Distribution of Portfolio

Asset Allocation 2006 (2005)



Quoted Equities by Sector 2006 (2005)

Investment Changes (£'000)

	Valuation at 31 Dec 2005	Net acquisitions/ (disposals)	Appreciation/ (depreciation)	Valuation at 31 Dec 2006
Quoted equities:				
United Kingdom	241,205	(11,890)	31,939	261,254
North America	60,861	2,451	(8,222)	55,090
Continental Europe	19,025	5,504	5,025	29,554
Japan	3,361	4,471	243	8,075
Asia Pacific/Emerging Markets	39,944	(9,506)	6,377	36,815
Total quoted equities	364,396	(8,970)	35,362	390,788
Unquoted	5,021	(1,420)	(536)	3,065
Quoted fixed interest	17,331	6,383	459	24,173
Properties	38,700	318	4,682	43,700
Total investments	425,448	(3,689)	39,967	461,726
Net liquid assets	573	330	44	947
Total assets	**426,021**	**(3,359)**	**40,011**	**462,673**

The figures above for total assets are made up of total net assets before deduction of the debenture.

Thirty Largest Equity Holdings

Name	Region	Sector	2006 Value £'000	2006 % of total assets	2005 Value £'000
Royal Bank of Scotland	United Kingdom	Banks	19,335	4.2	14,598
Barclays	United Kingdom	Banks	15,854	3.4	13,004
GlaxoSmithKline	United Kingdom	Pharmaceuticals and biotechnology	15,611	3.3	14,989
HSBC	United Kingdom	Banks	14,250	3.1	9,472
Petrobras	Brazil	Oil and gas producers	12,297	2.7	10,612
HBOS	United Kingdom	Banks	12,175	2.6	10,637
BP	United Kingdom	Oil and gas producers	10,619	2.3	9,117
Royal Dutch Shell	United Kingdom	Oil and gas producers	9,070	2.0	7,642
Rio Tinto	United Kingdom	Mining	8,933	1.9	6,093
Diageo	United Kingdom	Beverages	8,274	1.8	6,937
Aviva	United Kingdom	Life insurance	8,010	1.7	8,030
Lonmin	United Kingdom	Mining	7,505	1.6	4,020
Vodafone	United Kingdom	Mobile telecommunications	7,157	1.5	14,460
Atlas Copco	Sweden	Industrial engineering	6,947	1.5	6,117
Wolseley	United Kingdom	Support services	6,818	1.4	–
Admiral	United Kingdom	Tobacco	6,528	1.3	6,489
Prudential	United Kingdom	Life insurance	6,198	1.3	4,878
Man Group	United Kingdom	General financial	6,195	1.1	5,839
Carnival	United Kingdom	Travel and leisure	5,243	1.1	–
Buffey European Property	United Kingdom	Real estate	5,125	1.1	5,730
Samsung Electronics	South Korea	Electronic and electrical equipment	5,074	1.1	8,080
Moody's	North America	General financial	4,912	1.0	–
BHP Billiton 6% 2007	United Kingdom	Mining	4,782	1.0	–
Topps Tiles	United Kingdom	General retailers	4,585	1.0	–
Yell	United Kingdom	Media	4,526	1.0	–
Tesco	North America	Food and drug retailers	4,449	1.0	2,845
eBay	Germany	General retailers	4,434	1.0	4,280
SAP	Japan	Software and computer services	4,422	0.9	3,361
Canon	United Kingdom	Electronic and electrical equipment	4,252	0.9	–
Low & Bonar		Construction and materials	4,247	0.9	–
			237,627	**51.3**	**177,230**

Property Portfolio

Location	Type	Tenant	2006 Value £'000	2006 % of total assets	2005 Value £'000
Ashford	Shop	W H Smith Plc	1,800	0.4	1,650
Dundee	Public House	J D Wetherspoon plc	1,450	0.3	1,250
Dunfermline	Shop	W H Smith Plc	2,950	0.6	2,750
Kenilworth	Nursing Home	Southern Cross Plc	5,250	1.1	4,150
Kingston upon Hull	Public House	Whitbread Plc	1,100	0.2	950
Milton Keynes	Hotel	CHE plc	8,500	1.8	7,400
Newcastle under Lyme	Shop	W H Smith Plc	1,650	0.4	1,550
New Romney	Holiday Village	Leisure Group GB plc	5,500	1.2	5,000
Nottingham	Public House/Restaurant	Morland Plc	5,000	1.1	4,750
Oban	Shop	W H Smith Plc	1,500	0.3	1,250
Portsmouth	Public House	J D Wetherspoon plc	2,950	0.6	2,650
Reading	Restaurant	Bright Reasons Restaurants Ltd	1,450	0.3	1,350
St Andrews	Shop	W H Smith Plc	1,100	0.2	950
Torquay	Public House	Ind Coope (Oxford & West) Ltd	1,350	0.3	1,250
Weybridge	Restaurant	City Centre Restaurants (UK) Ltd	850	0.2	800
Winchester	Public House	Fuller Smith & Turner Plc	1,300	0.3	1,000
			43,700	**9.3**	**38,700**

	For the year ended 31 December 2006 Revenue £'000	Capital £'000	Total £'000	For the year ended 31 December 2005 Revenue £'000	Capital £'000	Total £'000
	–	35,285	35,285	–	63,771	63,771
	–	44	44	–	(691)	(691)
	–	13,326	13,326	13,986	(812)	13,986
	–	(1,982)	(1,982)	(812)	(706)	(1,424)
	–	(800)	(800)	(812)	–	(706)
	34,338	47,873		12,378	62,268	
	(3,025)	(6,032)		(3,035)	(3,035)	
	313	41,821		9,343	59,233	
	12	(94)		(343)	203	
		41,727		9,000	59,438	
		31.50p		6.80p	44.86p	

	For the year ended 31 December 2005 Revenue £'000	Capital £'000	Total £'000
	9,000	59,438	68,438
	–	4,728	4,728
	9,000	64,166	73,166
		48.43p	55.23p

	Notes	At 31 December 2006 £'000	£'000	At 31 December 2005 £'000	£'000
Fixed assets					
Investments – securities	9	418,026		385,748	
Investment – property	9	43,700		38,700	
			461,726		424,448
Current assets					
Debtors	10	1,621		1,393	
Cash and deposits	19	1,414		1,095	
		3,035		2,488	
Creditors					
Amounts falling due within one year	11	(2,088)		(1,915)	
Net current assets			947		573
Total assets less current liabilities			462,673		424,021
Creditors					
Amounts falling due after more than one year	12		(89,079)		(89,430)
Share capital and reserves			373,594		336,591
Called up share capital	13				
Capital redemption reserve	14		33,121		33,121
Capital reserve – realised	14		22,781		22,781
Capital reserve – unrealised	14		200,533		172,099
Revenue reserve	14		103,050		93,077
			14,109		13,513
Net asset value per ordinary share	15		373,594		336,591
(Debenture at fair value)			272.6p		241.2p
Net asset value per ordinary share	15				
(Debenture at book value)			282.0p		254.1p

The financial Statements were approved and authorised for issue by the Board on 16 February 2007.

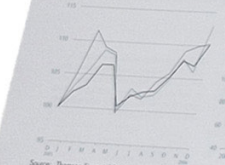
SIR BRIAN MORY
Chairman

The accompanying notes on pages 38 to 48 are an integral part of this statement.

13.7% 27.3%
13.4% 35.0%
22.9%

One Year Performance

(figures rebased to 100 at 31 December 2005)



Source: Thomson Financial Datastream/ Baillie Gifford & Co

Share price
NAV (fair value)
Benchmark*

Dividends are not reinvested.

5 Year Total Return Performance

(figures rebased to 100 at 31 December 2001)



Source: Thomson Financial Datastream/ Baillie Gifford & Co

Share price total return
NAV total return (book value)
Benchmark† total return

Dividend and RPI Growth Rate

(figures rebased to 100 at 31 December 2001)



Source: Thomson Financial Datastream

RPI
SAINTS' dividend

The line at 31 December 2003 signifies the appointment of Baillie Gifford & Co as Managers and Secretaries.

Past performance is no guarantee of future performance.

* Benchmark: 70% FTSE All-Share Index and 30% FTSE World Ex UK Index (in sterling terms)

† On 1 January 2004 the Company changed its benchmark from 65% FTSE All-Share Index and 35% FTSE World Ex UK Index to 70% FTSE All-Share Index and 30% FTSE World Ex UK Index. For the purposes of the above graphs the returns on both benchmarks for their respective periods have been linked to form a single benchmark.

Chairman's Statement

I am pleased to report very satisfactory rises in your Company's net asset value, earnings per share and dividend per share over 2006. For the third year in a row, SAINTS portfolio has outperformed its benchmark.

Results

The net asset value total return, with the debenture valued at its market price, was 16.1%. This compares to a benchmark return of 13.4%. The benchmark is a composite index comprising 70% FTSE All-Share Index and 30% FTSE World Ex UK Index.

Asset allocation was positive, with our commercial property portfolio producing a total return of 18.5%. In the equity portfolios, the contribution to return from stock selection was marginally negative this year. However, having now been with Baillie Gifford for three years, we are able to assess their choice of stocks over a more meaningful period than just twelve months and, since their appointment, stock selection has made a positive contribution to performance. We had a rewarding experience in fixed interest markets where, despite finding the general level of markets unattractive, we were able to invest in a small number of specific overseas opportunities which produced good returns.

Past performance is no guarantee of future performance.

Dividend

The capital performance of the portfolio has been matched by similar strength in the revenue account with the level of earnings per share rising from 6.80p last year to 7.55p in 2006. Consequently, SAINTS was able to pay quarterly dividends for the first three quarters of the year that were significantly higher than for the same period in 2005.

We are recommending that the final dividend payment be set at 2p per share. If approved at the AGM, this would give a total dividend for 2006 of 7.4p, a 13% increase on the 2005 total.

Discount

At the start of 2006, SAINTS' share price was 218.75p and the net asset value per share (with the debenture at market value) was 241.2p. By the end of the year, the share price had risen to 241.25p and the net asset value per share to 272.6p. This means that the discount to net asset value (the difference between the share price and the net asset value per share) widened from 9.3% to 11.5% despite the strong capital performance and the dividend increase achieved in 2006. However, the underlying trend over the last three years has been for the discount to narrow reflecting SAINTS' success in delivering growth in both capital and income.

Buy-backs and Treasury Shares

The power to buy back shares was renewed at last year's Annual General Meeting. The Board is mindful of the enhancement to net asset value that can accrue to shareholders through use of buy-backs and of the desire of shareholders to avoid undue volatility in the discount. However, because the widening in the discount was modest, the Board chose not to buy back shares during 2006. The Board intends asking for the authority to be renewed at this year's AGM so that it is available should future circumstance make a buy-back more appropriate.

SPOTLIGHT



Competitive Advantage

The basic objective of our research process is to identify companies that have superior growth prospects. In order to evaluate the long term potential of a business, one of the key factors we seek in the companies we research are superior business models with sustainable competitive advantages. In this article, we take a look at what competitive advantage is and why it is important.

Microeconomic theory suggests that companies within industries generating high returns on invested capital will attract competition. This, in turn, will drive down overall industry returns. Therefore, to make profits consistently on investment in excess of its cost of capital, and in doing so create shareholder value, a company must possess some form of sustainable competitive advantage.

"In terms of which businesses succeed and which businesses fail, advantages of scale are ungodly important"

As long-term investors, we explore evidence for and assess the sustainability of competitive advantage in every stock we consider.

Harvard professor, Michael Porter, one of the best known commentators on competitive forces within industries, argues that the collective strength of "five forces" can be used as a framework for assessing potential profitability.

- the power of customers
- the power of suppliers
- the threat of new entry
- the pressure of substitutes
- the nature of rivalry

It can be argued, however, that not all Porter's forces are equal. The most important aspect of any competitive dynamic is the threat of new entrants. By definition, the existence of barriers to entry means that incumbent firms are able to do what potential rivals cannot. No other feature of the competitive environment has as much impact on whether a company is able to create shareholder value.

What is a barrier to entry?

It can be argued that the most important aspect of any competitive dynamic is the threat of new entrants*. If there are barriers to entry, then incumbent firms are able to do what potential rivals cannot.

Probably the most obvious example of a barrier to entry is scale. According to Charlie Munger (Vice Chairman of Berkshire Hathaway), "in terms of which businesses succeed and which businesses fail, advantages of scale are ungodly important".** Economies of scale occur when unit costs decline as output rises. They are particularly relevant for high fixed cost businesses where the requirement for high significant commitment can be a significant deterrent to new entrants because of potential market positions. Historically, for example, the world cruise industry was effectively a duopoly with Carnival and Royal Caribbean accounting for around 70% of the global market. Barriers to entry are significant. Although in theory anyone can build a ship, a potential entrant would have to consider the significant upfront capital outlay: typically ships $400m and takes four years before any revenues are generated and this is before any potential entrant considers port facilities and training a crew in an industry where staff turnover is high.

Advantages of cost or supply

There are also sustainable cost advantages that allow a company to produce and deliver its products or services more cheaply than competitors. The low cost production profile of CVRD (the previously state-owned Brazilian iron ore producer) is a function of its superior access to easily mineable deposits (primarily in Carajas) which in itself is a result of extremely heavy state intervention in the past to transform the economics of a previously isolated reserve base. Products protected by patents are another example of what can be referred to as a supply advantage.

What about brands?

The key to a successful brand is customer captivity or "share of mind"†. Customer captivity can be thought of as product purchases which are based on habit, have high switching costs or are difficult to substitute. In fact, Warren Buffett has described mind share as "priceless". We believe that penetration of own label brands is a good indicator of the extent of customer captivity, with low own brand penetration indicating high customer captivity. Taking Wm. Wrigley as an example, chewing gum is said by AC Nielson to be second only to baby formula in having the lowest own label brand penetration [at 1%].

Possibly the most powerful example of a barrier to entry is a network effect. This occurs when a good or service has a value to a potential customer dependent on the number of customers already owning that good or using that service. This combines does not exist. Small retailers are a good example of this. In fact, we believe that sustainable competitive advantage is rare and that the companies mentioned above tend to be the exception rather than the rule.

Without barriers to entry a company must run itself as efficiently and effectively as possible. Golden West, the US adjustable rate mortgage lender, and Progressive, the US auto insurer, are good examples of this. Because of its focussed approach Golden West is by some margin the low cost producer, measured by costs to income, in a commodity business, a fact which has not gone unnoticed – it is currently the subject of a merger. Similarly, over the past ten years Progressive has consistently outperformed its industry peers averaging insurance profit margins of nearly 7% p.a., [insurance profit margins of industry as a whole that has delivered an annual insurance loss over the same period.

The key to a successful brand is customer captivity or "share of mind"

both economies of scale and customer captivity and creates what Munger would call a "lollapalooza effect" (where factors combine to amplify each other). For example, eBay would not be an attractive site to potential sellers if there were no potential customers. As the numbers of active users on eBay [currently over 70m] grows, a self perpetuating cycle extends which, in turn, attracts more sellers. The greater the number of users of eBay, so more find the site to be useful. Moubousson describes this as a "winner-take-most situation". SAP and Microsoft are other good examples of companies that combine network effects with customer captivity (switching costs are high).

What if there are no barriers to entry?

Stability of market shares over time and the presence of a few dominant, profitable participants are generally strong indicators of sustainable competitive advantage. However, most industries exhibit the entry and exit of many companies. In such cases it is likely that a competitive advantage

Conclusion

The source of a worthwhile advantage is typically something a company does or has that is difficult to replicate and therefore provides a barrier to entry. A sustainable barrier to entry should lead to a company creating value for long term investors. Such advantage is, however, rare and where companies do not possess an inherent competitive advantage they must be run as efficiently and effectively as possible.

*For more details refer to "Measuring the Moat", M. Mauboussin and K. Bartholdson, CSFB Strategy, 2002 or "Competition Demystified", B. Greenwald and J. Kahn, 2005. Greenwald is the Robert Heilbrunn Professor of Finance and Asset Management at Columbia Business School. Mauboussin is the currently the Chief Investment Strategist at Legg Mason.

**"A Lesson on Elementary, Worldly Wisdom As It Relates To Investment Management & Business", Charlie Munger, USC Business School, 1994.

†Buffett lecture at the University of Florida School of Business, October 1998.



