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2002

Edinburgh Dragon Trust plc

Annual Report and Accounts 31 August 2002



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Company Summary

Objective	To achieve long term capital growth through investment in the Far East. The company's benchmark index is the MSCI All Country Asia Free (ex Japan) Index. Investments are made in stock markets in the region, with the exception of Japan and Australasia, principally in large companies. When appropriate, the trust will utilise gearing to maximise long term returns.
Benchmark	MSCI All Country Asia Free (ex Japan) Index.
Investment manager	Edinburgh Fund Managers plc, investment manager to 11 investment trusts valued at around £1.6 billion. Total assets managed by the group are in the region of £4.7 billion.
Equity shareholders' funds	£158.7 million at 31 August 2002.
Capital structure	226,628,835 ordinary shares of 20p each, 10,648,040 warrants (which may be exercised at 60p on 31 January in any of the years 2003 to 2005).
Management fee	0.25% per quarter of the total net assets (after excluding commonly managed funds and 50% of the value of investment funds managed by other advisers). The management agreement is terminable by either party on one years' notice.
ISA status	The company's shares are eligible for Individual Savings Accounts (ISAs).
AITC	The company is a member of The Association of Investment Trust Companies.

Financial Summary

	2002	At 31 August 2001	% change
Performance			
Equity shareholders' funds	£158.7m	£165.2m	-3.9
Capital return			
Net asset value per share	69.95p	72.80p	-3.9
MSCI All Country Asia Free (ex Japan) Index in Sterling terms	125.60	126.47	-0.7
Share price	57.75p	57.75p	—
Warrant price	13.00p	15.50p	-16.1
Revenue return per share	(0.49p)	(0.24p)	
Gearing			
Actual gearing ratio	15.7%	6.5%	
Maximum potential	42.4%	39.7%	
Discount			
Level of discount at which the shares trade:			
to the adjusted net asset value	17.4%	20.7%	
to the adjusted diluted net asset value	16.9%	20.0%	
Expense ratio			
– as % of average total assets less current liabilities	1.0%	1.0%	
– as % of average shareholders' funds	1.4%	1.3%	
Year's Highs/Lows			
	High	Low	
Net asset value	85.18p	56.94p	
Share price	71.75p	42.50p	
Warrant price	27.00p	9.50p	
Discount	14.2%	25.4%	

Chairman's Statement

Over the past year Edinburgh Dragon Trust's net asset value has declined by 3.9% from 72.80p to 69.95p. In comparison its benchmark, the MSCI All Country Asia Free (ex Japan) Index ('MSCI'), has fallen by 0.7% in sterling terms. The underperformance was due to an underweight position in technology companies, principally Samsung Electronics and Taiwan semi-conductors stocks which performed strongly in the first half of the year under review. The share price has remained unchanged over the year reflecting a narrowing of the discount.

Tony Cassidy

Over the past year the modest decrease in the MSCI Index masks considerable volatility in markets and share prices. Following the events of 11 September, Asian markets fell to levels comparable to the depth of the Asian crisis in 1998. However, over the next six months, the region's markets staged a remarkable comeback in anticipation of a vigorous global economic recovery. From trough to peak, this rally measured some 56%. As expectations of economic and corporate growth were reduced to more realistic levels, share prices encountered profit taking and since May, the MSCI Index has declined by around 20%.

Revenue account

Gross revenue has fallen from £6.9 million to £6.0 million due mainly to a fall of £1.3 million in interest receivable. The reduction in deposit interest was due to lower levels of liquidity following the increase in gearing and the reduction in interest rates. The reduction in expenses from £2.6 million to £2.2 million reflects lower investment management fees which are calculated on the value of net assets.

The net result is that the revenue deficit per share after taxation, has risen from 0.24p to 0.49p. In line with our investment objective, it is again proposed that no dividend be paid.

Marketing initiatives

The company is a member of the Association of Investment Trust Companies (AITC) and contributes towards the campaign to raise awareness to potential investors of the attractions of investment trusts. In the year under review the company contributed £11,000 to the campaign.

The board continues to promote the company by participating with other investment trusts managed by Edinburgh Fund Managers in the managers Investment Trust Initiative which provides a range of savings products, including ISA and Pension Schemes, in a cost effective manner. Shareholders can receive up to date information on recent performance and the trust's strategy on the manager's website, www.edfd.com.

Change of Portfolio Manager

Jeremy Whitley took over as portfolio manager from Alistair Thompson in September 2002. Jeremy had been Alistair's deputy and the trust will continue to be run with the same investment philosophy and similar style.

Future prospects

Asian markets have spent the last year trying to decouple from the US market. To that end, it is encouraging to note that Asia, in falling 0.7%, did better than global markets which fell 20.2% as measured by the MSCI World Index.

One reason for this better relative performance is that Asia, having suffered its deflationary crisis four years ago, is now in a stronger position to withstand another significant fall in confidence. It is now clear that poor corporate governance, unorthodox accounting practices, mistreatment of minority shareholders and fraud are confined not just to emerging markets. Asia has been punished for its past excesses and, on most valuation measures, still trades at a steep discount to developed markets. However, many Asian corporates have emerged

Chairman's Statement

from the crisis with restructured balance sheets, access to lower cost capital and more proactive and transparent management. As a result, discounts between Asian and Western corporate valuations are expected to narrow over the next few years.

Given the difficulty in predicting the likely strength of any global economic recovery, we believe the future performance of the Asian markets will be more dependent on specific global and domestic issues. The short term direction of the markets will be dependent on their response both to events in the Middle East and to the monetary policies adopted by the region's central bankers to cope with the ongoing threat of deflation and lack of investment.

A more positive case can be made for growth in Asian markets in the longer term. First, both Korea and Thailand have started new credit cycles brought about by low interest rates and increased domestic demand, with Malaysia not far behind. The younger generation appear more willing to spend their savings than their more thrifty forefathers. Second, enforced cost cutting by global corporates should ensure a steady stream of new orders and production facilities being redirected to the low cost manufacturing bases located across Asia, particularly in China. Finally, as the risk profile of Asian markets improves, they should attract a greater share of global capital, which would be highly beneficial for future returns.

With favourable demographics, increasing consumer confidence and strong economic growth, the prospects for the Asian stock markets over the next few years are encouraging.

Tony Cassidy
Chairman

18 October 2002

In aggregate, Asian markets were flat over the year. Of the ten major Asian markets, only two, Korea and Thailand, posted positive returns in sterling terms. Korea rose 48% whilst Thailand rose only 1%. The other eight markets showed negative returns. The traditional safe haven markets in times of increased volatility, Hong Kong and Singapore, fell 18% and 13% respectively. The Philippine market fell 27%. As a result, the key driver of performance in Asia over the year was Korea and the key driver of the Korean market was Samsung Electronics. Any portfolio that did not hold Samsung Electronics would have found it difficult to outperform the index – the portfolio was specifically hindered by its underweight position in Samsung Electronics.

However, Asian markets did better than their Western counterparts with the US and European markets all posting significant negative returns over the period. A strong case can be made for the continuing relative outperformance of Asian markets over Western markets over the next few years.

During the year the key asset allocation switches involved taking money out of Hong Kong (reduced from 23.2% to 13.8%), Singapore (reduced from 11.5% to 5.2%) and Taiwan (reduced from 11.3% to 6.7%) and redeploying the proceeds into Korea (increased from 8.1% to 25.3%), Malaysia (increased from 3.7% to 7.4%) and Thailand (increased from 2.9% to 7.8%). In essence, these moves reallocated capital from countries prone to structural inefficiencies caused by deflation and government intermediation to countries liable to benefit from greater consumer confidence and increased domestic demand.

Performance

The trust underperformed the benchmark index. The MSCI All Country Asia Free (ex Japan) Index fell 0.7%, whilst the net asset value fell 3.9% in sterling terms.

The two bright areas of the portfolio in terms of positive contribution have been China and Thailand. For some time, the manager has held a negative view

Jeremy Whitley

on the prospects for Hong Kong believing it unlikely that the Territory would be able to resist the continued deflationary cycle that has persisted for the past four years. On the other hand, prospects for China appear much brighter although given the increased risks, stock selection has assumed even greater importance. The portfolio has benefited from the manager's long held view that better economic prospects in Thailand should be played through the higher growth stocks to be found in the financial and property sectors.

The trust suffered from poor stock selection in Korea, Taiwan and India.

Portfolio activity

Total turnover was £262 million, with purchases outweighing sales by £12 million. This represents the increase in the trust's gearing from 6.5% at the start of the financial year to 15.7% at the end. The changes in the asset distribution table on page 9 detail the turnover for each market.

Outlook and strategy

The short term direction of the Asian markets will likely be dictated by a number of factors. These include the markets' reaction to ongoing events in the Middle East and its impact on the price of oil, the response of central bankers to a profitless and muted economic recovery in the West and the threat of continuing deflationary pressures across the globe.

Key to the longer term performance of the markets is whether Asia can either distance itself from these threats or indeed benefit from them. Eighteen

Manager's Review

Performance Attribution

Analysis for the year ended 31 August 2002

	%
Decrease in Net Asset Value	(3.9)
Decrease in MSCI A/C Asia Free ex Japan Index	(0.7)
Difference	(3.2)

Difference attributable to:	Currency %	Asset Allocation %	Stock Selection %	Total %
Hong Kong equities	0.2	(0.9)	0.0	(0.7)
China equities	(0.3)	2.1	2.1	3.9
Singapore equities	(0.1)	(0.5)	(0.1)	(0.7)
Taiwan equities	0.1	0.6	(1.2)	(0.5)
Malaysian equities	(0.2)	1.3	0.0	1.1
Indian equities	0.1	(0.2)	(2.0)	(2.1)
South Korean equities	0.4	(1.5)	(2.3)	(3.4)
Thailand equities	0.1	1.5	0.9	2.5
Unit trusts	0.0	(0.1)	0.0	(0.1)
Philippines equities	0.0	0.1	0.2	0.3
Other equities	0.1	0.0	0.0	0.1
Total equities	0.4	2.4	(2.4)	0.4
Borrowings	0.4	1.9	—	2.3
Cash	1.3	(7.2)	—	(5.9)
Net assets	2.1	(2.9)	(2.4)	(3.2)

months after the onslaught of the Asian crisis, markets rallied excessively as Asian corporates discovered that the US export market still had an insatiable desire for its products. There exists now a significant risk that this demand could soon be choked off.

Global markets have spent the past year contemplating whether or not businesses will start investing again before the US consumer realises that his personal balance sheet is too highly leveraged and decides to stop consuming. Should this occur, Asian corporates would have to rely on one of two

things happening. The first is that Asian governments can and will continue to provide a domestic monetary environment that actively encourages a feeling of well being that induces consumer spending. This would enable Asia to distance itself from what might be taking place in the West. The second is that US and European companies will sufficiently feel the need to cut costs and either initiate or expand plans to outsource their orders to lower cost production facilities located in Asia. This would be a case of Asia benefiting from the West's problems.

The trust's strategy is twofold:

- First, to identify and invest in well-managed companies which should profit from four key factors at work across Asia. These factors should contribute to driving sustainable economic growth in the region. They include the presence of low interest rates, the easy availability of finance, low unemployment and rising consumer confidence. Together these factors are encouraging consumers to utilise their historic high savings rates. The trust is playing this dynamic trend through investing in companies providing consumer related services such as banking, autos, housing and construction. Alternatively, the trust has invested in companies with a niche product or a specific competitive advantage. These investments include holdings in the Chinese oil, technology and retail sectors.
- Second, and a strategy which receives too little attention, is to avoid those companies and sectors which are susceptible to misallocation of capital, to intense competitive pressure or to prolonged and unavoidable deflationary forces. The trust has few investments in areas where there exists a surplus of excess capacity or a lack of pricing power. For example, this would include the property sector in Hong Kong or the technology arena in general. Hong Kong remains mired in a deflationary cycle that has already lasted for four years with few signs of a catalyst to initiate a change in consumer confidence.

Manager's Review

Likewise, a sustainable pick up in demand for computing and telecommunications equipment seems unlikely given the excessive levels of overcapacity that have been built up in these sectors in recent years. As a recent leader in the Financial Times put it: "the job of clearing up after the last party is still half-done. The next one cannot begin until it is finished."

Given the short term uncertainty surrounding the global equity markets, characterised by a heightened level of volatility, the trust's gearing is currently under utilised. Should Asian markets retreat to below fair value on the back of prolonged equity falls elsewhere in the world, the manager would consider utilising fully the potential gearing of the trust.

Edinburgh Fund Managers plc

18 October 2002

Changes in Asset Distribution

Country	Value at 31 August 2001 £000	Purchases £000	Sale Proceeds £000	Appreciation (depreciation) £000	Value at 31 August 2002 £000
China	23,234	14,616	15,879	2,932	24,903
Hong Kong	53,422	20,060	35,668	(7,586)	30,228
India	11,143	5,599	7,245	(3,465)	6,032
Indonesia	—	2,325	—	(212)	2,113
South Korea	18,647	44,346	11,740	4,475	55,728
Malaysia	8,555	12,843	5,311	112	16,199
Phillipines	14	—	—	(7)	7
Singapore	26,498	3,170	15,994	(2,136)	11,538
Taiwan	25,999	19,408	26,160	(4,491)	14,756
Thailand	6,665	13,799	6,637	3,398	17,225
Other	1,517	—	1,406	(111)	—
Total investments	175,694	136,166	126,040	(7,091)	178,729
Net current assets	54,781	—	—	(13,575)	41,206
Total assets less current liabilities	230,475	136,166	126,040	(20,666)	219,935

Ten Year Record

Year ended 31 August	Equity shareholders' interest £000	Net asset value per ordinary share p	Revenue return per ordinary share p	Ordinary share price p	Share price discount %	Expenses as a % of average shareholders' funds
1993	225,016	85.44	0.05	79.00	7.5	1.4
1994	331,716	125.64	(0.02)	113.25	9.9	1.4
1995	282,358	106.84	0.04	105.25	1.5	1.1
1996	282,386	104.34	(0.48)	93.25	10.6	1.3
1997	240,151	88.72	(0.33)	73.50	17.2	1.3
1998	106,353	44.82	0.31	33.75	24.7	1.1
1999	205,476	89.36	(0.37)	71.75	19.7	1.4
2000	244,108	107.39	(1.00)	91.75	14.6	1.4
2001	165,196	72.80	(0.24)	57.75	20.7	1.3
2002	158,707	69.95	(0.49)	57.75	17.4	1.4

Notes:

Net asset value per equity share adjusted for the 4 for 1 share consolidation on 17 November 1993.

With effect from 1 September 1996, 100% of the management fee has been charged to revenue.

Distribution of Investments

at 31 August 2002

	Manufac- turing %	Con- sumer %	Utilities %	Conglom- erates %	Financial %	Property %	Services %	Net current assets %	2002 Total %	2001 Total %
Hong Kong	—	—	3.4	1.3	3.9	1.9	3.3	—	13.8	23.2
Singapore	—	—	—	—	4.5	—	0.7	—	5.2	11.5
Taiwan	6.7	—	—	—	—	—	—	—	6.7	11.3
China	3.1	1.5	1.6	1.9	—	—	3.3	—	11.4	10.1
South Korea	7.6	6.3	2.7	—	8.7	—	—	—	25.3	8.1
India	—	1.9	—	—	0.8	—	—	—	2.7	4.8
Malaysia	2.2	—	1.3	2.5	1.4	—	—	—	7.4	3.7
Thailand	0.6	0.9	—	—	3.2	2.0	1.1	—	7.8	2.9
Indonesia	—	1.0	—	—	—	—	—	—	1.0	—
Other	—	—	—	—	—	—	—	—	—	0.7
Net current assets	—	—	—	—	—	—	—	18.7	18.7	23.7
2002 Total %	20.2	11.6	9.0	5.7	22.5	3.9	8.4	18.7	100.0	100.0
2001 Total %	18.8	5.9	11.7	5.7	19.2	7.7	7.3	23.7	100.0	

Twenty Largest Investments

at 31 August 2002

Company	Market Value £000	Country /Region	Sector Classification
CNOOC	7,194	China	Energy sources
Samsung Electronics	7,121	Korea	Electrical & electronics
Kookmin Bank	6,408	Korea	Banking
United Overseas Bank	6,339	Singapore	Banking
KT Corporation	5,872	Korea	Telecommunications
Samsung Fire and Marine	5,768	Korea	Insurance
Gamuda	5,520	Malaysia	Building materials & components
Hang Seng Bank	5,206	Hong Kong	Banking
Hong Kong Electric	5,039	Hong Kong	Utilities
Perusahaan Otomobil	4,716	Malaysia	Automobiles
Ten largest investments	59,183	26.9% of the total assets less current liabilities	
Hindustan Lever	4,233	India	Food & household products
Cheung Kong Holdings	4,158	Hong Kong	Real estate
United Micro Electronics	4,141	Taiwan	Electric components & instruments
China Merchant Holdings Intl.	4,103	China	Multi-industry
Cathay Pacific Airlines	3,995	Hong Kong	Transport-airlines
Daewoo Shipbuilding and Marine Engineering	3,969	Korea	Machinery & engineering
Bangkok Bank Public Company	3,907	Thailand	Banking
Cheil Jedang	3,880	Korea	Food & household products
Land & House	3,853	Thailand	Real estate
Shinhan Financial Group	3,829	Korea	Financial Services
Twenty largest investments	99,251	45.2% of the total assets less current liabilities	
Other investments (36 investments)	79,478	36.1% of the total assets less current liabilities	
Total value of investments	178,729	81.3% of the total assets less current liabilities	
Net current assets	41,206	18.7% of the total assets less current liabilities	
Total assets less current liabilities	219,935	100.0% of the total assets less current liabilities	

Analysis of Shareholders

at 31 August 2002

% of ordinary shares held by shareholders

Pension funds (35%)

Individuals (19%)

Insurance and
assurance companies (16%)

Overseas (14%)

Unit and investment trusts (8%)

Other institutions (8%)

Capital Gains Tax Information

For capital gains tax purposes, the base costs of an ordinary share and a warrant issued by the company under the Placing (during September 1987) are calculated using the closing prices on the first day of dealings as quoted in the Stock Exchange Daily Official List. The base costs are:

Ordinary share	9.4059p
Warrant	2.9703p

During November 1989, the company issued further ordinary shares of 5p each and warrants 2005 under Placing and Open Offer. The base costs, using the closing prices on the first day of dealing, are:

Ordinary share	11.4300p
Warrant 2005	5.3502p

The above prices do not take account of the share consolidation which took place on 17 November 1993.

Corporate Information

Registered Office

Donaldson House
97 Haymarket Terrace
Edinburgh EH12 5HD
Telephone: 0131-313 1000

Manager and Secretary

Edinburgh Fund Managers plc
Donaldson House
97 Haymarket Terrace
Edinburgh EH12 5HD
Telephone: 0131-313 1000
Website: www.edfd.com
Regulated by the FSA

Registrar

Lloyds TSB Registrars Scotland
PO Box 28448
Finance House
Orchard Brae
Edinburgh EH4 1WQ
Telephone: 0870-601 5366
Website: www.lloydstsb-registrars.co.uk

Custodian/Banker

Royal Trust Corporation of Canada
71 Queen Victoria Street
London EC4V 4DE

Auditors

KPMG Audit Plc
Saltire Court
20 Castle Terrace
Edinburgh EH1 2EG

Company Brokers

Close WINS

Company Registration Number

SC 106049

Board of Directors

Tony Cassidy

Chairman

Tony Cassidy (57)*, appointed on 12 August 1987, has been associated with business in the Far East and Japan for many years, and has worked in Japan. He has a wide range of experience in economic development and international business cooperation.

Frank Frame

Director

Frank Frame (72)*, appointed on 22 February 1994, was formerly an adviser to the board of HSBC Holdings, deputy chairman of The Hongkong and Shanghai Banking Corporation, chairman of South China Morning Post and a director of Swire Pacific. He is currently chairman of the Wallem Group (of Hong Kong) and a former director of Baxter International Inc.

Adam Fleming

Director

Adam Fleming (54)*, appointed on 25 June 2001, retired as deputy chairman of the investment bank Robert Fleming Holdings in 1999, having spent several years working for associate Jardine Fleming in Hong Kong and Singapore. He is currently chairman of the South African gold mining company, Harmony Gold Mining Co and a director of Merrill Lynch World Mining Trust plc.

the board

Peter Tyrie

Director

Peter Tyrie (56)*, appointed on 5 July 1989, was managing director of Mandarin Oriental Hotel Group until 1989 when he returned to Great Britain to start Balmoral International Hotels. He established Eton Town House Hotels (1998), a venture capital backed company specialising in luxury city centre hotels.

Iain Watt

Director

Iain Watt (57), appointed on 12 August 1987, is the chief executive of Edinburgh Fund Managers Group plc and a Fellow of the Institute of Bankers in Scotland.

*Members of the Audit and Management Engagement Committee

Directors' Report

Business and status

The company carries on business as an investment trust. The company has received requisite approval of that status from the Inland Revenue for accounting periods up to and including 31 August 2001. The directors believe that the company meets the requirements of section 842 of the Income and Corporation Taxes Act 1988 regarding approved investment trust status for the year ended 31 August 2002.

The company is an investment company within the terms of Section 266 of the Companies Act 1985.

Review of activities

During the year the company undertook the normal activities of an investment trust. Details of these are given in the Chairman's Statement and the Manager's Review.

Dividends

The directors recommend that no final dividend be paid (2001–nil).

Directors

The names of the directors who served throughout the year and their holdings in the company's shares are shown in Table 1 below.

Since 31 August 2002, the company has been notified that Mr Watt purchased 99 shares as part of a monthly savings scheme.

Mr Frame, who has attained the age of 72, retires under Section 293(3) of the Companies Act 1985 and offers himself for re-election. Special notice under Section 293(5) of the Companies Act 1985 to propose the re-election of Mr Frame has been received by the company.

Under the terms of appointment, Mr Cassidy and Mr Watt retire from the board at the Annual General Meeting and will be proposed for re-election.

No contract or arrangement subsisted during the period in which any of the directors was materially interested. No director had a service contract with the company.

Payments Policy

The company's payment policy is to ensure settlement of suppliers' invoices in accordance with the stated terms. In certain circumstances, settlement terms are agreed prior to business taking place.

Corporate Governance

Compliance

The company is committed to high standards of corporate governance. The board is accountable to the company's shareholders for good governance and this statement describes how the company applies the principles identified in the Combined Code (appended to the Financial Services Authority Listing Rules).

The board confirms that the company has complied throughout the accounting period with the provisions set out in Section 1 of the Code.

	31 August 2002		31 August 2001	
	Ordinary shares	Warrants	Ordinary shares	Warrants
A F Cassidy	9,238	300	9,238	300
A Fleming	—	—	—	—
F R Frame	8,500	—	8,500	—
P R Tyrie	11,000	—	11,000	—
I A Watt	16,248 [†]	—	16,722 [†]	—

Table 1 Directors and their holdings in the company

[†] of which 1,250 (2001–1,896) ordinary shares are held in trust

Directors' Report

Directors

The board has overall responsibility for the company's affairs. It delegates, through an investment management agreement and specific instructions, the day to day management of the company to the manager, Edinburgh Fund Managers plc. The company has no executive directors or employees. Messrs Cassidy, Fleming, Frame and Tyrie are considered by the board to be independent of the company and the manager and free of any material relationship with the manager which could interfere with the exercise of their independent judgement.

Profiles of the board members appear on page 13 of the annual report. Each director has the requisite range of business and financial experience which enables the board to provide clear and effective leadership and proper stewardship of the company. The board considers that the role of a senior independent director is not appropriate due to the size of the board.

The board meets at least four times each year and more frequently where business needs require. The board has a schedule of matters reserved to it for decision and the requirement for board approval on these matters is communicated directly to the senior staff of the manager. Such matters include strategy, borrowings, treasury and dividend policy. Full and timely information is provided to the board to enable the directors to function effectively and to discharge their responsibilities. The board also reviews the financial statements, performance and revenue budgets.

Appointments to the board of directors are considered by the whole board. Possible new directors are identified against the requirements of the company's business and the need to have a balanced board. External search consultants may be used to ensure that a wide range of candidates can be considered. Every director is entitled to receive appropriate training as deemed necessary.

A director appointed during the year is required, under the provisions of the company's Articles of

Association, to retire and seek election by shareholders at the next annual general meeting. The Articles also require that one third of the directors retire by rotation each year and seek re-election at the annual general meeting. In addition, all directors are required to submit themselves for re-election at least every three years.

Since all directors are non-executive, the company is not required to comply with Principles B.1 to B.3 of the Combined Code in respect of executive directors' remuneration. There is no separate remuneration committee and the board as a whole considers changes in directors' fees on a periodic basis. In setting the directors' fee levels it is the company's policy to take account of fees paid by comparable investment trusts to ensure that the remuneration is sufficient to attract directors of appropriate quality and experience. No director has a service contract and there is no notice period. Directors' fees are detailed in note 5 on page 24; no benefits are provided.

Relations with shareholders

The directors place a great deal of importance on communication with shareholders. The report and accounts are widely distributed to other parties who have an interest in the company's performance. Shareholders and potential investors may obtain up to date information on the company through the manager's freephone information service and the company responds to letters from shareholders on a wide range of issues.

The notice of the annual general meeting included within the annual report and accounts is sent out at least 20 working days in advance of the meeting. All shareholders have the opportunity to put questions at the company's annual general meeting.

Proxy voting as an institutional shareholder

The manager has the right to vote on behalf of the company if they believe it is appropriate.

Accountability and audit

The respective responsibilities of the directors and the auditors in connection with the financial statements appear on pages 18 and 19.

Directors' Report

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

The board confirms that there is an ongoing process for identifying, evaluating and managing the company's significant business and operational risks, that it has been in place for the year ended 31 August 2002 and up to the date of approval of the annual report and accounts, that it is regularly reviewed by the board and accords with the internal control guidance for directors in the Combined Code.

The responsibility to ensure compliance with regulations and company law to provide effective and efficient operation and investment management has been delegated to the manager under the terms of the management agreement.

The board receives reports from the manager covering key performance and risk indicators and considers control and compliance issues brought to their attention. The board's agenda includes a regular item for consideration of risk and control and receives reports thereon from the manager. The emphasis is on obtaining the relevant degree of assurance and not merely reporting by exception.

The manager is responsible for the design, implementation and maintenance of controls and procedures to safeguard the assets of the company

and to manage its affairs properly. The system extends to operational and compliance controls and risk management. Clear lines of accountability have been established between the board and the manager and regular reports on controls and compliance issues are provided to the board. In carrying out its review, the board has had regard to the activities of the manager, the manager's internal audit function and the external auditors.

The directors have appointed an audit and management engagement committee, chaired by Mr Cassidy. The committee considers reports from the external auditors as well as from the manager. The scope and effectiveness of the external audit is also kept under review. The independence and objectivity of the external auditors is also considered on a regular basis, with particular regard to the level of any non-audit fees.

Corporate Governance and Socially Responsible Investment Policy

The directors, through the company's manager, encourage companies in which investments are made to adhere to best practice in the area of Corporate Governance and Socially Responsible Investing. They believe that this can best be achieved by entering into a dialogue with company management to encourage them, where necessary, to improve their policies in both areas.

The manager's ultimate objective however is to deliver superior investment return for their clients. Accordingly, whilst the manager will seek to favour companies which pursue best practice in these areas this must not be to the detriment of the return on the investment portfolio.

Going concern

The directors believe 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.

Holder	No of ordinary shares	%
Lazard Freres Asset Management*	25,769,900	11.4
Derbyshire County Council	9,500,000	4.2
Merseyside Pension Fund	8,000,000	3.5
Co-operative Insurance Society	7,209,927	3.2

Table 2 Substantial share interests

*Non-beneficial interest

Substantial share interests

At 18 October 2002 the substantial interests in the ordinary share capital which had been notified during the period to the company are shown opposite.

Auditors

The company's auditors, KPMG Audit Plc, are willing to continue in office and resolutions will be proposed at the Annual General Meeting to re-appoint them and to authorise the directors to fix their remuneration.

Annual general meeting

Resolutions relating to the following items of special business will be proposed at the forthcoming annual general meeting:-

(i) Authority to allot shares

An ordinary resolution will be proposed to authorise the directors to allot up to 75,542,945 unissued ordinary shares being up to an aggregate maximum nominal amount of £15,108,589. This maximum nominal amount represents 33.3% of the company's total ordinary share capital currently in issue and meets institutional guidelines. These guidelines permit such authorities to be calculated on the basis of one-third of the existing issued share capital.

The authority conferred by this resolution will expire on 1 December 2007.

(ii) Limited disapplication of Pre-emption Provisions

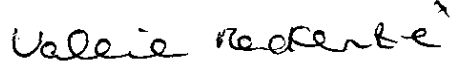
A special resolution will be proposed to give the directors power to allot ordinary shares up to an aggregate nominal amount of £2,266,288, being 5% of the current issued share capital of the company, for cash other than to existing shareholders pro rata to their holdings. Under this authority, ordinary shares would only be issued for cash at a price not less than the net asset value per share. A maximum of £15,108,589 of unissued ordinary share capital may also be allotted for cash pursuant to a rights issue made *pro rata* to shareholders in the future. Ordinary shares would only be issued for cash pursuant to a rights issue at a price not less than the net asset value per share.

The directors consider that the powers proposed to be granted by the resolutions described at (i) and (ii) above are necessary to retain flexibility. Save for the 10% limited disapplication of pre-emption rights which will be used to meet investor demand, the directors do not have any intention of exercising such powers at the present time.

(iii) Purchase of the company's own ordinary shares

A special resolution will be proposed to authorise the company to make market purchases of its own shares. The maximum number of ordinary shares which may be purchased pursuant to the authority shall be 14.99% of the issued share capital of the company as at the date of the passing of the resolution (approximately 33.97 million ordinary shares). The minimum price which may be paid for an ordinary share shall be 25p. The maximum price for an ordinary share (exclusive of expenses) shall be an amount equal to 105% of the average of the middle market quotations for the company's ordinary shares for the five business days immediately preceding the date of purchase.

This authority, if conferred, will only be exercised if to do so would enhance the net asset value and is in the best interests of shareholders generally.

By order of the board, 
Edinburgh Fund Managers plc
Secretary

Edinburgh, 18 October 2002

Statement of Directors' Responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the revenue of the company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable 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 confirm that they comply with all the above requirements. 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 have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and to detect fraud and other irregularities.

Report of the Independent Auditor

Independent auditors' report to the members of Edinburgh Dragon Trust plc

We have audited the financial statements on pages 20 to 35.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report, including as described on page 18 the financial statements. Our responsibilities, as independent auditors, are established 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 opinions as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the company is not disclosed.

We review whether the statement on pages 14 to 16 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the company's corporate governance procedures or its internal controls.

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

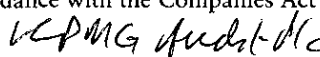
Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group'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 presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company as at 31 August 2002 and of the return for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



KPMG Audit Plc

Chartered Accountants

Registered Auditor

Edinburgh, 18 October 2002

Statement of Total Return

for the year ended 31 August

	Notes	Revenue £000	2002 Capital £000	Total £000	Revenue £000	2001 Capital £000	Total £000
Realised net losses on investments	19	—	(18,167)	(18,167)	—	13,943	13,943
Unrealised gains on investments	18	—	11,076	11,076	—	(90,348)	(90,348)
Currency gains	24	—	1,712	1,712	—	(1,570)	(1,570)
Investment income	2	4,791	—	4,791	4,326	—	4,326
Interest receivable		1,149	—	1,149	2,499	—	2,499
Other income	3	22	—	22	93	—	93
Investment management fee	4	(1,741)	—	(1,741)	(1,925)	—	(1,925)
Administrative expenses	5	(507)	—	(507)	(600)	(50)	(650)
NET RETURN BEFORE FINANCE COSTS AND TAXATION							
		3,714	(5,379)	(1,665)	4,393	(78,025)	(73,632)
Interest payable and similar charges	6	(4,659)	—	(4,659)	(4,844)	—	(4,844)
RETURN ON ORDINARY ACTIVITIES BEFORE TAXATION							
		(945)	(5,379)	(6,324)	(451)	(78,025)	(78,476)
Taxation	7	(165)	—	(165)	(89)	—	(89)
RETURN ATTRIBUTABLE TO EQUITY SHAREHOLDERS AFTER TAXATION							
		(1,110)	(5,379)	(6,489)	(540)	(78,025)	(78,565)
RETURN PER ORDINARY SHARE	8	(0.49p)	(2.37p)	(2.86p)	(0.24p)	(34.42p)	(34.66p)
DILUTED RETURN PER ORDINARY SHARE	8	(0.49p)	(2.37p)	(2.86p)	(0.24p)	(34.13p)	(34.37p)

The revenue column of this statement represents the revenue account of the company.
All revenue and capital items in the above statement derive from continuing operations.

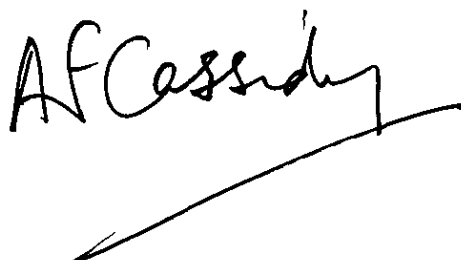
Balance Sheet

at 31 August

	Notes	2002 £000	2001 £000
FIXED ASSETS			
Investments	9	178,729	175,694
CURRENT ASSETS			
Debtors	10	2,586	737
US Treasury Bills	24	19,326	30,840
Cash and short term deposits	23	21,106	24,712
		<u>43,018</u>	<u>56,289</u>
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR			
	11	<u>1,812</u>	<u>1,508</u>
NET CURRENT ASSETS		<u>41,206</u>	<u>54,781</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>219,935</u>	<u>230,475</u>
CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR			
	12	<u>61,228</u>	<u>65,279</u>
		<u>158,707</u>	<u>165,196</u>
CAPITAL AND RESERVES			
Called up share capital	13	45,325	45,325
Share premium	14	26	26
Capital redemption reserve	15	8,752	8,752
Special reserve	16	85,520	85,520
Warrant reserve	17	1,047	1,047
Capital reserve – unrealised	18	(12,242)	(27,851)
Capital reserve – realised	19	35,723	56,711
Revenue reserve	20	(5,444)	(4,334)
TOTAL EQUITY SHAREHOLDERS' FUNDS		<u>158,707</u>	<u>165,196</u>
ADJUSTED NET ASSET VALUE PER SHARE	26	69.95p	72.80p
ADJUSTED DILUTED NET ASSET VALUE PER SHARE	26	69.50p	72.22p

The financial statements on pages 20 to 35 were approved by the board on 18 October 2002 and were signed on its behalf by:

A F CASSIDY, Director



Cashflow Statement

for the year ended 31 August

	Notes	2002 £000	2001 £000
NET CASH INFLOW			
FROM OPERATING ACTIVITIES	21	3,628	4,500
SERVICING OF FINANCE			
Interest paid		(4,688)	(4,847)
NET CASH OUTFLOW			
FROM SERVICING OF FINANCE		(4,688)	(4,847)
TAXATION			
UK income tax received less paid		168	131
Overseas tax paid		(165)	(133)
NET TAX RECOVERED		3	(2)
FINANCIAL INVESTMENT			
Purchase of investments		(135,734)	(202,536)
Sale of investments		124,041	223,548
NET CASH OUTFLOW FROM FINANCIAL INVESTMENT		(11,693)	21,012
NET CASH OUTFLOW BEFORE FINANCING		(12,750)	20,663
MANAGEMENT OF LIQUID RESOURCES	24	10,675	(13,586)
FINANCING			
Buyback of ordinary shares	22	—	(378)
Exercise of warrants	22	—	31
NET CASH OUTFLOW FROM FINANCING		—	(347)
DECREASE IN CASH AND CASH EQUIVALENTS	23	(2,075)	6,730
RECONCILIATION OF NET CASHFLOW TO MOVEMENT IN NET DEBT			
Decrease in cash		(2,075)	6,730
Net change in liquid resources		(10,675)	13,586
Change in net debt			
resulting from cashflows	24	(12,750)	20,316
Amortised Loan Note expenses	24	(31)	(31)
Foreign exchange differences	24	1,712	(1,570)
Movement in net debt in year		(11,069)	18,715
Opening net debt	24	(9,727)	(28,442)
Closing net debt	24	(20,796)	(9,727)

Notes to the Financial Statements

1 Accounting policies

The accounts have been prepared under the historical cost convention, modified to include the revaluation of investments and in accordance with applicable Accounting Standards and with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies'. They have also been prepared on the assumption that approval as an investment trust will continue to be granted.

(a) Revenue, expenses and interest payable – Income from equity investments, including taxes deducted at source, is included in revenue by reference to the date on which the investment is quoted ex-dividend. Interest receivable on fixed interest securities, short term deposits, expenses and interest payable are accounted for on an accruals basis. All of the expenses and interest payable is chargeable to revenue.

(b) Investments – Listed investments are valued at mid market prices, foreign currencies being translated at the rates of exchange ruling at the relevant balance sheet date. Unlisted investments are valued by the directors taking account of latest dealing prices, brokers' valuations and other available accounting information as appropriate.

(c) Foreign currencies – Transactions involving foreign currencies are translated at the rate ruling on the date of the transaction other than investment income which is translated at the rate ruling on the date of receipt. Assets and liabilities in foreign currencies are translated at the rates of exchange ruling on the balance sheet date, with the exception of forward exchange contracts which are valued at the forward rate ruling at the time of the balance sheet date.

(d) Realised capital reserves – Gains and losses on realisation of investments and differences on exchange are dealt with in this reserve.

(e) Unrealised capital reserves – Increases and decreases in the valuation of investments and the revaluation of the currency loans outstanding at the year end are dealt with in this reserve.

(f) Taxation – Deferred taxation is provided on all timing differences.

2 Investment income

Dividends from investments:

Listed:

United Kingdom (franked investment income)	6	179
Overseas	4,785	4,081

Unlisted:

United Kingdom (franked investment income)	—	66
	<u>4,791</u>	<u>4,326</u>

3 Other income

Income from stock lending	20	23
Other income	<u>2</u>	<u>70</u>
	<u>22</u>	<u>93</u>

All stocks lent under these arrangements are fully secured against collateral. As at 31 August 2002, there were holdings of £17.1 million on loan (2001—no holdings on loan).

Notes to the Financial Statements

	2002 £000	2001 £000
4 Investment management fee		
Investment management fee	1,741	1,925

The management fee paid to Edinburgh Fund Managers plc is 0.25% per quarter of the total net assets less (i) the value of any investment funds managed by Edinburgh Fund Managers plc and (ii) 50% of the value of any investment funds managed or advised by investment managers other than Edinburgh Fund Managers plc. The fee is subject to VAT at the appropriate rate although the company currently recovers all VAT paid.

The management agreement between the company and Edinburgh Fund Managers plc is terminable by either party on one years' notice.

Edinburgh Unit Trust Managers Limited (a subsidiary of Edinburgh Fund Managers Group plc) received fees amounting to £2,600 (2001-£11,000), excluding VAT, relating to the OEIC holdings held by the trust during the year ended 31 August 2002. As at 31 August 2002 the portfolio no longer held OEIC holdings (2001-£1,113,000).

5 Administrative expenses

Directors' fees	55	47
Audit fees	9	9
Secretarial fees	62	61
Custody fees	145	175
Bank charges	24	32
Registrar's fees	45	46
Investment Trust Initiative	76	47
Other expenses	91	133
'its' marketing campaign	—	50
	<u>507</u>	<u>600</u>

The secretarial fee is paid to Edinburgh Fund Managers plc and adjusted annually in line with the Retail Prices Index. The contribution to the Investment Trust Initiative was paid to Edinburgh Fund Managers plc in respect of marketing and promotion of the company.

The chairman who was the highest paid director received £15,000 (2001-£15,000). The emoluments of the other directors were £10,000 each (2001-£10,000) per annum. Mr Watt received fees of £10,000 (2001-£10,000), however, as non-executive chairman of Edinburgh Fund Managers plc, these fees were paid directly to Edinburgh Fund Managers plc. Directors also received £5,000 in total for reimbursement of travel costs.

6 Interest payable and similar charges

Loans repayable in more than 2 years but not more than 5 years	776	—
Loans repayable in more than 5 years	3,883	4,844
	<u>4,659</u>	<u>4,844</u>

Notes to the Financial Statements

7 Taxation

	Revenue £000	2002 Capital £000	Total £000	Revenue £000	2001 Capital £000	Total £000
Tax on ordinary activities	165	—	165	89	—	89

At 31 August 2002, the company had unutilised management expenses and loan relationship losses of £10,266,551 (2001—£8,662,274). No deferred tax asset has been recognised on the unutilised management expenses and loan relationship losses.

A reconciliation of the company's current tax charge is set out below:

	2002 £000	2001 £000
Return on ordinary activities before tax	(945)	(451)
Return on ordinary activities at the UK standard rate of corporation tax (30%)	(284)	(135)
Unutilised management expenses	284	135
Foreign withholding tax paid	165	89
Current revenue tax charge for the year	165	89

8 Return per ordinary share

The return per ordinary share is based on the following figures:

	2002	2001
Revenue return	(£1,110,000)	(£540,000)
Capital return	(£5,379,000)	(£78,025,000)
Weighted average ordinary shares in issue	226,628,707	266,713,635

Diluted calculation:

Weighted average number of warrants during the year	10,648,293	10,670,231
Less number of shares that would have been issued at fair value using an average share price of 59.62p (2001—72.90p) during the year	(10,648,293)	(8,781,620)
Shares that would have been issued for no consideration	—	1,888,611
Add weighted average number of shares in issue during the year	226,628,707	226,713,635
Number of shares used to determine fully diluted returns per share	226,628,707	228,602,246

Notes to the Financial Statements

	2002 £000	2001 £000
9 Investments		
Opening market value	175,694	279,291
Opening unrealised depreciation	25,265	(65,083)
Opening book cost	200,959	214,208
Additions at cost	136,166	196,045
Disposals at cost	(144,207)	(209,294)
Closing book cost	192,918	200,959
Closing unrealised depreciation	(14,189)	(25,265)
Closing market value	178,729	175,694
Listed on overseas stock exchanges	178,729	174,177
Listed on the London Stock Exchange	—	404
Unlisted – open-ended investment companies	—	1,113
	178,729	175,694

Unrealised depreciation of £14,189,000 (2001–depreciation of £25,265,000) includes depreciation of £nil (2001–depreciation of £1,104,000) relating to unlisted investments. The portfolio contains no convertible stocks having an element of equity (2001–nil).

10 Debtors

Dividends and interest receivable	517	486
Withholding taxes deductible therefrom	(46)	(66)
Net dividends and interest receivable	471	420
Taxation recoverable	—	168
Amount due from brokers	1,999	—
Other debtors and prepayments	116	129
	2,586	717
Amounts falling due after more than one year:		
Taxation recoverable	—	20
	2,586	737

11 Creditors: amounts falling due within one year

Investment management fee due	397	409
Interest accrued	849	909
Sundry creditors	134	190
Amount due to brokers	432	—
	1,812	1,508

Notes to the Financial Statements

	2002 £000	2001 £000
12 Creditors: amounts falling due after more than one year		
Repayable in more than 2 years but not more than 5 years:		
US\$15,000,000 7.56% Loan repayable 12 May 2007	9,697	—
Repayable in more than 5 years:		
US\$80,000,000 7.26% Loan Notes repayable 30 December 2008	51,531	54,938
US\$15,000,000 7.56% Loan repayable 12 May 2007	—	10,341
	<u>61,228</u>	<u>65,279</u>

Interest on the Loan Notes is payable in half-yearly instalments in June and December. The Loan Notes are secured by a floating charge over the company's assets. The estimated repayment value of the Loan Notes, which are unquoted, was £62,739,000 as at 31 August 2002 (2001—£64,193,000).

Interest on the loan is payable at 7.56% per annum by equal half-yearly instalments in May and November. The loan is secured by a floating charge over the whole of the company's assets. The estimated repayment value of the loan as at 31 August 2002 was £11,172,000 (2001—£11,364,000).

13 Called up share capital

Authorised:		
325,000,000 (2001—325,000,000) ordinary shares of 20p each	65,000	65,000
Issued and fully paid:		
226,628,835 (2001—226,628,325) ordinary shares of 20p each	45,325	45,325

During the year the company did not buy back any of the ordinary shares. Under the authority granted at 2001's Annual General Meeting, the company, as at 18 October 2002, may purchase a further 33,971,585 (2001—33,538,782) ordinary shares.

Holders of 510 (2001—51,722) ordinary share subscription warrants 2005, exercised their subscription rights on 31 January 2002, resulting in the allotment of 510 (2001—51,722) ordinary shares at a price of 60p per share. During the year the company did not buy back any warrants for cancellation (2001—nil).

The unissued ordinary shares are being reserved in part to satisfy the subscription rights attached to 10,648,040 warrants 2005 (2001—10,648,550), exercisable at 60p on 31 January in any one of the years 2003 to 2005 inclusive.

Notes to the Financial Statements

	2002 £000	2001 £000
14 Share premium		
Opening balance	26	5
Premium arising on warrant exercise	—	21
Closing balance	<u>26</u>	<u>26</u>

A share premium of £200 (2001–£21,000) arose as holders of ordinary share subscription warrants 2005 exercised their subscription rights on 31 January 2002.

15 Capital redemption reserve		
Opening balance	8,752	8,652
Transfer from called up share capital arising from the buyback of ordinary shares (see note 13)	—	100
Closing balance	<u>8,752</u>	<u>8,752</u>

16 Special reserve		
Opening balance	85,520	85,898
Buyback of ordinary shares	—	(378)
Closing balance	<u>85,520</u>	<u>85,520</u>

During the year no ordinary shares were bought back. In 2001 500,000 ordinary shares were bought back for a total consideration of £376,000 and were subsequently cancelled.

17 Warrant reserve		
Unexercised warrant reserve:		
Opening balance	658	661
Transfer to exercised warrant reserve	—	(3)
Closing balance	<u>658</u>	<u>658</u>
Exercised warrant reserve:		
Opening balance	389	386
Transfer from unexercised warrant reserve	—	3
Closing balance	<u>389</u>	<u>389</u>
Total of warrant reserves	<u>1,047</u>	<u>1,047</u>

The warrant reserves recognise that a proportion of the proceeds from the issue of ordinary shares and warrants attached can be attributed to the warrants. When warrants are exercised, the amount previously recognised as warrant premium is transferred to the exercised warrant reserve.

Notes to the Financial Statements

	2002 £000	2001 £000
18 Capital reserve – unrealised		
Opening balance	(27,851)	63,685
Revaluation of loans	4,082	(202)
Movement in unrealised depreciation on investments	11,076	(90,348)
Revaluation of US Treasury Bills	451	(986)
Closing balance	<u>(12,242)</u>	<u>(27,851)</u>

19 Capital reserve – realised		
Opening balance	56,711	43,200
Realised net losses on investments	(18,167)	13,943
Foreign exchange loss during the year	(2,821)	(382)
Professional fees	—	(50)
Closing balance	<u>35,723</u>	<u>56,711</u>

20 Revenue reserve		
Opening balance	(4,334)	(3,794)
Transfer in year	(1,110)	(540)
Closing balance	<u>(5,444)</u>	<u>(4,334)</u>

21 Reconciliation of operating profits to net cash inflow from operating activities		
Revenue before finance costs and taxation	3,714	4,393
Increase in accrued income	(31)	217
Decrease in other debtors	13	57
Decrease in creditors	68	(117)
Expenses charged to capital	—	(50)
Net cash inflow from operating activities	<u>3,628</u>	<u>4,500</u>

22 Analysis of changes in financing during the year

	2002		2001	
	Share capital, (including special reserve) £000	Currency loan & loan notes £000	Share capital, (including special reserve) £000	Currency loan & loan notes £000
Opening balance	140,670	65,278	141,017	65,045
Amortised loan note issue expenses	—	31	—	31
Exercise of warrants	—	—	31	—
Buyback of ordinary shares	—	—	(378)	—
Effect of foreign exchange rate movements	—	4,081	—	202
Closing balance	<u>140,670</u>	<u>61,228</u>	<u>140,670</u>	<u>65,279</u>

Notes to the Financial Statements

	2002 £000	2001 £000
23 Analysis of changes in cash during the year		
Opening balance	24,712	19,545
Net cash outflow before adjustments for the effect of foreign exchange rate movements	(2,075)	6,730
Effect of foreign exchange rate movements	(1,531)	(1,563)
Closing balance	<u>21,106</u>	<u>24,712</u>

24 Analysis of changes in net debt

	At 31 August 2001 £000	Cashflow £000	Currency Movements £000	Other Movements £000	At 31 August 2002 £000
Cash and short term deposits	24,712	(2,075)	(1,531)	—	21,106
US Treasury Bills	30,840	(10,675)	(839)	—	19,326
Debt due after more than one year	(65,279)	—	4,082	(31)	(61,228)
Net debt	<u>(9,727)</u>	<u>(12,750)</u>	<u>1,712</u>	<u>(31)</u>	<u>20,796</u>

	2002 £000	2001 £000
25 Reconciliation of movement in shareholders' funds		
Net revenue for the year	(1,110)	(540)
Total recognised capital gains for the year	(5,379)	(78,025)
Buyback of ordinary shares	—	(378)
Exercise of warrants	—	31
Opening shareholders' funds	165,196	244,108
Closing shareholders' funds	<u>158,707</u>	<u>165,196</u>

26 Total shareholders' funds

Total shareholders' funds attributed to equity shares	<u>158,707</u>	<u>165,196</u>
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Total shareholders' funds have been calculated in accordance with the provisions of Financial Reporting Standard 4 'Capital Instruments'. The analysis of total shareholders' funds on the face of the balance sheet does not reflect the rights, under the articles of association, of the ordinary shareholders on a return of assets. These rights are reflected in the net asset value and the net asset value per share attributable to ordinary shareholders at the year end, adjusted to reflect the deduction of the loan notes and loan at par. A reconciliation between the two sets of figures is given below:

Notes to the Financial Statements

26 Total shareholders' funds--contd

	2002	2001
Shareholders' funds attributable as above (£000)	£158,707,000	£165,196,000
Number of equity shares in issue at year end	226,628,835	226,628,325
	2002 p	2001 p
Funds per share	70.03	72.89
Deduct: loan note issue expenses	(0.08)	(0.09)
Adjusted net asset value per share	<u>69.95</u>	<u>72.80</u>
Diluted funds per share	69.58	72.31
Deduct: loan note issue expenses	(0.08)	(0.09)
Adjusted diluted net asset value per share	<u>69.50</u>	<u>72.22</u>

27 Net asset value per share

The net asset value per share and the net assets attributable to the ordinary shareholders at the year end, adjusted to reflect the deduction of the loan notes and the loan at par, were as follows:

	2002 p	2001 p	2002 £000	2001 £000
Net asset value per equity share	69.95	72.80	158,707	164,980

The net asset value per ordinary share is based on net assets (adjusted to reflect the deduction of the Loan Notes and the loan at par) and on 226,628,835 (2001–226,628,325) ordinary shares, being the number of ordinary shares in issue at the year end. The analysis of shareholders' funds on the face of the balance sheet has been computed in accordance with the provisions of Financial Reporting Standard 4 'Capital Instruments', and does not reflect the rights under the Articles of Association of the respective classes of share on a return on assets. A reconciliation of the two sets of figures is given in note 26.

The adjusted fully diluted net asset value per share is 69.50p (2001–72.22p). This is based on the assumption that the warrants in issue were fully converted at the end of the financial year at 60p per share, giving 237,277,385 (2000–237,276,875) shares in issue.

The net asset value per share, adjusted to include the loan notes and the loan at the estimated repayment value rather than par, is 64.35p (2001–68.27p).

Notes to the Financial Statements

28 Risk management, financial assets and liabilities

The following information is given in accordance with Financial Reporting Standard 13, 'Derivatives and Other Financial Instruments'. Short term debtors and creditors are excluded from disclosure as permitted by Financial Reporting Standard 13.

Risk management

The company's financial instruments comprise equity investments, US treasury bills, cash and short term deposits, the income from which can fluctuate, and which value can change with movements in stock markets, interest rates, and foreign exchange rate movements. The company's financial structure also includes a foreign currency loan, foreign currency loan notes and debtors and creditors which arise directly from operations.

The major risks associated with the company are market price risk, dividend income risk, interest rate risk, foreign currency risk and liquidity risk. These risks vary continually as the company's investment activities change, and the company has evolved a framework for managing them. This framework can reduce the risks inherent in the company's financial structure, but cannot completely eliminate them. Events may occur that would result in either a reduction in the company's net assets or a reduction of revenue profits available for dividend.

It is the company's policy that no trading in derivatives shall be undertaken.

Market price risk

The company's exposure to market price risk arises mainly from uncertainty in share prices of equities, interest rates and movements in price and liquidity of treasury bills. Market price risk represents the potential loss the company may suffer through holding such financial instruments. Market price risk is managed through investment guidelines agreed by the board with the manager and is discussed at each board meeting. The investment manager actively monitors the existing portfolio and seeks to ensure that individual stocks also meet an acceptable risk-reward profile.

The company's policy is to increase its exposure to the equity market price risk through the investment of borrowings, thus increasing the opportunity for growth of assets in rising markets but also the risk when markets fall. The amount of borrowings is fixed, but the gearing percentage will vary with movements in the market value of the portfolio and value of the borrowings. The gearing percentage is reported at each board meeting and is regularly reviewed by the directors. The downside risk may be reduced by increasing the level of cash balances through the sale of equities.

Dividend income and interest rate risk

The company finances its operations through a mixture of share capital raised, a foreign currency loan and foreign currency loan notes. The interest on the foreign currency loan is fixed at 7.56% per annum, and the interest on the foreign loan notes is fixed at 7.26%.

Risk arises from uncertainty in dividend and interest receipts from the company's investments. Loan and loan note interest are at a fixed rate and rises or falls in dividend and interest income affect the revenue account disproportionately. The investment manager actively monitors actual and expected dividend and other distributions and reports them at each board meeting.

Foreign currency risk

The company's portfolio is invested in overseas securities and US treasury bills. The sterling value of the portfolio can be significantly affected by movements in foreign exchange rates. The table below sets out the currency exposure of the portfolio as at 31 August 2002.

Notes to the Financial Statements

28 Risk management, financial assets and liabilities—contd

	Local currency 000	Foreign exchange rate	Sterling equivalent £000
Hong Kong dollars	665,199	12.0658	55,131
Indonesian rupee	28,950,000	13697.8000	2,113
Indian rupee	452,239	74.9783	6,031
Korean won	86,897,570	1859.2965	46,737
Malaysian ringgit	95,220	5.8782	16,199
Filipino peso	589	80.1990	7
Singaporean dollar	31,232	2.7069	11,538
Taiwan dollar	781,707	52.9736	14,756
Thai baht	1,124,143	65.2638	17,225
US dollar	43,805	1.5469	28,318
Total overseas equities and treasury bills			198,056

The company also holds cash on deposit in foreign currencies. The sterling value of cash and short term deposits can also be significantly affected by movements in foreign exchange rates. The table below sets out the currency exposure of the cash and short term deposits as at 31 August 2002.

	Interest rate %	Local currency 000	Foreign exchange rate	Sterling equivalent £000
Hong Kong dollars	0	1,498	12.0658	124
Indonesian rupee	0	446,250	13697.8000	33
Indian rupee	0	8,245	74.9783	110
Korean won	0	901,462	1859.2965	485
Malaysian ringgit	0	619	5.8782	105
New Zealand dollar	1.0	(2)	3.3085	(1)
Singaporean dollar	0	287	2.7069	106
Taiwan dollar	0.5	796,607	52.9736	15,038
US dollar	1.5	4,504	1.5469	2,911
Sterling	3.75	2,195	n/a	2,195
Total cash on deposit per balance sheet				21,106

The currency exposure on the creditors: amounts falling due after more than one year is summarised below:

	Local currency 000	Foreign exchange rate	Sterling equivalent £000
US\$80m 7.26% Loan Notes 2008	80,000	1.5469	51,716
US\$15m 7.56% Loan 2007	15,000	1.5469	9,697
Loan Note expenses			(185)
Total creditors: amounts falling due after more than one year			61,228

Notes to the Financial Statements

28 Risk management, financial assets and liabilities—contd

The company does not hedge against foreign currency movements affecting the value of the portfolio but takes account of the risk when making investment decisions.

Movements in the foreign currency exchange rates affects the amount of income and interest paid as disclosed in the revenue account.

Liquidity risk

The company's policy with regard to liquidity is to ensure continuity of funding until maturity of the foreign currency loan in 2007 and of the foreign currency loan notes in 2008. The foreign currency loan and loan notes provide secure long term funding. The company's assets mainly comprise of readily realisable securities that can be easily sold to meet funding commitments if necessary.

Financial assets

The company's financial assets comprise fixed asset investments, treasury bills and cash and short term deposits. The values in the balance sheet represent the fair values as stated below:

	Company 2002		Company 2001	
	Book value £000	Fair value £000	Book value £000	Fair value £000
Non-interest bearing				
Fixed asset investments	178,729	178,729	175,694	175,694
Floating rate				
Treasury bills	19,326	19,326	30,840	30,840
Cash and short term deposits	21,106	21,106	24,712	24,712
	<u>40,432</u>	<u>40,432</u>	<u>55,552</u>	<u>55,552</u>

The fixed asset investments are valued at middle market prices, representing their fair value.

At the balance sheet date the company held three tranches of nil coupon treasury bills as noted below:

Nominal value	Maturity date	Value at 31 August 2002 £000
USD 10,000,000 Treasury bill	14.11.2002	6,439
USD 5,000,000 Treasury bill	05.09.2002	3,226
USD 15,000,000 Treasury bill	07.11.2002	9,661
		<u>19,326</u>

Cash and short term deposits are held in floating rate accounts.

At the balance sheet date, the company held no fixed interest investments.

Notes to the Financial Statements

28 Risk management, financial assets and liabilities—contd

Financial liabilities

The company's financial liabilities include a USD\$15,000,000 loan at a fixed rate of 7.56% and USD\$80,000,000 loan notes at a fixed rate of 7.26%. The fair value of these liabilities at 31 August 2002 is stated below:

	Company 2002		Company 2001	
	Book value £000	Fair value £000	Book value £000	Fair value £000
USD\$15,000,000 Loan	9,697	11,172	10,341	11,364
USD\$80,000,000 Loan Notes	51,531	62,739	54,938	64,193
	<u>61,228</u>	<u>73,911</u>	<u>65,279</u>	<u>75,557</u>

Maturity of financial liabilities

The maturity profile of the company's financial liabilities at 31 August 2002 was as follows:

	2002 £000	2001 £000
In more than two years but not more than five years	9,697	—
More than five years	51,531	65,279
	<u>61,228</u>	<u>65,279</u>

Notice of Meeting

Notice is hereby given that the fifteenth Annual General Meeting of Edinburgh Dragon Trust plc will be held in Donaldson House, 97 Haymarket Terrace, Edinburgh on 2 December 2002 at 11.00am, for the following purposes:

ORDINARY BUSINESS

1. To receive the Report of the Directors and Auditors and the Accounts for the year to 31 August 2002;
2. To re-elect Mr Cassidy as a director of the company;
3. To re-elect Mr Watt as a director of the company;
4. To re-appoint KPMG Audit Plc as auditor of the company;
5. To authorise the directors to fix the remuneration of the auditors for the year to 31 August 2003.

SPECIAL BUSINESS

To consider and, if thought fit, to pass the following resolutions with resolutions 6 and 7 being proposed as ordinary resolutions and resolutions 8 and 9 as special resolutions.

Ordinary Resolutions

6. To re-elect Mr Frame as a director of the company having received special notice pursuant to Sections 293 and 379 of the Companies Act.
7. That, in substitution for any existing authority under Section 80 of the Companies Act 1985 ("the Act"), but without prejudice to the exercise of any such authority prior to the date hereof, the directors be and they are hereby generally and unconditionally authorised, pursuant to Section 80 of the Act, to allot relevant securities (as defined in Section 80(2) of the Act) up to an aggregate nominal amount of £15,108,589, such authority to expire on 1 December 2007, 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 authority, make an offer or enter into an agreement which would or might require relevant securities to be allotted after the expiry of such authority and the directors may allot relevant securities in pursuance of such an offer or agreement as if such authority had not expired.

Special Resolutions

8. That the directors be and are hereby empowered pursuant to Section 95 of the Companies Act 1985 ('the Act') to allot equity securities (within the meaning of Section 94(2) of the Act) for cash at a price not below the net asset value per share, pursuant to any general authority conferred upon them for the purposes of Section 80 of the Act as if Section 89(1) of the Act did not apply to any such allotment, provided that this power shall be limited:
 - (a) to the allotment of equity securities in connection with any rights issue in favour of the holders of ordinary shares on the register on a date fixed by the directors where the equity securities respectively attributable to the interests of all the holders of ordinary shares are proportionate (as nearly as practicable) to the respective numbers of ordinary shares held by them on that date, provided that the directors may make such exclusions or other arrangements as they may deem necessary or expedient in relation to fractional entitlements or legal or practical problems under the laws in any territory or the requirements of any relevant regulatory body or stock exchange; and
 - (b) to the allotment (otherwise than pursuant to paragraph (a) of this resolution) of equity securities up to an aggregate nominal amount of £2,266,289, equal to 5% of the nominal value of the existing issued share capital of the company;

and shall expire at the conclusion of the next Annual General Meeting of the company after the passing of this Resolution or fifteen months from the passing of this Resolution, whichever is earlier,

Notice of Meeting

save that the company may, before such expiry, make an offer or agreement which would or might require equity securities to be allotted after such expiry and the directors may allot equity securities pursuant to any such offer or agreement as if the power conferred hereby had not expired.

9. That the company be and it is hereby authorised in accordance with Section 166 of the Act to make purchases (within the meaning of Section 163 of the Act) of ordinary shares of 20p each in the company ('shares') provided that:

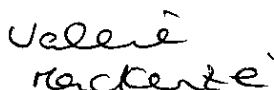
(i) the maximum number of shares hereby authorised to be purchased is 14.99% of the issued share capital of the company as at the date of the passing of this resolution;

(ii) the minimum price which may be paid for a share shall be 20p;

(iii) the maximum price (exclusive of expenses) which may be paid for a share shall not be more than 5% above the average of the middle market quotation (as derived from the Daily Official List of the London Stock Exchange) for the shares for the five business days immediately preceding the date of purchase; and

(iv) unless renewed, the authority hereby conferred shall expire at the conclusion of the Annual General Meeting of the company to be held in 2003 save that the company may, prior to such expiry, enter into a contract to purchase shares which will or may be completed or executed wholly or partly after such expiry.

By order of the board



Edinburgh Fund Managers plc

Secretary

31 October 2002

Registered office:

Donaldson House, 97 Haymarket Terrace,
Edinburgh EH12 5HD

Notes:

1. A member who is entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and, on a poll, vote on his/her behalf. A proxy need not be a member of the company.

2. A form of proxy for use by shareholders is enclosed with these accounts. Completion and return of the form of proxy will not prevent any shareholder from attending the meeting and voting in person. To be valid, the form of proxy should be lodged, together with any Power of Attorney or other authority (if any) under which it is signed or an extract from the Books of Council and Session or a notarially certified copy of such power or authority at the address stated thereon, so as to be received not less than 48 hours before the time of the meeting.

3. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the company specifies that only those shareholders entered on the register of members of the company as at 6.00pm on 30 November 2002 or, in the event that the meeting is adjourned, on the register of members 48 hours before the time of any adjourned meeting, shall be entitled to attend and vote at the meeting in respect of the number of ordinary shares registered in their name at that time. Changes to the entries on the register of members after 6.00pm on 30 November 2002 or, in the event that the meeting is adjourned, in the register of members 48 hours before the time of any adjourned meeting, shall be disregarded in determining the rights of any person to attend or vote at the meeting, notwithstanding any provisions in any enactment, the articles of association of the company or other instrument to the contrary.

4. There are special arrangements for holders of shares through InvestIT – The Edinburgh Fund Managers Investment Trust Savings Plan and Individual Savings Account/Personal Equity Plan and Pension arrangements. These are explained in the 'Letter of Direction' which such holders will have received with this report.

Financial Calendar

Announcements and the issue of the annual and interim reports may normally be expected in the following months:

October – Preliminary results for year announced.

October – Annual report and accounts published.

December – Annual General Meeting.

April – Interim figures announced.

April – Interim report for half-year to 28 February published.

This year's Annual General Meeting will be held on Monday 2 December 2002 at 11.00am. Coffee will be available from 10.30am.



The Company is a member of The Association of Investment Trust Companies.

EDINBURGH FUND MANAGERS

Edinburgh Fund Managers plc was formally established in 1969 and has grown steadily since that time now with offices in Edinburgh, Dundee, London and Newcastle. Today Edinburgh Fund Managers Group is one of the largest managers of investment trusts in the UK with £1.6 billion of funds under management as at 31 August 2002. Total assets managed by the group at the same date were around £4.7 billion.

Investment Trusts

It is the business of investment trusts, advised by their managers, to invest in the shares of other companies. The investment objectives vary from trust to trust ranging from investment for capital growth and/or income, to trusts which invest internationally, in a specific area of the world or in a single country market. Investing in investment trusts can provide a spread of investments, managed by experts, at low cost.

HOW TO INVEST

Ordinary shares

Investors can buy and sell shares in Edinburgh Dragon Trust directly through a stockbroker or indirectly through a lawyer, accountant or other professional adviser. Alternatively shares can be bought directly through The Edinburgh Fund Managers Investment Trust Savings Plan, Investment Trust ISA and Investment Trust Pension.

PRODUCT DETAILS

InvestIT – The Edinburgh Fund Managers Investment Trust Savings Plan

InvestIT provides a straightforward way to invest in Edinburgh Dragon Trust and other investment trusts managed by Edinburgh Fund Managers. Investors can make regular monthly payments (minimum £30 per month) or invest occasional lump sums (minimum £250 initially and £30 thereafter). Existing shareholders can also invest in the Plan and have their dividends reinvested. There is no charge for buying or holding shares through InvestIT other than 0.5% Government Stamp Duty which is currently payable

on all share purchases. There is a £10+VAT transaction fee applied to all sales.

Edinburgh Fund Managers

Investment Trust ISA

The Edinburgh Fund Managers Investment Trust Individual Savings Account (ISA) is a tax efficient savings vehicle. There are two types of ISAs available, a Maxi and a Mini. A Maxi ISA allows investors to maximise the amounts placed in stocks and shares. Investors will have the opportunity to invest up to £7,000 in each of the tax years up to 2005/2006 in Edinburgh Dragon Trust where they take out a Maxi ISA.

A feature of the Edinburgh Fund Managers Investment Trust ISA is its low charges. The annual management fee is 0.5%+VAT (capped at £60+VAT). No charges are made for buying or selling shares other than Government Stamp Duty on share purchases.

The Edinburgh Fund Managers

Investment Trust Pension

The Investment Trust Pension enables investors to save for retirement by investing in Edinburgh Dragon Trust. The Investment Trust Pension offers the choice of a Personal Pension Plan. Contributions can be made monthly, yearly or by lump sums, and there are low minimum investment amounts.

Note

Please remember that past performance is not necessarily a guide to the future. Stock market and currency movements may cause the value of shares and the income from them to fall as well as rise and investors may not get back the amount they originally invested.

As with all equity investments, the value of investment trusts purchased will immediately be reduced by the difference between the buying and selling prices of the shares, the market maker's spread.

Investors should further bear in mind that the value of any tax relief will depend on the individual

Information for Investors

circumstances of the investor and that tax rates and reliefs, as well as the tax treatment of ISAs, may be changed by future legislation.

Keeping you informed

The company's share price appears under the heading 'Investment Trusts' in the Financial Times, and other national newspapers. Investors can also obtain the latest share price by phoning FT Cityline on 0906-843 4608. All calls cost 60p per minute.

For internet users, detailed data on Edinburgh Dragon Trust, including price and performance information, is available on the Edinburgh Fund Managers website (www.edfd.com) and the TrustNet website (www.trustnet.co.uk).

Lloyds TSB Registrars also have a website (www.lloydstsb-registrars.co.uk) which includes a page entitled 'Shareholder Services', which gives shareholders an insight into their shareholding. The website also has information about how to register a change of name and what to do if you have lost your share certificate.

For information concerning your shareholding, please contact:

Registrar

Lloyds TSB Registrars Scotland
PO Box 28448
Finance House
Orchard Brae
Edinburgh EH4 1WQ
Telephone: 0870-601 5366
Textphone: 0870-600-3950
Website: www.lloydstsb-registrars.co.uk

For information and application forms on the InvestIT, ISA, PEP, Pension and Share Exchange Schemes please contact:

Support Desk

Edinburgh Fund Managers plc
Donaldson House
97 Haymarket Terrace
Edinburgh EH12 5HD
Telephone: 0131-313 1000
or FREE on 0800-028 6789 (24 hours)
Website: www.edfd.com

InvestIT Administrator

Lloyds TSB Registrars Scotland
Registrar Department (SP)
PO Box 28448
Finance House
Orchard Brae
Edinburgh EH4 1WQ
Telephone: 0870-606 0268

Individual Savings Account/Personal Equity

Plan Administrator

Bank of New York Ltd
(Edinburgh Fund Managers plc)
ISA/PEP Department
12 Blenheim Place
Edinburgh EH7 5ZR
Telephone: 0800-028 6789

Pension Administrator

Edinburgh Pension Centre
Personal Pension Management Limited
141 Castle Street
Salisbury
Wiltshire SP1 3TB
Telephone: 0800-137 079

The above has been approved for the purposes of Section 21 of the Financial Services and Markets Act 2000 by Edinburgh Fund Managers plc which is regulated by the Financial Services Authority.