for holders of Ordinary Shares*

Holders of Ordinary Shares benefit from income gearing since, after the deduction of expenses, the entire income earned on the total assets of the Company is available to pay dividends exclusively to them.

As a result, holders of Ordinary Shares receive a significantly higher income return than would have been the case if the Zero Dividend Preference Shares had not been issued. The holders of Zero Dividend Preference Shares are not entitled to receive any income. The effect of the income gearing, as at 31 May 2000 was that, although the net yield on the Company's portfolio was 3.1 per cent, the implied net dividend yield for holders of Ordinary Shares was 7.0 per cent.

#### *Capital gearing for holders of Ordinary Shares*

Holders of Ordinary Shares also benefit from capital gearing if the Company's total assets increase by more than the amount required to meet the capital entitlement of the Zero Dividend Preference Shares. Conversely the capital gearing will have an adverse effect on holders of Ordinary Shares if the increase in total assets does not exceed such increments. During the year to 31 May 2000, the Company's total assets increased by 2.5 per cent.

Having deducted the capital entitlement of the Zero Dividend Preference Shares, the Company's net asset value per Ordinary Share decreased by 4.4 per cent. The chart on this page illustrates the assets which will be available for distribution to holders of Ordinary Shares, after satisfying the entitlement of the Zero Dividend Preference Shares, assuming various compound rates of growth in the Company's assets to the anticipated winding-up date of 26 March 2004.

Total assets less current liabilities increased at the assumed annual compound growth rates noted below, less the total final predetermined payment to Zero Dividend Preference Shareholders.

Pence per share at 26 March 2004

300

—

—

—

—

—

0

Annual growth rate

Shareholders should be aware that this chart is for illustration purposes only. The actual return of the Ordinary Shares will be determined by the performance of the Company's total assets, which is influenced by the performance of the UK stockmarket, which can go down as well as up.

**Ordinary Shares** | *At 31 May 2000 there were 35,223,639 Ordinary Shares in issue.*

***Investment characteristics:***

The Ordinary Shares provide investors with a high and growing income return, benefiting from the gearing of the Zero Dividend Preference Shares.

***Income entitlement:***

Holders of Ordinary Shares are entitled to all of the Company's income. Dividends are paid quarterly in August, November, February and May each year. Total dividends for the year to 31 May 2000 amounted to 7.70p per Ordinary Share.

***Capital entitlement:***

Holders of Ordinary Shares are also entitled to the remainder of the Company's assets after having satisfied the capital entitlement of the Zero Dividend Preference Shares. At 31 May 2000 the capital attributable to the Ordinary Shares was 133.20p, equivalent to the net asset value per Ordinary Share.

***Voting entitlement:***

Holders of Ordinary Shares participate in all general meetings of the Company on the basis of one vote for each share held.

**Zero Dividend Preference Shares** | *At 31 May 2000 there were 35,223,639 Zero Dividend Preference Shares in issue.*

***Investment characteristics:***

The Zero Dividend Preference Shares provide investors with a predetermined entitlement to capital growth, but no entitlement to income. Since the Zero Dividend Preference Shares have a predetermined capital entitlement and preference on winding up, they are considered to have a lower degree of risk than the Ordinary Shares. They are not, however, entirely free from risk.

***Income entitlement:***

The Zero Dividend Preference Shares have no entitlement to income.

***Capital entitlement:***

On a return of capital on winding-up or otherwise, the surplus assets of the Company remaining, after payment of its liabilities, shall be applied first in the payment to the holders of Zero Dividend Preference Shares of an amount equal to £1.2675 per share, increased on the same day of each month at the rate of 8.78 per cent, per annum (compounding annually on 26 March). The first such increase occurred on 26 April 1997 and the last will occur on 26 March 2004. The anticipated final redemption value of the Zero Dividend Preference Shares is £2.2838 per share.

***Voting entitlement:***

The holders of Zero Dividend Preference Shares have the right to receive notice of, but do not have the right to attend, or vote at, any general meeting – unless the business of the meeting includes consideration of any matter affecting the special rights attached to the Zero Dividend Preference Shares.

**Rodger McNair**  
(Investment Manager)

Rodger McNair joined Ivory & Sime in 1990 and has overall responsibility for UK equity portfolios. He has over ten years' investment experience and is also the manager of Investors Capital Trust.

**Martin Cassels**  
(Company Secretary)

Martin Cassels, a chartered accountant, started working for Ivory & Sime in 1990, and is responsible for the provision of company secretarial services for several investment trusts.

***Friends Ivory & Sime, Investment Managers***

Friends Ivory & Sime traces its origins back to 1895 and has been managing money on behalf of its clients for over a century. Its first client was an investment trust and its commitment to the sector is underlined by the fact that today it manages, advises or provides secretarial services to no fewer than sixteen investment companies.

Ivory & Sime merged in 1998 with Friends Provident Asset Management. Friends Ivory & Sime is listed on the London Stock Exchange and with offices in London, Edinburgh, New York and Hong Kong together with representation in Tokyo, is well-positioned as a global player in the investment business.

With some £38 billion of assets under management, Friends Ivory & Sime is committed to providing its clients with superior investment returns and outstanding service.

The primary aim of Ivory & Sime Optimum Income Trust is to provide ordinary shareholders with a high and growing level of income.

This is achieved by investing in a portfolio of UK equities and equity-related securities, predominantly selected from a universe of the UK's largest companies.

The stock selection process places considerable emphasis on companies which have a yield above that of the market and which have both the financial strength and management intent to maintain a policy of real dividend growth.

The management of the portfolio and the disciplines we apply in making investment decisions typically mean that Ivory & Sime Optimum Income Trust will have a concentrated portfolio with low portfolio turnover.

## Board of Directors at 31 May 2000

Mr R A Hammond-Chambers, Mr S Coke, Mr A W Downie, Mr A R Irvine and Mr P N B Kennedy were appointed as Directors of the Company on 7 February 1997. Mr R A Hammond-Chambers, Mr S Coke and Mr A R Irvine are Directors of First Optimum plc, the predecessor company of Ivory & Sime Optimum Income Trust plc, which went into Members' Voluntary Liquidation on 26 March 1997.

**Simon Coke**  
(age 68) is Professor Emeritus of International Business at the University of Edinburgh. Prior to taking up this appointment he was general manager of Johnson & Johnson Far East Inc. He has both theoretical and practical marketing expertise.

**Peter Kennedy**  
(age 57) retired at the end of 1996 as Managing Director of Gartmore Scotland Limited which managed the *Scottish National Trust plc*, a split capital investment trust. He is also Chairman of BFS Income and Growth Trust plc and a member of the Board of West of Scotland Water Authority.

**Alex Hammond-Chambers**  
(Chairman) (age 57) is Chairman of Fidelity Special Values plc, Fidelity Japanese Values plc and American Opportunity Trust plc. He is also a Director of Finsbury Income and Growth Investment Trust plc and a number of other companies, including Euro Sales Finance (Chairman) and Dobbies Garden Centre (Chairman). He was Chairman of Ivory & Sime between 1985 and 1991.

**Andrew Irvine**  
(age 48) is Managing Director of Jones Lang LaSalle, Scotland. He is a Director of Securities Trust of Scotland plc, Ivory & Sime UK Smaller Companies Trust plc and a number of other companies.

**Alan Downie**  
(age 50) is Group Managing Director of CALA PLC. Prior to his appointment to CALA, he was Regional Director for Wimpey Homes in Scotland. He is a chartered civil engineer.



**Results and Dividends**

The Directors submit their third Annual Report together with the Accounts (of the Company) for the year to 31 May 2000.

	£'000
Revenue available for dividends	2,716
First interim dividend of 1.90p per share paid on 5 November 1999	(669)
Second interim dividend of 1.90p per share paid on 2 February 2000	(669)
Third interim dividend of 1.925p per share paid on 5 May 2000	(678)
Fourth interim dividend of 1.975p per share payable on 25 August 2000 to shareholders on the register at close of business on 11 August 2000	(696)
Transferred to revenue reserve	4

**Principal Activity and Status**

The Company is registered as a Public Limited Company in terms of the Companies Act 1985.

It is an Investment Company as defined in Section 266 of the Companies Act 1985 and qualifies as an Investment Trust within the meaning of Section 842 of the Income and Corporation Taxes Act 1988. Inland Revenue approval for such treatment has been given up to 31 May 1999. Since that date, the Company's affairs have been conducted in a manner to enable it to continue to seek such approval.

A review of the Company's business during the period is contained in the Chairman's Statement and the Managers' Review.

**Corporate Governance**

The Board consists solely of non-executive Directors who are all independent of the Company's Managers. The Board has access to a Company Secretary who also attends all Board Meetings which are held at least five times a year. The Company Secretary provides full information on the Company's assets, liabilities and other information to the Board before each Board Meeting. Arrangements to ensure the appropriate level of corporate governance have been put in place by the Board which it believes are appropriate to an investment trust and will enable the Company to operate within the spirit of the Combined Code on Corporate Governance ('the Code').

Whilst these arrangements do not comply with the Code in certain areas, as detailed below, they are considered by the Board to be more appropriate than those set out in the formal Code, given the non-executive status of the Directors and the business activity of the Company as an investment trust.

In accordance with the Code, that Directors be appointed for a specified term and the Articles of Association, that Directors retire by rotation at the AGM, the Board has deemed that each Director's appointment shall be for a three year term. Each Director, being eligible, can be re-elected following the expiry of the three year term. There is no formal training programme for Directors. Full details of the duties and obligations are provided at the time of appointment and are supplemented by further details as requirements change.

A management agreement between the Company and its Managers, Friends Ivory & Sime, sets out the matters over which the Managers have authority and the limits above which Board approval must be sought. All other matters are reserved for the approval of the Board of Directors. The Investment Manager, in the absence of explicit instruction from the board, is empowered to exercise discretion in the use of the Company's voting rights.

Individual Directors may, at the expense of the Company, seek independent professional advice on any matter that concerns them in the furtherance of their duties.

Committees comprising the full Board carry out the functions of Audit, Nomination and Remuneration Committees. The Audit Committee reviews the Annual Report and Accounts and the terms of appointment of the auditors together with their remuneration. The Remuneration Committee reviews the terms and conditions of the Managers' appointment on a regular basis.

After making enquiries and bearing in mind the nature of the Company's business and assets, the Directors consider that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

The Directors are responsible for the Company's system of internal financial control. Day to day operations are delegated, through a management agreement, to Friends Ivory & Sime plc which has established and disseminated clearly defined policies and standards. The system of internal financial control, which includes procedures such as physical controls, segregation of duties, authorisation limits and comprehensive financial reporting to the Board, is designed to provide reasonable but not absolute assurance against material misstatement or loss. In accordance with the Code's recommendations, the Directors have reviewed with the Investment Managers the effectiveness of the system of internal financial control in operation. Guidance on internal control has been published by the Turnbull Working Party. The Directors are currently considering the recommendations of the Turnbull Report and will have procedures in place to meet the internal control requirements of the Code by 30 September 2000. The London Stock Exchange has implemented transitional arrangements which enable the Company to satisfy the requirements of the Code this year by making the above statement on internal financial control and disclosing a timescale for implementation of internal control procedures.

### Relations with Shareholders

The Company welcomes the views of shareholders and where practicable, enters into dialogue with institutional shareholders based on the need for mutual understanding of objectives. The Annual General Meeting is a meeting of the Shareholders and of the Company and provides a forum both formal and informal for Shareholders to meet and discuss issues with Directors and Managers of the Company. Details of the resolutions to be proposed at the Annual General Meeting on 24 August 2000 can be found in the Notice of Meeting on page 30.

### Directors

Mr R A Hammond-Chambers and Mr A W Downie both retire at the Annual General Meeting of the Company and, being eligible, offer themselves for re-election.

The Directors who held office at the end of the year, and their interests in the share capital of the Company were:

		Ordinary Shares at 31 May 2000	Ordinary Shares at 31 May 1999
R A Hammond-Chambers	Beneficial and family	15,010	15,010
S Coke	Beneficial and family	11,339	11,339
A W Downie	Beneficial and family	5,000	5,000
A R Irvine	Beneficial and family	65,644	63,542
P N B Kennedy	Beneficial and family	2,000	2,000

Mr P N B Kennedy had an interest in 2,000 Zero Dividend Preference Shares at 31 May 2000.

There have been no changes in the holdings of the Directors between 31 May 2000 and 24 July 2000.

#### Management

Details of the contract between the Company and Friends Ivory & Sime plc in respect of management services provided are given in Note 3 to the accounts.

#### Year 2000 Computer Compliance

Given the complexity of the problem, it is not possible for any organisation to guarantee that no Year 2000 problems remain. However, the Directors believe that an acceptable level of readiness had been achieved. Since 31 December 1999, the Company has not suffered any adverse consequences relating to the Year 2000 computer compliance issue. The Company did not bear any of the costs associated with ensuring that the computer systems used in respect of the Company's operations were Year 2000 compliant.

#### Marketing

The Company has entered into an agreement with Friends Provident Life Office in relation to savings plans, ISAs and similar products which may include the Company's shares. This agreement is for an initial two year period commencing 11 August 1998. The total cost incurred in respect of this agreement, excluding VAT, is expected to be £32,000. The Company is participating in the 'its' campaign.

#### Creditor Payment Policy

The Company's payment policy is to settle investment transactions in accordance with market practice and to ensure settlement of supplier invoices in accordance with stated terms. The Company did not have any trade creditors at the year end.

#### Substantial Interests in Share Capital

Under the terms of Section 199 of the Companies Act 1985 the following interests of 3 per cent or more of the ordinary share capital of the Company had been notified to the Company at 24 July 2000.

	Ordinary Shares	Percentage Held
CGU	3,414,443	9.7%
CTCL Guinness Flight Income Share Trust	2,359,638	6.7%

#### Auditors

Ernst & Young have expressed their willingness to continue in office as auditors and a resolution proposing their re-appointment will be submitted at the forthcoming Annual General Meeting.

By Order of the Board,

Friends Ivory & Sime plc  
Secretary  
Edinburgh  
24 July 2000

## Statement of Total Return

(incorporating the Revenue Account\*) for the year ended 31 May 2000

	Notes	2000 Revenue £'000	2000 Capital £'000	2000 Total £'000	1999 Revenue (restated) £'000	1999 Capital £'000	1999 Total (restated) £'000
Realised gains/(losses) on investments	8	–	5,376	5,376	–	(1,060)	(1,060)
Unrealised (losses)/gains on investments	8	–	(2,293)	(2,293)	–	660	660
<b>Total capital gains/(losses) on investments</b>		–	3,083	3,083	–	(400)	(400)
Income	2, 12	3,290	38	3,328	3,539	176	3,715
Investment management fee	3	(334)	(620)	(954)	(324)	(602)	(926)
Realised exchange differences		–	(2)	(2)	–	–	–
Other expenses	4	(206)	–	(206)	(226)	(11)	(237)
<b>Return on ordinary activities before tax</b>		2,750	2,499	5,249	2,989	(837)	2,152
Tax on ordinary activities	5	(34)	32	(2)	(108)	46	(62)
<b>Return on ordinary activities after tax</b>		2,716	2,531	5,247	2,881	(791)	2,090
Appropriations in respect of Zero Dividend Preference Shares	11, 12	–	(4,701)	(4,701)	–	(4,322)	(4,322)
<b>Return attributable to equity shareholders</b>		2,716	(2,170)	546	2,881	(5,113)	(2,232)
Dividends in respect of equity shares	6	(2,712)	–	(2,712)	(2,624)	–	(2,624)
Transfer to/(from) reserves	12	4	(2,170)	(2,166)	257	(5,113)	(4,856)
<b>Return per Ordinary Share:</b>							
Basic	7	7.71p	(6.16)p	1.55p	8.18p	(14.52)p	(6.34)p

\* The revenue column of this statement is the profit and loss account of the Company.  
The accompanying notes are an integral part of this statement.  
All revenue and capital items in the above statement derive from continuing operations.  
No operations were acquired or discontinued in the year.

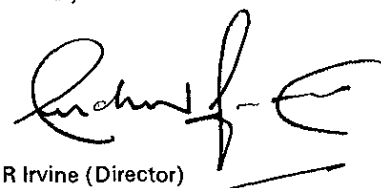
**Balance Sheet**  
As at 31 May 2000

	Notes	2000 £'000	1999 £'000
<b>Fixed assets</b>			
Investments	8	102,613	100,169
<b>Current assets</b>			
Debtors	9	907	862
Cash at bank and in hand		3,313	3,198
		4,220	4,060
<b>Creditors: amounts falling due within one year</b>	10	(1,642)	(1,573)
<b>Net current assets</b>		2,578	2,487
<b>Total assets less current liabilities</b>		105,191	102,656
<b>Capital and reserves</b>			
Called-up share capital			
Ordinary shares	11	3,522	3,522
Zero dividend preference shares	11	35,224	35,224
		38,746	38,746
Share premium account	12	40,607	40,607
Other reserves –			
Redemption reserve	12	23,049	18,348
Capital reserve – realised	12	(19,306)	(19,429)
Capital reserve – unrealised	12	21,263	23,556
Revenue reserve	12	832	828
	14	105,191	102,656
<b>Equity shareholders' funds</b>	13	46,918	49,084
<b>Zero dividend preference shareholders' funds</b>	13	58,273	53,572
		105,191	102,656
<b>Net asset value per Ordinary Share</b>	13	133.20p	139.35p
<b>Net asset value per Zero Dividend Preference Share</b>	13	165.44p	152.09p

The financial statements on pages 18 to 28 were approved by the Board of Directors on 24 July 2000 and were signed on its behalf by



R A Hammond-Chambers (Director)



A R Irvine (Director)

The accompanying notes are an integral part of this balance sheet.

**Cash Flow Statement**  
for the year ended 31 May 2000

	Notes	2000 £'000	1999 £'000
<b>Operating activities</b>			
Investment income received		3,247	2,964
Deposit interest received		133	359
Other income		1	1
Investment management fees paid		(948)	(927)
Other cash payments		(231)	(180)
Net cash inflow from operating activities	15	2,202	2,217
<b>Taxation</b>			
Tax recovered		25	–
<b>Capital expenditure and financial investment</b>			
Purchase of investments		(19,609)	(8,554)
Disposals of investments		20,137	7,208
Capital dividends		38	173
Net cash inflow/(outflow) from investing activities		566	(1,173)
Equity dividends paid		(2,676)	(2,598)
Increase/(decrease) in cash in the year	16	117	(1,554)
<b>Reconciliation of net cash to movement in net funds</b>			
Increase/(decrease) in cash in the year		117	(1,554)
Currency losses		(2)	–
		115	(1,554)
Net funds at 31 May 1999		3,198	4,752
Net funds at 31 May 2000		3,313	3,198

## 1. Accounting Policies

A summary of the principal accounting policies, all of which have been applied consistently throughout the year is set out below.

### a) Basis of accounting

The accounts are prepared under the historic cost convention, modified to include the revaluation of fixed asset investments. The accounts have been prepared in accordance with applicable accounting standards and with the Statement of Recommended Practice 'Financial statements of investment trust companies'.

### b) Valuation of investments

Listed investments are valued at middle market prices. Unlisted investments are valued by the Directors on the basis of all the information available to them at the time of valuation.

### c) Income

Dividends are recognised as income on the date that the related investments are marked ex-dividend.

Dividends receivable on equity shares where no ex-dividend date is quoted are brought into account when the Company's right to receive payment is established.

In accordance with FRS 16, dividend income is now shown excluding any associated tax credit with a subsequent reduction in the amount of the tax charge. The effect of this change in policy is to decrease franked investment income and the tax charge by £342,000 (1999: £440,000). There is no change to the returns attributable to equity shareholders for either 2000 or 1999.

Income from fixed interest securities, other investment income and deposit interest are included on an accruals basis. Where the Company has elected to receive its dividends in the form of additional shares rather than cash, the amount of the cash dividend is recognised as income.

### d) Expenses

All expenses are accounted for on an accruals basis. Expenses are charged through the revenue account except where incurred in connection with the maintenance or enhancement of the value of the Company's assets and taking account of the expected long term returns as follows:

– Management fees payable have been allocated 35 per cent to revenue and 65 per cent to capital.

### e) Taxation

Advance corporation tax ("ACT") payable on dividends paid or provided for up to April 1999 is written off, except when recoverability is considered to be reasonably certain and foreseeable.

The tax effect of different items of income/gain and expenditure/loss is allocated between capital and revenue as set out in note 5 to the accounts. The standard rate of corporation tax is applied to taxable net revenue. Provision is made for deferred taxation, using the liability method, on all material timing differences to the extent that it is probable that a liability will crystallise.

### f) Capital reserves

Capital reserve – realised

The following are accounted for in this reserve:

- gains and losses on the realisation of investments;
- expenses and finance costs, together with the related taxation effect, charged to this reserve in accordance with the above policies;
- transfers to the redemption reserve;
- realised gains and losses on transactions undertaken to hedge an exposure of a capital nature.

Capital reserve – unrealised

The following are accounted for in this reserve:

- increases and decreases in the valuation of investments held at the year-end;
- unrealised gains and losses on transactions undertaken to hedge an exposure of a capital nature.

### g) Redemption reserve

The redemption reserve has been set up to provide for the repayment entitlements attached to the Zero Dividend Preference Shares which accrue on a monthly basis to the date of the Company's winding up on 26 March 2004. These shares are entitled to repayment of 126.75p initially on winding-up, increasing on a monthly basis by 8.78 per cent per annum compounded annually. Transfers are made to the redemption reserve from the capital reserve realised.

### h) Foreign currency

Transactions denominated in foreign currencies are recorded in the local currency at actual exchange rates as at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the year end are reported at the rates of exchange prevailing at the year end or, where appropriate, at the rate of exchange in a related forward exchange contract. Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included as an exchange gain or loss in capital reserve or in the revenue account depending on whether the gain or loss is of a capital or revenue nature respectively.

## Notes to the Accounts

### 1. Accounting Policies (continued)

#### (i) Rates of exchange

	31 May 2000	31 May 1999
Euro	1.6117	1.5381

### 2. Income

	2000 £'000	1999 (restated) £'000
<b>Income from investments</b>		
Listed on the London Stock Exchange	3,158	3,177
<b>Other income</b>		
Deposit interest	131	361
Other income	1	1
	132	362
<b>Total income</b>	<b>3,290</b>	<b>3,539</b>
<b>Total income comprises:</b>		
Dividends	3,095	3,098
Interest from investments	63	79
Other income	132	362
	3,290	3,539
<b>Income from investments:</b>		
Franked investment income	3,087	2,682
UK unfranked investment income	71	79
Foreign income dividends	–	387
Stock dividends	–	29
	3,158	3,177

### 3. Investment management fee

	Revenue £'000	2000 Capital £'000	Total £'000	Revenue £'000	1999 Capital £'000	Total £'000
Investment management fee	334	620	954	324	602	926

The Company's investment manager is Friends Ivory & Sime plc. The contract between the Company and Friends Ivory & Sime plc may be terminated at any date by either party giving one year's notice of termination. Friends Ivory & Sime plc receives a quarterly fee, payable in arrears, equal to 0.2 per cent of total assets less current liabilities. 35 per cent of this fee is charged to revenue. In addition, Friends Ivory & Sime receives an annual fee of £40,000, payable quarterly in arrears, in respect of the provision of secretarial services to the Company.



**4. Other Expenses**

	2000 £'000	1999 £'000
Directors' fees	52	50
Auditors' remuneration for:		
– audit	8	8
– other services to the company	5	6
Other	141	162
	<b>206</b>	<b>226</b>

**Capital**

Expenses in relation to the liquidation of Optimum 1	–	11
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The remuneration of the Chairman, the highest paid Director, was £14,250, and that of each of the other four Directors was £9,500.

**5. Tax on ordinary activities**

	Revenue £'000	2000 Capital £'000	Total £'000	Revenue £'000	1999 Capital £'000	Total £'000
UK corporation tax at 30%	32	(32)	–	77	(77)	–
Overseas tax	2	–	2	1	–	1
Section 242 claim	–	–	–	30	31	61
	<b>34</b>	<b>(32)</b>	<b>2</b>	<b>108</b>	<b>(46)</b>	<b>62</b>

**6. Dividends**

	2000 £'000	1999 £'000
Dividends on equity shares:		
– ordinary – first interim 1.90p per share (1999: 1.85p)	669	652
– ordinary – second interim 1.90p per share (1999: 1.85p)	669	652
– ordinary – third interim 1.925p per share (1999: 1.875p)	678	660
– ordinary – fourth interim 1.975p per share (1999: 1.875p)	696	660
	<b>2,712</b>	<b>2,624</b>

The fourth interim dividend is payable on 25 August 2000 to ordinary shareholders on the register at the close of business on 11 August 2000.

## Notes to the Accounts

### 7. Return per ordinary share

	Revenue £'000	2000 Capital £'000	Total £'000	Revenue £'000	1999 Capital £'000	Total £'000
Basic	7.71p	(6.16)p	1.55p	8.18p	(14.52)p	(6.34)p

Basic revenue return per Ordinary Share is based on the net revenue on ordinary activities after taxation of £2,716,000 (1999: £2,881,000), and on 35,223,639 (1999: 35,223,639) Ordinary Shares, being the weighted average number of Ordinary Shares in issue during the period.

Basic capital return per Ordinary Share is based on net capital losses for the financial year of £2,170,000 (1999: loss of £5,113,000) and on 35,223,639 (1999: 35,223,639) Ordinary Shares, being the weighted average number of Ordinary Shares in issue during the period.

### 8. Investments

	2000 £'000	1999 £'000
Investments listed on a recognised investment exchange	102,613	100,169
Total listed investments	102,613	100,169
		2000 Listed and Total £'000
Opening book cost		76,613
Opening unrealised appreciation		23,556
Opening valuation		100,169
Movements in the period:		
Purchases at cost		19,644
Sales – proceeds		(20,283)
– realised gains on sales		5,376
Decrease in unrealised appreciation		(2,293)
Closing valuation		102,613
Closing book cost		81,350
Closing unrealised appreciation		21,263
		102,613
	2000 £'000	1999 £'000
Realised gains/(losses) on sales of investments	5,376	(1,060)
(Decrease)/increase in unrealised appreciation	(2,293)	660
Gains/(losses) on investments	3,083	(400)

**8. Investments (continued)****Market price risk**

The management of market price risk is part of the fund management process and is typical of equity investment. The portfolio is managed with an awareness of the effects of adverse price movements through detailed and continuing analysis with an objective of maximising overall returns to shareholders. Further information on the investment portfolio is set out on pages 8 and 9. No derivatives are used.

**Interest rate risk****Floating rate**

When the Company retains cash balances the majority of the cash is held on a deposit account yielding a higher rate of interest than a current account, which the remainder of the cash is held in, for the day-to-day running of the Company. The Company's policy is to invest in UK equities and equity-related securities.

The benchmark rate which determines the interest received on cash balances held is the bank base rate which was 6.0 per cent as at 31 May 2000. Interest rate sensitive assets and liabilities were all denominated in sterling at 31 May 2000 and 31 May 1999.

**Fixed rate**

The Company may from time to time hold fixed interest investments.

At 31 May 2000, the Company held:

	2000 £'000	1999 £'000	Average interest rate	Period until maturity
De Vere Group 7% Convertible Bonds	875	943	7%	3.3 years
Williams 8% CCRP	1,147	1,265	8%	8.1 years

It is the responsibility of Friends Ivory & Sime's dealing department to monitor and maximise the level of interest rates being applied to cash balances.

**Liquidity risk**

In respect of liquidity risk, the Company's assets comprise mainly realisable securities and cash at bank.

**9. Debtors**

	2000 £'000	1999 £'000
Due from brokers	440	294
Tax recoverable	25	39
Prepayments and accrued income	442	527
Other debtors	—	2
	<b>907</b>	<b>862</b>

**10. Creditors: amounts falling due within one year**

	2000 £'000	1999 £'000
Due to brokers	635	600
Dividend	696	660
Other creditors	311	313
	<b>1,642</b>	<b>1,573</b>

**11. Called-up share capital**

	2000 £'000	1999 £'000
<b>Authorised: as at 31 May 2000</b>		
60,000,000 Ordinary Shares of 10p each	6,000	6,000
60,000,000 Zero Dividend Preference Shares of 100p each	60,000	60,000
<b>Allotted, called-up and fully-paid as at 31 May 2000</b>		
35,223,639 Ordinary Shares of 10p each	3,522	3,522
35,223,639 Zero Dividend Preference Shares of 100p each	35,224	35,224
	<b>38,746</b>	<b>38,746</b>

**Rights attaching to the Ordinary Shares and Zero Dividend Preference Shares****Income**

The Ordinary Shares carry the right to receive the revenue profits of the Company (including accumulated revenue reserves) available for distribution and resolved to be distributed by way of interim or final dividend at such times as the Directors may determine.

The Zero Dividend Preference Shares carry no rights to receive dividends out of the revenue or any other profits of the Company.

**Capital**

On a winding-up or other return of assets of the Company, the assets of the Company available for distribution to shareholders after payment of all debts and satisfaction of all liabilities of the Company (including the costs of winding-up, if appropriate) will be applied as follows (and, in each case, distributed among the holders of shares of each class rateably according to the amounts paid or credited as paid up on such shares held by them):

- (i) first, there shall be paid to the holders of the Zero Dividend Preference Shares an amount equal to 126.75p per Zero Dividend Preference Share as increased on the 26th day of each month at a rate of 8.78 per cent per annum (compounding annually on 26 March in each year from 1998 to 2004), the first such increase occurring on 26 April 1997 (in respect of the period from 26 March 1997) and the last on 26 March 2004; and
- (ii) secondly, there shall be paid to the holders of Ordinary Shares all further surplus assets of the Company available for distribution.

**12. Reserves**

	Share premium account £'000	Redemption reserve £'000	Capital reserve— realised £'000	Capital reserve— unrealised £'000	Revenue reserve £'000
At 31 May 1999	40,607	18,348	(19,429)	23,556	828
Net gain on sales of investments			5,376		
Decrease in unrealised appreciation				(2,293)	
Exchange losses			(2)		
Capital dividends			38		
Management fees charged to capital			(620)		
Taxation			32		
Transfer to redemption reserve		4,701	(4,701)		
Retained net revenue for the period					4
At 31 May 2000	40,607	23,049	(19,306)	21,263	832

**13. Net asset value per share**

The net asset value per share and the net asset values attributable to each class of share at the year end calculated in accordance with their entitlements in the Articles of Association were as follows:

	Net asset value per share attributable	Net asset value per share attributable
	2000 p	1999 p
Ordinary Shares	133.20	139.35
Zero Dividend Preference Shares	165.44	152.09

The movements during the period of the assets attributable to the Ordinary Shares and the Zero Dividend Preference Shares were as follows:

	Ordinary Shares (basic) £'000	Zero Dividend Preference Shares £'000	Total £'000
Total net assets attributable at beginning of year	49,084	53,572	102,656
Total recognised gains and losses for the year	546	4,701	5,247
Dividend appropriated in the year	(2,712)	–	(2,712)
Total net assets attributable at end of year	46,918	58,273	105,191

Basic net asset value per Ordinary Share is based on net assets, and on 35,223,639 Ordinary Shares, being the number of Ordinary Shares in issue at the year end (1999: 35,223,639).

Basic net asset value per Zero Dividend Preference Share is based on net assets, and on 35,223,639 Zero Dividend Preference Shares, being the number of Zero Dividend Preference Shares in issue at the year end (1999: 35,223,639).

**14. Reconciliation of movements in total shareholders' funds**

	2000 £'000	1999 £'000
Total shareholders' funds at 31 May 1999	102,656	103,190
Total recognised gains and losses before dividends and other appropriations	5,247	2,090
Dividends payable in respect of equity shares	(2,712)	(2,624)
Total shareholders' funds at 31 May 2000	105,191	102,656

**15. Reconciliation of return on ordinary activities before tax to net cash inflow from operating activities**

	2000 £'000	1999 £'000
Return on ordinary activities before tax	2,750	2,989
Stock dividends	–	(47)
Decrease/(increase) in accrued income	85	(154)
Decrease in other creditors	(2)	(2)
Decrease in other debtors	2	46
Investment management fee charged to capital	(620)	(602)
Tax on investment income	(13)	(13)
	<b>2,202</b>	<b>2,217</b>

**16. Analysis of changes in net funds**

	At 31 May 1999 £'000	Cash Flow £'000	Currency Movement £'000	At 31 May 2000 £'000
Cash at bank and in hand	3,198	117	(2)	3,313

**17. Financial instruments**

During the course of the year the Company held fixed asset investments and cash balances. The Company holds financial assets to invest in UK equities and equity-related securities quoted on the London Stock Exchange. Fixed asset investments held (see note 8) are valued at middle market prices which equate to their fair values. The fair value of all other financial assets and liabilities is represented by their carrying value in the Balance Sheet. Short term debtors and creditors are excluded from disclosure as allowed by FRS 13, other than for currency disclosures.

**18. Foreign currency risk**

The Company invests in overseas securities and holds foreign currency cash balances, which give rise to currency risks. It is not the Company's policy to hedge this risk on a continuing basis but it may do so from time to time.

Foreign currency exposure at 31 May 2000:

	2000 £'000	1999 £'000
Euro – investments	255	1,386
	<b>2000 £'000</b>	<b>1999 £'000</b>
Euro – cash	2	–

## Directors' Responsibility Statement and Auditors' Report

### Directors' Responsibility Statement

The Directors are required by law to prepare accounts for each financial period which give a true and fair view of the state of affairs of the Company as at the end of the financial period and of the revenue of the Company for that period.

They are also responsible for ensuring that adequate accounting records are maintained and that the assets of the Company are safeguarded and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The accounts have been prepared on a going concern basis, appropriate accounting policies have been used and consistently applied and reasonable and prudent judgements and estimates have been made in the preparation of the accounts. Applicable UK accounting standards have been followed.

### Auditors' Report to the Shareholders of Ivory & Sime Optimum Income Trust plc

We have audited the accounts on pages 18 to 28 which have been prepared under the historical cost convention modified to include the revaluation of fixed asset investments and on the basis of the accounting policies set out on pages 21 and 22.

#### Respective Responsibilities of Directors and Auditors

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

We report to you our opinion as to whether the accounts give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the Directors' Report is not consistent with the accounts, 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 the information specified by law or the Listing Rules regarding Directors' remuneration and transactions with the Company is not disclosed.

We review whether the corporate governance statement on pages 15 and 16 reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of either the Company's corporate governance procedures or its risk and control procedures.

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

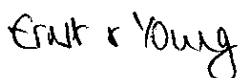
#### Basis of Audit Opinion

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 accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the accounts 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 accounts are free from material mis-statement, 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 accounts.

#### Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the Company as at 31 May 2000 and of the revenue of the Company for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



ERNST & YOUNG  
Registered Auditor  
Edinburgh  
24 July 2000

## Notice of Annual General Meeting

Notice is hereby given that the Third Annual General Meeting of Ivory & Sime Optimum Income Trust plc will be held at the offices of Friends Ivory & Sime plc, One Charlotte Square, Edinburgh on 24 August 2000 at 12.00 noon for the following purposes:

### Ordinary Business

1. That the Report and Accounts for the year ended 31 May 2000 be received.
2. To re-elect Mr R A Hammond-Chambers, a Director retiring by rotation under the Articles of Association.
3. To re-elect Mr A W Downie, a Director retiring by rotation under the Articles of Association.
4. To re-appoint Ernst & Young as the Company's Auditors and to authorise the Directors to fix their remuneration.
5. That the Directors be and they are hereby empowered, pursuant to section 95(1) of the Companies Act 1985 (the 'Act') but subject to article 4.4 of the Articles of Association of the Company, to allot equity securities (as defined in section 94(2) of the Act) for cash, pursuant to the authority under section 80 of the Act conferred on the Directors by an ordinary resolution of the Company passed on 26 August 1998 (the 'Section 80 Authority'), as if section 89(1) of the Act did not apply to any such allotment, up to 3,522,363 Ordinary Shares of 10p each and 3,522,363 Zero Dividend Preference Shares of 100p each, such power to expire at the end of the Annual General Meeting of the Company held in 2001 (or, if earlier, on the revocation of the Section 80 Authority), unless previously revoked, varied or extended by the Company in general meeting, save that the Company may at any time prior to the expiry of such power make an offer or enter into an agreement which would or might require equity securities to be allotted after the expiry of such power and the Directors may allot equity securities in pursuance of such an offer or agreement as if such power had not expired.

By Order of the Board

Friends Ivory & Sime plc  
Secretary  
24 July 2000

### Notes

1. *Explanatory note to Resolution 5.*  
Resolution No. 5 (which will be proposed as a special resolution) contains a disapplication of pre-emption rights on the issue of Ordinary Shares and Zero Dividend Preference Shares for cash that would otherwise exist for Shareholders under section 89(1) of the Act. The disapplication is, however, limited to 3,522,363 Ordinary Shares and 3,522,363 Zero Dividend Preference Shares, each representing 10 per cent of its respective class of issued share capital of the Company as at 24 July 2000. The disapplication will last until the date of the Annual General Meeting in 2001.  
Resolution No. 5 is subject to the Company's Articles of Association. Accordingly, no new shares will be allotted pursuant to Resolution No. 5 unless they are issued simultaneously in the ratio of 1 Ordinary Share to 1 Zero Dividend Preference Share and at prices such that the aggregate cash consideration received on their issue (net of issue expenses) is not less than the aggregate net asset value of the equivalent number of Ordinary Shares and Zero Dividend Preference Shares in issue at the time the allotment of the new shares is approved by the Directors. In addition to satisfying those requirements, the Directors will only allot shares pursuant to the authority and power conferred by Resolution No. 5 if they believe, at the time of such allotment, it is in the interests of Shareholders generally to do so.
2. A holder of Ordinary Shares entitled to attend and vote at the above meeting is entitled to appoint one or more proxies to attend and, on a poll, vote instead of him. A proxy need not also be a member.
3. A form of proxy is enclosed for use at the above meeting. To be effective, the form of proxy, duly executed, must be lodged at the address shown on the form of proxy not later than 48 hours before the meeting.
4. To have the right to attend and vote at the meeting referred to above (and also for the purposes of calculating how many votes a holder of Ordinary Shares may cast), a holder of Ordinary Shares must have his or her name entered in the register of members by not later than 12.00 noon on 22 August 2000. Changes to entries on that register after that time shall be disregarded in determining the rights of any holders of Ordinary Shares to attend and vote at the meeting referred to above.
5. Holders of Zero Dividend Preference Shares are not entitled to attend or vote at the above meeting.
6. No Director has a contract of service with the Company.



% of Ordinary Shares held at 31 May 2000

**Annual General Meeting**

The Annual General Meeting of Ivory & Sime Optimum Income Trust plc will be held at One Charlotte Square, Edinburgh on 24 August 2000.

**Dividends**

Ordinary dividends are paid quarterly in August, November, February and May each year. Shareholders who wish to have dividends paid directly into a bank account rather than by cheque to their registered address can complete a mandate form for the purpose. Mandates may be obtained from Lloyds TSB Registrars, 117 Dundas Street, Edinburgh EH3 5ED on request.

**Share Prices**

The Company's Ordinary Shares are listed on the London Stock Exchange under 'Investment Companies'. Prices are given daily in the *Financial Times*, *The Scotsman* and other newspapers.

**Change of Address**

*Communications with shareholders are mailed to the address held on the share register.* In the event of a change of address or other amendment this should be notified to Lloyds TSB Registrars, under the signature of the registered holder.

**Daily Net Asset Value**

The net asset value of the Company's shares can be obtained by contacting Friends Ivory & Sime Customer Services on 0845 600 6166.



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

## Investment Services to Shareholders

### **ZeroCharge™ investment plans and ISAs**

We have recently introduced a number of cost-effective plans which will allow you to invest in the shares of Ivory & Sime Optimum Income Trust plc without incurring any initial, annual or exit plan charges. All the running costs of the plans are borne by Ivory & Sime Optimum Income Trust plc itself. Cost-effective, tax-efficient and flexible, the ZeroCharge™ investment plans include:

- An Individual Savings Account, for both lump sums and regular savings;
- PEP Transfer Plans where you can transfer your existing PEP investments without affecting their tax status; and
- An Investment Plan, for both lump sums and regular savings.

For more information on any of these plans, please call the Customer Services team on 0845 600 6166 (7 days a week, 24 hours a day) or visit the website, [www.itszerocharge.co.uk](http://www.itszerocharge.co.uk).

### **Friends Provident Investments Products**

We also have a range of products available through Friends Provident Investments which are designed to enable investors to build shareholdings in Ivory & Sime Optimum Income Trust plc. These include a managed portfolio service offering a free lifetime guarantee.

Please contact your independent financial adviser for further information on any of these products.

*Ivory & Sime Optimum Income Trust plc is managed by Friends Ivory & Sime plc which is regulated by IMRO. Past performance is not necessarily a guide to future performance. Stockmarkets and currency movements may cause the value of investments and the income from them to fall as well as rise and investors may not get back the amount they originally invested. Where investments are made in emerging markets, unquoted securities or smaller companies, their potential volatility may increase the risk to the value of, and the income from, the investment. All sources Friends Ivory & Sime plc unless otherwise stated.*

### **Financial Calendar**

24 August 2000	Annual General Meeting
25 August 2000	Payment of fourth interim dividend
November 2000	Payment of first interim dividend
December 2000	Announcement of interim results and posting of interim report for the six months ending 30 November 2000
February 2001	Payment of second interim dividend
May 2001	Payment of third interim dividend
July 2001	Announcement of annual results for the year ending 31 May 2001
August 2001	Posting of annual report and accounts for the year ending 31 May 2001

**Directors**

R A Hammond-Chambers (Chairman)  
S Coke  
A W Downie  
A R Irvine  
P N B Kennedy

**Registered Office**

One Charlotte Square  
Edinburgh EH2 4DZ  
Tel No. 0131-465 1000  
Telex No. 727242  
Facsimile No. 0131-225 2375

**Secretaries**

Friends Ivory & Sime plc  
One Charlotte Square  
Edinburgh EH2 4DZ

**Investment Managers**

Friends Ivory & Sime plc  
One Charlotte Square  
Edinburgh EH2 4DZ

**Friends Ivory & Sime Customer**

**Services**  
One Charlotte Square  
Edinburgh EH2 4DZ  
Tel No. 0845 6006166

**Registrars and Transfer Office**

Lloyds TSB Registrars Limited  
117 Dundas Street  
Edinburgh EH3 5ED  
Registrar's Shareholder Helpline  
Tel No. 0870 6015366

Registrar's Broker Helpline  
Tel No. 0906 5596025

**Auditors**

Ernst & Young  
Ten George Street  
Edinburgh EH2 2DZ

**Brokers**

Warburg Dillon Read  
1 Finsbury Avenue  
London EC2M 2PA

**Solicitors**

Shepherd & Wedderburn WS  
Saltire Court  
20 Castle Terrace  
Edinburgh EH1 2ET

**Bankers**

Chase Manhattan Bank  
Woolgate House  
Coleman Street  
London EC2P 2HD