Allianz
Global Investors

The Merchants Trust PLC

Report and Accounts for the year ended 31 January 2006

Contents

Key Facts

Investment Objective

To provide an above average level of income and income growth together with long term growth of capital through a policy of investing mainly in higher yielding UK FTSE 100 companies.

Benchmark

The Company's investment performance is assessed by comparison with other investment trusts within the UK Growth and Income sector. In addition, it is benchmarked against the FTSE 100 Index, reflecting the emphasis within the portfolio, as well as the FTSE 350 Higher Yield Index, reflecting the Company's higher yield objective.

Financial Highlights for the years ended 31 January

Revenue	2006	2005	% change
Revenue	£24,714,263	£22,674,672	+9.0
Available for Ordinary Dividend	£19,853,959	£17,950,187	+10.6
Earnings per Ordinary Share	19.44p	17.58p	+10.6
Dividends per Ordinary Share	18.90p	18.00p	+5.0

Assets	2006	2005	% change
Total Net Assets	£514,713,196	£424,510,908*	+21.2
Net Asset Value per Ordinary Share	504.1p	415.8p*	+21.2
Ordinary Share Price	451.0p	383.8p	+17.5
Discount of Net Asset Value to Ordinary Share Price	10.5%	7.7%*	n/a

*Figures are restated in accordance with Financial Reporting Standards 21, 25 and 26.

Performance Attribution Analysis

for the year ended 31 January 2006

	%
Capital return of FTSE 100 Index	18.7
Relative return from Portfolio	(0.3)
Capital return of Portfolio	18.4
Impact of gearing on Portfolio	4.1
Retained Revenue	0.2
Expenses charged to Capital	(1.5)
Change in Net Asset Value per Ordinary Share	21.2

Chairman's Statement

Results

The last financial year has witnessed further growth in the value of world equity markets, including the UK. The Trust's net asset value per share rose by 21.2% to 504.1p and, including dividends paid, the total return per share was 25.6%. This compares with the total return of 22.8% recorded by the FTSE 100 Index and 22.7% recorded by the FTSE Higher Yield Index.

In capital terms, the Trust's total assets increased in value by 18.4% before allowing for the impact of gearing and costs. In comparison the FTSE100 Index rose by 18.7%, whilst the FTSE Higher Yield Index rose by 17.9%. After a relatively dull capital return in the Trust's first half, the portfolio made up much of the lost ground in the second six months.

In line with 2004/5 the Trust's gearing has had a positive impact, adding approximately 4% to the returns to shareholders. The full performance attribution is shown on page 2.

In the twelve months to 31 January 2006, the Trust's share price rose by 17.5% from 383.8p to 451.0p. At 5 April 2006, the Trust's ordinary shares yielded 3.9 compared with the yield on the FTSE 100 Index of 3.0.

Market Background

The UK equity market has shown good growth throughout much of the last financial year. In the second half, despite a sharp set-back in October, the market rose against a background of good company results and a pick-up in mergers and acquisitions activity. Sentiment was also helped by the first cut in UK base rates for over two years in August 2005 and the further fall in yields on gilt-edged securities. UK company dividend payments were generally higher, reflecting the improvement in corporate cash flows and profitability.

Earnings Per Share

In 2005/6 net earnings per share rose by 10.6% to 19.44p. In contrast to 2004/5, the modest rise in the U.S. dollar, in which approximately 17.5% of the Trust's income is received, has had a small positive influence on dividend receipts. More generally the Trust has participated well in the general improvement in company dividend payments, despite the continued absence of any special dividends in revenue. It should be noted, however, that in the 2005/6 financial year the Trust gained approximately £400,000 of extra dividend receipts through Royal Dutch Shell's change to quarterly dividend payments.

Dividends

The Board is recommending a final dividend of 4.8p per share, giving a total of 18.9p for the year, an increase of 5% in total over 2004/5. The total cost of these payments for 2005/6 is £19.3m. In the 2004/5 accounts, we flagged that the convergence of UK accounting standards towards International Financial Reporting Standards would have an impact on the Trust's accounts. One key change is that dividends declared, but not paid, are not recognised in the published accounts. As a result the revenue reserve at 31st January 2006 stood at £19.9m, reflecting the fact that the last two dividends declared for 2005/6, totalling £9.8m, were paid after the year end. At that date the underlying revenue reserve stood at £10.1m, after allowing for these last two dividend payments. The previous year's accounts have been adjusted in a similar manner.

Repurchase of Shares

During the year, the Trust did not add to the number of shares repurchased and cancelled. Thus the total number of shares repurchased and cancelled remains at 225,000. As in previous years, the Board is proposing to renew this authority at the forthcoming AGM on 9 May 2006. Since December 2003 it has been possible for companies, including investment trusts, to hold shares repurchased in the market in Treasury, rather than cancel them. At this stage, your Board has decided not to seek approval from shareholders to hold shares in Treasury, but we will continue to monitor how the use of this facility by the investment trust sector develops.

New Articles of Association

A special resolution will be proposed at the forthcoming AGM of the Trust to adopt new Articles of Association. A summary of the principal proposed changes is set out in the Directors' Report on pages 44 and 45.

Prospects

Many of the factors which drove shares higher in 2005/6 are still in place. In particular take-over activity has re-asserted itself, especially in the FTSE 100 segment of the UK market. Corporate profits and cash flows remain strong although, after such an extended period of economic expansion, there is a risk that forecasts may prove to be too optimistic. There are encouraging signs for further growth in dividends and demand for higher yielding quality UK shares is likely to remain strong.

Investment Manager

After what will have been twenty two years of managing the trust, Nigel Lanning has chosen to retire at the end of May this year. Under his tenure as fund manager, dividends have increased from 2.4p to 18.9p a share, equivalent to 10.5% per annum compound. Net asset value per share has increased from 112p to 504p at the recent year end and £1,000 invested in Merchants in May 1984 would, with net dividends reinvested, be worth £10,473 as at that date. Nigel has managed the trust with great skill, coping admirably with the very diverse stockmarket conditions over this eventful period. He will be stepping down after an excellent year, when the performance of the Trust was comfortably ahead of its benchmarks. Nigel's achievement as Manager of the Trust's portfolio speaks for itself. I am sure that all shareholders will join me in thanking him for his contribution over so many years and in wishing him well in his retirement. Nigel will be succeeded by Simon Gergel. Simon has previously managed UK equity income funds at Phillips & Drew and HSBC. Both Nigel and Simon will be attending the forthcoming AGM on 9 May 2006.

Hugh Stevenson
Chairman
6 April 2006

Historical Record

Years ended 31 January
Revenue and Capital

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Revenue (£'000s)	18,769[I]	20,399[I]	20,119[I]	22,590	21,546	21,596	22,101	22,247	22,675	24,714
Earnings per Share (net)	13.66p	14.88p	15.21p	17.93p	16.35p	16.70p	17.26p	17.34p	17.58p	19.44p
Dividends per Share	13.65p[Ø]	14.25p	15.59p[†]	16.00p	16.40p	16.80p	17.20p	17.60p	18.00p	18.90p
Tax Credit per Share	3.41p[#]	3.56p	3.90p§	1.78p	1.82p	1 .87p	1.91p	1.96p	2.00p	2.10p
Gross Ordinary Dividend	17.06p	17.81p	19.49p	17.78p	18.22p	18.67p	19.11p	19.56p	20.00p	21.00p
Total Net Assets attributable to Ordinary Capital (£'000s)	334,034[I]	420,326	424,859	390,317	473,729	20,983	273,407	357,442	424,511[s]	514,713
Net Asset Value per Ordinary Share	326.4p	410.8p	415.2p	381.4p	463.5p	412.3p	267.8p	350.1p	415.8p[s]	504.1p
NAV Total Return (%)*	+14.9	+30.2	+4.9	-4.3	+25.8	-7.4	-30.9	+37.3	+20.8[s]	+25.6
Retail Price Index Increases (%)**	+3.1	+2.5	+2.6	+2.1	+1.8	+2.6	+2.7	+2.4	+2.1	+2.3

Notes

I Restated in accordance with Financial Reporting Standard 16 'Current Taxation'.

Ø The total distribution for 1997 was 13.65p. This was made up of interim dividends of 9.75p, a final foreign income dividend ('FID') of 2.00p and a final ordinary dividend of 1.90p. The final ordinary dividend was enhanced by 0.40p to ensure no shareholder would be adversely affected by the FID. Excluding this enhancement the 'normal' distribution for 1997 was therefore 13.25p.

Inclusive of 0.50p tax credit on the FID which is notional and not repayable.

† The total distribution for 1999 was 15.59p. This was made up of interim ordinary dividends of 8.86p, an interim FID of 2.98p and a final ordinary dividend of 3.75p. The interim FID was enhanced by 0.59p to ensure no shareholder would be adversely affected by receiving this form of dividend. Excluding this enhancement the 'normal' distribution for 1999 was therefore 15.00p.

§ Inclusive of 0.74p tax credit on the FID which is notional and not repayable.

* NAV total return reflects both the change in net asset value per ordinary share and the net ordinary dividends paid.

** RPIX – excludes the effect of mortgage rates.

s Restated in accordance with Financial Reporting Standards 25 'Financial Instruments: Disclosure and Presentation' and 26 'Financial Instruments: Measurement'. Years prior to 2005 have not been restated.

Thirty Largest Holdings
at 31 January 2006

	Valuation	% Fixed Assets	Unrealised Gain (Loss) Over Book Cost
	£'000s	%	£'000s
BP	54,080	8.70	15,192
Royal Dutch Shell 'B' Shares	48,288	7.76	11,277
HSBC	45,206	7.27	5,103
GlaxoSmithKline	33,913	5.45	2,345
Royal Bank of Scotland	25,056	4.03	5,189
Lloyds TSB	23,055	3.71	(1,611)
HBOS	22,724	3.65	6,239
BT	16,933	2.72	(10,153)
Rio Tinto	16,342	2.63	8,860
Anglo American	15,984	2.57	6,563
Barclays	15,326	2.46	2,038
Land Securities	13,396	2.15	5,890
Vodafone	12,815	2.06	(3,137)
Scottish Power	12,090	1.94	1,302
Slough Estates	11,830	1.90	5,067
Scottish & Southern Energy	10,316	1.66	4,043
Alliance & Leicester	9,880	1.59	2,752
Lonmin	9,619	1.55	5,886
Bradford & Bingley	9,315	1.50	2,883
Aviva	9,222	1.48	625
National Grid	9,200	1.48	1,814
Diageo	8,951	1.44	1,483
AWG	8,699	1.40	2,141
Legal & General	8,642	1.39	(139)
Tate & Lyle	8,064	1.30	2,615
Gallaher	7,862	1.26	3,031
British American Tobacco	7,792	1.25	3,122
Rank	7,135	1.15	1,238
DSG	7,020	1.13	2,373
Wimpey (George)	6,891	1.11	746
	495,646	79.69	% of Total Invested Funds

Investment Managers' Review

Economic Background

Despite a number of headwinds, the UK economy continued to produce steady growth in 2005. The latest indications are that growth was just under 2%, with uninterrupted economic expansion now stretching back over 13 years. After a series of interest rate rises, ending at 4.75% in August 2004, the consumer appears to have become more cautious. A major contributor to this consumer slow-down has been the rise in crude oil prices, which at one point rose to nearly $70 per barrel. Most commentators now consider that oil price increases are effectively a tax on Western consumers with the consequent inflationary impact being relatively minimal. This can be seen in the UK's consumer price index, which also ended 2005 at just under 2%.

As usual the trends in the housing market attracted much comment, with the fear that a fall in values would further dent consumer confidence. The more cautious forecasts proved unfounded and the cut in base rates by 0.25% in August 2005 appeared to bolster confidence. In the event, housing transactions showed a measure of stabilisation in the latter months of the year. Nevertheless unemployment rose steadily throughout most of 2005 and, coupled with this, there was an appreciable pick-up in the banks' arrears experience in unsecured lending.

One area of debate has been why there has not been a significant recovery in capital investment, despite the undoubted fact that company finances are now on a much firmer footing. It is clear that technology has led to more cost effective investment by companies and that, where capital expenditure has been put in place, it is very often in low cost economies like Eastern Europe and the Far East. In latter months a number of companies have deployed their balance sheet resources to fund acquisitions, impacting a number of sectors especially those with stable earnings characteristics. Whilst the dollar recorded a useful recovery, this has only been reflected in reported company profits and dividends relatively recently.

Market Trends

Having started 2005/6 very positively, the FTSE 100 Index was subdued for much of the first three months of the last financial year. After falling to just below 4800 at the end of April, it appreciated steadily throughout the summer. These gains were spurred by improved trading news from the corporate sector and the prospect of a cut in UK base rates. Take-over activity, often from overseas acquirers, re-affirmed the view that UK quoted companies appeared under-valued by international standards. Low borrowing costs were also a motivating factor.

October saw a relatively brief but sharp market correction with the index falling from about 5500 to just below 5200, led by weakness in U.S. markets. Thereafter there was a strong recovery, with the market improving in a consistent fashion so that the FTSE100 Index ended the financial year at 5760. A particularly notable feature for the last year has been the willingness of companies to return surplus cash resources to shareholders through enhanced dividends and share buy-backs as well as other means. This looks set to continue.

The past year has been one of great contrasts in terms of sector performances. Resource sectors led the way with Mining rising by over 70% and the Oil sector up by over 37%. Aerospace and Defence, where the Trust is not represented, did well rising by over 52%. Banks, one of the key sectors for the portfolio, rose only just over 7%, with investors concerned about their bad debt experience.

In a less positive vein a number of sectors recorded falls in share values, including Leisure (-5%), and Telecoms (-4%). The latter's weakness largely reflected Vodafone, which fell by nearly 14% over 2005/6. The portfolio was under-weight in this company throughout the year. Other disappointing sectors where the portfolio had limited exposure were Media (+3%) and Retail (+2%). As in 2004/5, "Mid-Caps" led the way in 2005/6 with the FTSE Mid 250 Index rising by 28.0% over the year.

Portfolio Changes

Over the course of the last financial year the key characteristics of the Trust's portfolio have remained broadly unchanged. As previously there has been a continued emphasis on established well financed high yielding companies, where market valuations appeared to under-estimate their prospects. Looking at new additions during 2005/6, these included A.B.Ports, BAA, Scottish Power and Wimpey. The first two were purchased following periods of under-performance when the market appeared to under-value the quality and sustainability of their earnings streams. Since the year end both AB Ports and BAA have been the subject of take-over interest, along with Lonmin in the mining sector. Scottish Power was purchased following a change in its strategy which has resulted in the sale of nearly all of its US interests. Wimpey also suffered a period of dull performance, reflecting the sluggish UK housing market over much of 2005. All of these shares have shown useful share price recoveries.

Investment Managers' Review

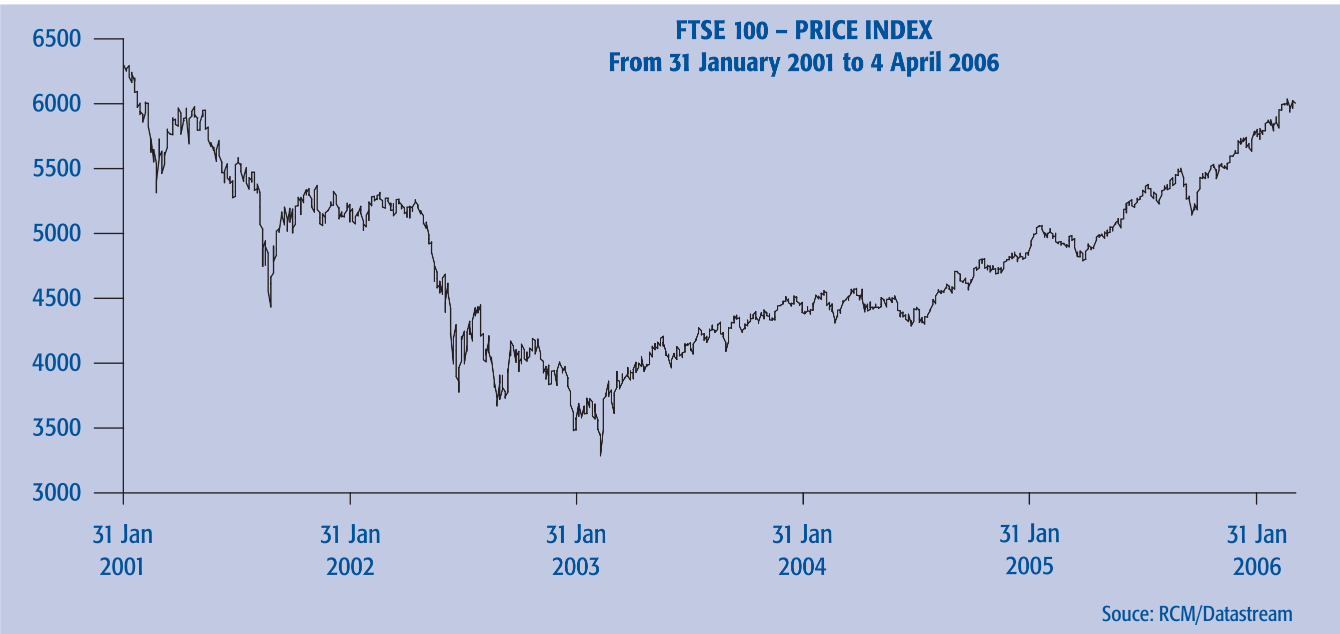
Additions to existing holdings included Alliance & Leicester, Anglo American, Aviva, Land Securities and Resolution. The latter changed its name from Britannic, following the merger with the unquoted Resolution Group. It is now the leading quoted investor in closed life assurance companies in the UK. Anglo American's shares have benefited from the Group's more focused strategy, as well as the rise in metal prices. Land Securities, the UK's largest property group, is a major potential beneficiary from the continued rise in commercial property values and the proposed legislation to create Real Estate Investment Trusts.

Sales from the portfolio during the year included Cantrell & Cochrane, Imperial Group and Rexam, all of whose valuations appeared to be up with events in terms of their profit prospects. Persimmon was "top-sliced" following sustained strong performance, and the company's successful take-over of Westbury led to a further sharp re-valuation of its shares. Its entry into the FTSE 100 Index means it is the first pure housebuilder to achieve this status.

The portfolio benefited from the take-over of Allied Domecq by Pernod Ricard and, just before the year end, BOC received a preliminary approach from Linde, the German industrial gases group. The Trust took part in the new issues from Inmarsat, subsequently sold, and RHM, formerly Rank Hovis MacDougall.

Future Policy

At present there is much discussion as to the future course of UK base rates. This is brought into focus by the potential for interest rates to increase further in both Europe and the US. Although UK company dividends are now growing well again, the trend in UK interest rates will be a key determinant of market levels in 2006. That said, the current spate of take-over activity, coupled with low nominal and real bond yields, suggests that the valuation of UK equities remains inexpensive by historic standards. All these factors are supportive of higher yielding shares.



United Kingdom Listed Holdings
at 31 January 2006

	Value (£)	Principal Activities
BP	54,080,000	Oil & Gas
Royal Dutch Shell 'B' Shares	48,288,000	Oil & Gas
HSBC	45,205,600	Banking
GlaxoSmithKline	33,913,200	Pharmaceuticals
Royal Bank of Scotland	25,056,000	Banking
Lloyds TSB	23,054,875	Banking
HBOS	22,724,000	Banking
BT	16,933,125	Telecommunications
Rio Tinto	16,341,900	Mining
Anglo American	15,984,000	Mining
Barclays	15,325,500	Banking
Land Securities	13,395,750	Real Estate
Vodafone	12,814,800	Telecommunications
Scottish Power	12,090,300	Electricity
Slough Estates	11,830,000	Real Estate
Scottish & Southern Energy	10,315,850	Electricity
Alliance & Leicester	9,879,550	Banking
Lonmin	9,618,600	Mining
Bradford & Bingley	9,315,000	Banking
Aviva	9,222,400	Life and General Insurance
National Grid	9,200,000	Electricity
Diageo	8,950,550	Beverages
AWG	8,698,637	Water
Legal & General	8,642,250	Life and General Insurance
Tate & Lyle	8,064,000	Food Production
Gallaher	7,862,400	Tobacco
British American Tobacco	7,792,050	Tobacco
Rank	7,135,125	Leisure & Gaming
DSG	7,020,000	Retailing
Wimpey (George)	6,890,950	Housebuilding
Persimmon	6,159,300	Housebuilding
BOC	6,150,300	Chemicals
Scottish & Newcastle	6,050,000	Beverages
Premier Foods	5,880,500	Food Production
Pearson	5,751,200	Media
BAA	5,750,000	Transportation Services
Resolution	5,452,750	Life Insurance

United Kingdom Listed Holdings
at 31 January 2006

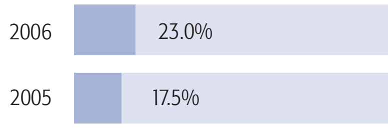
	Value (£)	Principal Activities
Taylor Woodrow	5,449,500	Housebuilding
Kesa Electricals	5,410,312	Retailing
British Insurance	5,142,500	Insurance
Severn Trent	5,042,400	Water
Kingfisher	4,963,750	Retailing
Boots	4,925,125	Retailing
Hanson	4,607,900	Building Materials
Associated British Ports	4,582,500	Transportation Services
EMI	4,479,200	Music
BBA	4,431,000	Transportation Services
Friends Provident	4,422,000	Life and General Insurance
Pennon	4,256,450	Water
RHM	4,087,500	Food Production
Provident Financial	4,012,500	Speciality Finance
GKN	3,917,100	Engineering
IMI	3,397,350	Engineering
Tomkins	3,177,200	Engineering
Cattles	3,025,750	Speciality Finance
Drax	2,954,400	Electricity
Mapeley	2,782,882	Real Estate
	621,905,781	

Distribution of Total Assets
at 31 January 2006

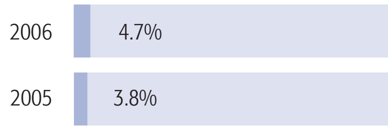
Total Assets (less creditors falling due within one year) £628,066,597 (2005 – £537,830,364 (restated))

	Percentage of Total Assets 2006	Percentage of Total Assets 2005
Equities		
Resources		
Mining	6.7	4.1
Oil and gas	16.3	13.4
	23.0	17.5
Basic Industries		
Chemicals	1.0	1.0
Construction and building materials	3.7	2.8
	4.7	3.8
General Industrials		
Engineering and machinery	1.1	2.6
	1.1	2.6
Cyclical Consumer Goods		
Automobiles and parts	0.6	–
	0.6	–
Non-Cyclical Consumer Goods		
Beverages	2.4	3.5
Food products & processing	2.9	1.6
Pharmaceuticals	5.4	5.8
Tobacco	2.5	4.2
	13.2	15.1
Cyclical Services		
General retailers	3.6	3.5
Leisure and hotels	1.1	2.2
Media and entertainment	1.6	0.9
Support services	–	0.5
Transport	2.3	0.4
	8.6	7.5
Non-Cyclical Services		
Telecommunication services	4.7	6.0
	4.7	6.0

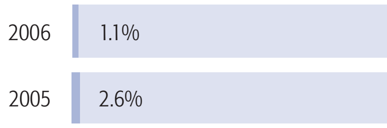
Resources



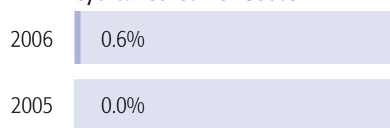
Basic Industries



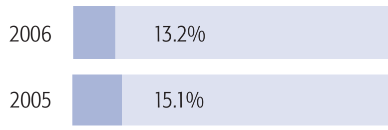
General Industrials



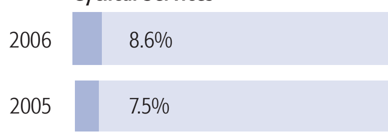
Cyclical Consumer Goods



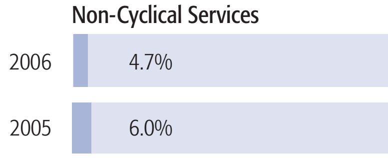
Non-Cyclical Consumer Goods



Cyclical Services

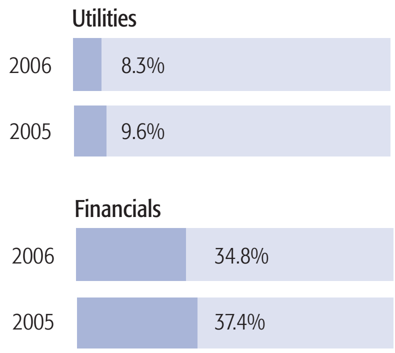


Non-Cyclical Services



Distribution of Total Assets
at 31 January 2006

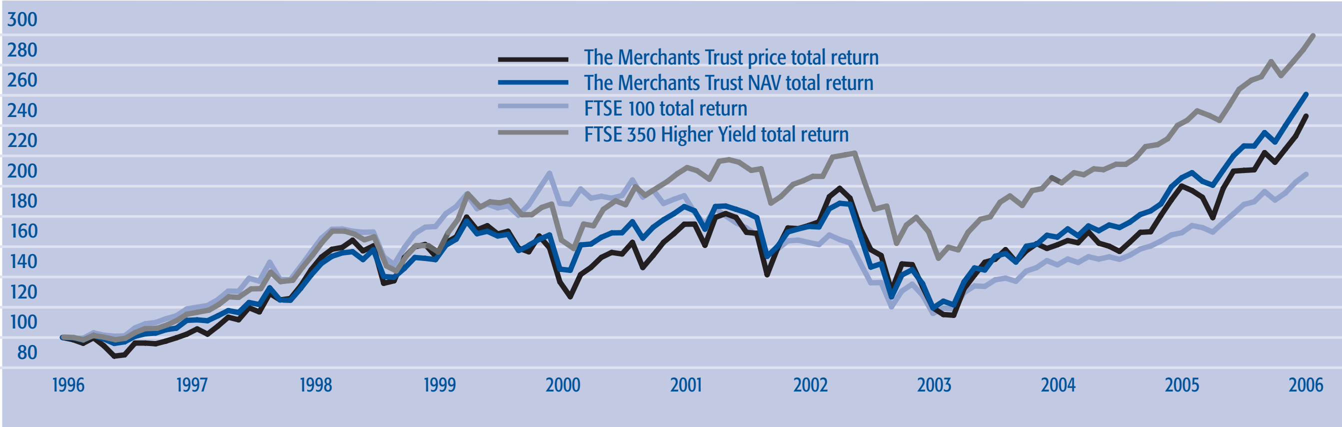
	Percentage of Total Assets	
	2006	2005
Utilities		
Electricity	5.5	3.7
Other	2.8	5.9
	8.3	9.6
Financials		
Banks	24.0	26.3
Insurance	0.8	0.8
Life assurance	4.4	4.2
Real estate	4.5	4.6
Speciality & other financials	1.1	1.5
	34.8	37.4
Total Equities	99.0	99.5
Net Current Assets	1.0	0.5
Total Assets	100.0	100.0



Performance Graphs

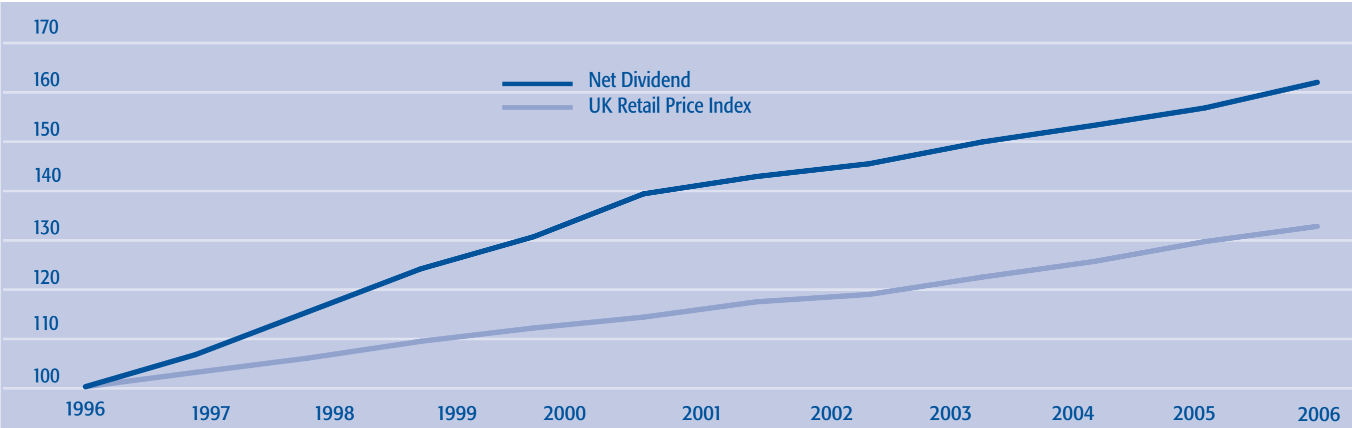
10 year record as at 31 January

The Merchants Trust Total Return compared to key UK equity indices



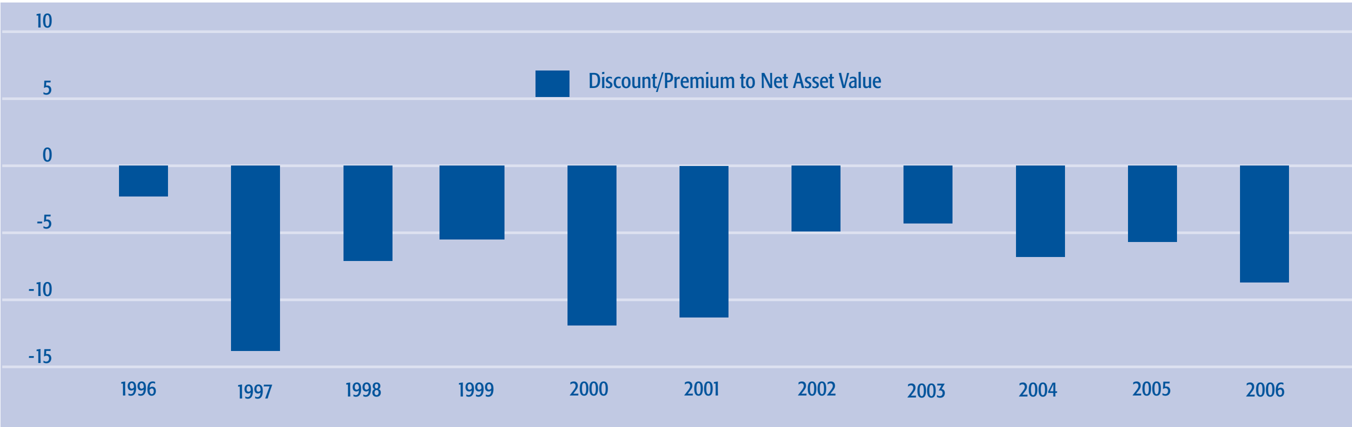
Source: Russell/Mellon

The Merchants Trust Net Dividend Growth compared to inflation



Source: Russell/Mellon

The Merchants Trust PLC



Source: Russell/Mellon

Financial Risk Management

The Company is exposed to financial risk through its financial assets and financial liabilities. The most important components of its financial risk are market price risk, interest rate risk, foreign currency risk, credit risk and liquidity risk. The risk profile and the policies adopted to manage risk did not change materially during either the current or previous year.

The narrative below explains the different types of risks the Company may face. Numerical disclosures are listed in Note 19 to the Accounts.

This information is given so that investors in the Company can decide for themselves whether their investment is high or low risk. It allows them to assess what kind of impact the use of financial instruments (investments, cash/overdraft and borrowings) will have on the performance of the entity. Short term debtors and creditors are not considered to be financial instruments. They have been included at the bottom of the numerical disclosure in Note 19(a) merely to enable users of the Accounts to reconcile the summary provided to total net assets per the balance sheet.

As an investment trust, the Company invests in securities for the long term. Accordingly it is, and has been throughout the year under review, the Company's policy that no short term trading in investments or other financial instruments shall be undertaken.

Market price risk

Market price risk arises mainly from the uncertainty about future prices of financial instruments held. It represents the potential loss the Company might suffer through holding market positions in the face of price movements. The Board meets regularly to consider the asset allocation of the portfolio in order to evaluate the risk associated with particular industry sectors. A dedicated fund manager has the responsibility for monitoring the existing portfolio selection in accordance with the Company's investment objectives and seeks to ensure that individual stocks meet an acceptable risk reward profile.

Interest rate risk

Interest rate risk is the risk of movements in the value of financial instruments as a result of fluctuations in interest rates.

The Company invests predominantly in equities, the values of which are not directly affected by changes in prevailing market interest rates. Therefore there is minimal exposure to interest rate risk.

The Company finances its operations through a mixture of share capital, retained earnings and long term borrowings.

Foreign currency risk

Foreign currency risk is the risk of movement in the values of overseas financial instruments as a result of fluctuations in exchange rates.

The Company invests predominantly in UK listed securities. Accordingly, the capital value of the Company's investments are not materially affected by exchange rate movements.

As a proportion of the investments pay their dividends in US dollars, income can be subject to exchange rate risk.

Credit risk

Credit risk is the risk of default by a counterparty.

In February 2000 the Company commenced stock lending in order to generate additional income. The risk of default is managed by holding collateral, in the form of letters of credit and FTSE 100 equities, amounting to 105% of the mid market value of the stock on loan. The level of collateral required is recalculated on a daily basis.

Liquidity risk

Liquidity risk relates to the capacity to meet liabilities.

The Company's assets mainly comprise realisable securities, which can be sold to meet funding requirements if necessary. Short term flexibility can be achieved through the use of overdraft facilities, where necessary.

Investor Information

The Managers

Allianz Global Investors is the marketing name of RCM (UK) Limited, Allianz Group's regulated UK fund management company, which is authorised and regulated by the Financial Services Authority.

Allianz Global Investors is one of the largest fund managers in Europe, and as at 31 December 2005, had combined assets of £647 billion under management. Through its predecessors, it has a heritage of investment trust management expertise in the UK stretching back to the nineteenth century and had £1.25 billion assets under management in a range of investment trusts as at 31 December 2005.

Results

Half-year announced September
Full-year announced March
Report and Accounts posted to shareholders April
Annual General Meeting held May

Ordinary Dividends

First quarterly paid August
Second quarterly paid November
Third quarterly paid February
Final usually paid May

Preference Dividends

Payable half-yearly 1 August and 1 February

Payment of Dividends Direct to Bank Accounts

Cash dividends will be sent by cheque to first-named shareholders at their registered address together with a tax voucher. Dividends may be paid directly into shareholders' bank accounts. Details of how this may be arranged can be obtained from the Registrars, Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU. Dividends mandated in this way are paid via BACS (Bankers' Automated Clearing Service). Tax vouchers will then be sent directly to shareholders at their registered address unless other instructions have been given.

Market and Portfolio Information

The Company's Ordinary Shares are listed on the London Stock Exchange. The market price, price range, gross yield and net asset value are shown daily in The Financial Times and The Daily Telegraph. The net asset value of the Ordinary Shares is calculated weekly and published by the London Stock Exchange Regulatory News Service. The geographical spread of investments and ten largest holdings are also published monthly by the London Stock Exchange Regulatory News Service. They are also available to any enquirer of Allianz Global Investors, either via Investor Services on 0800 317 573 or on the Managers' website: www.allianzglobalinvestors.co.uk.

Share Prices

The share prices quoted in the London Stock Exchange Daily Official List for 31 January 2006 were 450.75p-451.25p.

For CGT indexation purposes, at 31 March 1982 the share price, after adjustment for bonus issues, was 48.75p.

Share Plan

The Allianz Global Investors Investment Trust Share Plan provides a convenient and economical way for shareholders to increase their existing holdings. Investments can be in the form of a regular monthly contribution, or an individual lump sum or a combination of the two. There are arrangements for the reinvestment of dividends and for selling and switching. Full details of the plan are available from Allianz Global Investors, either via Investor Services on 0800 317 573 or the Managers' website: www.allianzglobalinvestors.co.uk.

Investment Trust Maxi ISA and PEP Transfer

Shareholders can invest in the shares of the Company through the Allianz Global Investors Investment Trust Maxi ISA and PEP Transfer. Full details are available from Allianz Global Investors, either via Investor Services on 0800 317 573 or the Managers' website: www.allianzglobalinvestors.co.uk.

Website

Further information about the The Merchants Trust PLC is available on the Managers' website: www.allianzglobalinvestors.co.uk.

Association of Investment Trust Companies (AITC)

The Company is a member of the AITC, the trade body of the investment trust industry, which provides a range of literature including fact sheets and a monthly statistical service. Copies of these publications can be obtained from the AITC, 9th Floor, 24 Chiswell Street, London EC1Y 4YY, or at www.aitc.co.uk.

Category: UK Growth and Income

Contact Details

Shareholders' Enquiries
Capita Registrars are the Company's registrars and maintain the share register. In the event of queries regarding their holdings of shares, lost certificates, dividend cheques, registered details, etc., shareholders should contact them on 0870 162 3100 or, if telephoning from overseas, 0044 20 8639 2157. Changes of name and address must be notified to the Registrars in writing.

Any general enquiries about the Company should be directed to the Company Secretary, The Merchants Trust PLC, 155 Bishopsgate, London EC2M 3AD.

Managers and Advisers

Fund Manager
RCM (UK) Limited
Represented by Nigel Lanning ASIP ACIS
Director UK Equities, RCM (UK) Limited

Secretary and Registered Office
Kirsten Salt BA(Hons) ACIS
155 Bishopsgate
London EC2M 3AD
Telephone: 020 7065 1513

Registered Number 28276

Registrars and Transfer Office
Capita Registrars
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU
Telephone (if calling from within the UK): 0870 162 3100
Telephone (if calling from overseas): 0044 20 8639 2157
Email: ssd@capitaregistrars.com

Independent Auditors
PricewaterhouseCoopers LLP
Southwark Towers
32 London Bridge Street
London SE1 9SY

Bankers
HSBC Bank
Barclays Bank

Stockbroker
JPMorgan Cazenove

Legal Advisers
Herbert Smith LLP

Allianz Global Investors
Telephone: 0800 317 573 or www.allianzglobalinvestors.co.uk.

Income Statement
for the year ended 31 January 2006

	Note	2006 £ Revenue	2006 £ Capital	2006 £ Total Return	2005 £ Revenue (restated)	2005 £ Capital (restated)	2005 £ Total Return (restated)
Net gains on investments at fair value	8	–	96,792,013	96,792,013	–	65,859,676	65,859,676
Income	1	24,714,263	–	24,714,263	22,674,672	–	22,674,672
Investment management fee	2	(823,956)	(1,530,205)	(2,354,161)	(722,446)	(1,341,685)	(2,064,131)
Expenses of administration	3	(621,878)	(5,424)	(627,302)	(593,850)	–	(593,850)
Net return before finance costs and taxation		23,268,429	95,256,384	118,524,813	21,358,376	64,517,991	85,876,367
Finance costs: interest payable and similar charges	4	(3,414,470)	(6,219,001)	(9,633,471)	(3,408,189)	(6,210,193)	(9,618,382)
Return on ordinary activities before taxation		19,853,959	89,037,383	108,891,342	17,950,187	58,307,798	76,257,985
Taxation	5	–	–	–	–	–	–
Return attributable to Ordinary Shareholders		19,853,959	89,037,383	108,891,342	17,950,187	58,307,798	76,257,985
Return per Ordinary Share (basic and diluted)	7	19.44p	87.20p	106.64p	17.58p	57.11p	74.69p

Dividends in respect of the financial year ended 31 January 2006 total 18.90p (2005 – 18.00p), costing £19,273,678 (2005 – £18,378,708). Details are set out in Note 6.

The total column of this statement is the profit and loss account of the Company.
All revenue and capital items in the above statement derive from continuing operations. No operations were acquired or discontinued in the year.
A Statement of Total Recognised Gains and Losses is not required as all gains and losses of the Company have been reflected in the above statement.

The Notes on pages 20 to 33 form part of these Accounts.

Reconciliation of Movements in Shareholders' Funds

for the year ended 31 January 2006

	Called up Share Capital £	Share Premium Account £	Preference Share Capital £	Capital Redemption Reserve £	Capital Reserve Realised £	Capital Reserve Unrealised £	Revenue Reserve £	Total £
Net Assets at 31 January 2004 as previously stated	25,525,984	39,809	1,178,000	56,250	331,128,953	(9,233,782)	9,925,063	358,620,277
Reclassification of 3.65% Cumulative Preference Stock as a long term creditor	–	–	(1,178,000)	–	–	–	–	(1,178,000)
Dividends on Ordinary Shares not recognised as a current liability	–	–	–	–	–	–	9,189,354	9,189,354
Net Assets at 31 January 2004 (restated)	25,525,984	39,809	–	56,250	331,128,953	(9,233,782)	19,114,417	366,631,631
Revenue Return	–	–	–	–	–	–	17,950,187	17,950,187
Dividends on Ordinary Shares	–	–	–	–	–	–	(18,378,708)	(18,378,708)
Capital Return	–	–	–	–	(8,888,626)	67,196,424	–	58,307,798
Net Assets at 31 January 2005 (restated)	25,525,984	39,809	–	56,250	322,240,327	57,962,642	18,685,896	424,510,908

	Called up Share Capital £	Share Premium Account £	Preference Share Capital £	Capital Redemption Reserve £	Capital Reserve Realised £	Capital Reserve Unrealised £	Revenue Reserve £	Total £
Net Assets at 31 January 2005 as previously stated	25,525,984	39,809	1,178,000	56,250	322,240,327	57,962,642	9,496,542	416,499,554
Reclassification of 3.65% Cumulative Preference Stock as a long term creditor	–	–	(1,178,000)	–	–	–	–	(1,178,000)
Dividends on Ordinary Shares not recognised as a current liability	–	–	–	–	–	–	9,189,354	9,189,354
Net Assets at 31 January 2005 (restated)	25,525,984	39,809	–	56,250	322,240,327	57,962,642	18,685,896	424,510,908
Adjustment to record investments at bid value	–	–	–	–	–	(28,000)	–	(28,000)
Revenue Return	–	–	–	–	–	–	19,853,959	19,853,959
Dividends on Ordinary Shares	–	–	–	–	–	–	(18,661,054)	(18,661,054)
Capital Return	–	–	–	–	28,867,475	60,169,908	–	89,037,383
Net Assets at 31 January 2006	25,525,984	39,809	–	56,250	351,107,802	118,104,550	19,878,801	514,713,196

The Notes on pages 20 to 33 form part of these Accounts.

Balance Sheet
as at 31 January 2006

	Note	2006 £	2006 £	2005 £ (restated)
Fixed Assets				
Investments held at fair value through profit or loss	8		621,948,270	535,094,994
Current Assets				
Debtors	10	3,586,680		1,713,769
Cash at Bank	10	5,374,796		3,192,907
		8,961,476		4,906,676
Creditors: Amounts falling due within one year	10	(2,843,149)		(2,171,306)
Net Current Assets			6,118,327	2,735,370
Total Assets Less Current Liabilities			628,066,597	537,830,364
Creditors: Amounts falling due after more than one year	10		(113,353,401)	(113,319,456)
Total Net Assets			514,713,196	424,510,908
Capital and Reserves				
Called up Share Capital	12		25,525,984	25,525,984
Share Premium Account			39,809	39,809
Capital Redemption Reserve			56,250	56,250
Capital Reserves: Realised	13	351,107,802		322,240,327
Unrealised	13	118,104,550		57,962,642
			469,212,352	380,202,969
Revenue Reserve	14		19,878,801	18,685,896
Equity Shareholders' Funds	15		514,713,196	424,510,908
Net Asset Value per Ordinary Share	15		504.1p	415.8p

Approved by the Board of Directors on 6 April 2006 and signed on its behalf by Hugh Stevenson

The Notes on pages 20 to 33 form part of these Accounts.

Cash Flow Statement
for the year ended 31 January 2006

	Note	2006 £	2006 £	2005 £
Net cash inflow from operating activities	17		22,805,795	22,380,842
Servicing of finance				
Interest paid		(9,556,529)		(9,543,139)
Dividends on Preference Stock		(64,496)		(42,997)
Net cash outflow from servicing of finance			(9,621,025)	(9,586,136)
Investing activities				
Purchases of fixed asset investments		(139,140,607)		(142,790,215)
Sales of fixed asset investments		146,798,780		145,334,022
Net cash inflow from investing activities			7,658,173	2,543,807
Equity dividends paid			(18,661,054)	(18,378,708)
Increase (decrease) in cash	18		2,181,889	(3,040,195)

The Notes on pages 20 to 33 form part of these Accounts.

Statement of Accounting Policies
for the year ended 31 January 2006

1. The accounts have been prepared under the historical cost convention, modified to include the revaluation of investments, and in accordance with the United Kingdom law and United Kingdom Generally Accepted Accounting Practice (UK GAAP) and the Statement of Recommended Practice – 'Financial Statements of Investment Trust Companies' (SORP) issued in December 2005 by the Association of Investment Trust Companies.

   The Company has adopted certain new accounting policies in the year due to the issue of new Financial Reporting Standards (FRSs). Further details can be found on this and the following page as well as in Note 11 which summaries all restatements and prior year adjustments.

   The SORP and changes to the Listing Rules have also given rise to some changes in the presentation. The Statement of Total Return is now called the Income Statement and the total return column, as opposed to the revenue column, is now the profit and loss account of the Company. There is a new primary statement, the Reconciliation of Movements in Shareholders' Funds.

2. Revenue – Dividends on equity shares are accounted for on an ex-dividend basis. UK dividends are shown net of tax credits. Income from convertible securities having an element of equity is recognised on an accruals basis. Interest receivable on non-equity shares is recognised on an accruals basis.

   Where circumstances dictate, special dividends will be recognised as a capital receipt.

   Where the Company has elected to receive its dividends in the form of additional shares rather than in cash, the equivalent of the cash dividend is recognised as income. Any excess in the value of the shares received over the amount of the cash dividend is recognised in capital reserves.

   Deposit interest receivable and stocklending fees are accounted for on an accruals basis. Underwriting commission is recognised when the issue underwritten closes.

3. Investment management fee – The investment management fee is calculated on the basis set out in Note 2 to the accounts and is charged to capital and revenue in the ratio 65:35 to reflect the Board's investment policy and prospective split of capital and income returns. Other administrative expenses are charged in full to revenue, except handling charges which are charged to capital.

4. Valuation – Investments are designated as held at fair value through profit or loss in accordance with FRS 26 'Financial Instruments: Measurement'. Listed investments are valued at bid market prices. This represents a change in accounting policy, however in accordance with the exemption conferred by paragraph 108D of FRS 26, comparatives have not been restated. In prior periods listed investments were valued at mid market prices, although for much of the portfolio this was last traded price which is the same as bid price. As a consequence the adoption of bid prices on 1 February 2005 decreased the value of investments by £28,000, as shown in Note 8. Unlisted investments are valued by the Directors based upon the latest dealing prices, stockbrokers' valuations, net asset values, earnings and other known accounting information in accordance with the principles set out by the British Venture Capital Association issued in July 2003.

   An unrealised Capital Reserve has been established to reflect differences between value and book cost. Net gains or losses arising on realisation of investments are taken directly to the realised Capital Reserve.

5. Finance costs – In accordance with the Financial Reporting Standard 25 'Financial Instruments: Disclosure and Presentation' and FRS 26 'Financial Instruments: Measurement', long term borrowings are stated as the amount of net proceeds immediately after issue plus the appropriate accrued finance costs at the balance sheet date. The finance costs of such borrowings, are allocated to periods over the term of the debt on the effective rate basis. Finance costs on long term borrowings are charged to capital and revenue in the ratio 65:35 to reflect the Board's investment policy and prospective split of capital and income returns.

   Dividends payable on the 3.65% Cumulative Preference Stock are classified as an interest expense and are charged in full to revenue.

6. Taxation – Where expenses are allocated between capital and revenue, any tax relief obtained in respect of those expenses is allocated between capital and revenue on the marginal basis using the Company's effective rate of Corporation tax for the accounting period.

Statement of Accounting Policies
for the year ended 31 January 2006

A deferred tax asset is recognised when it is more likely than not that the asset will be recoverable. Deferred tax is measured on a non-discounted basis at the rate of Corporation tax that is expected to apply when the timing differences are expected to reverse.

7. Foreign currency – In accordance with FRS 23 'The Effect of Changes in Foreign Currency Exchange Rates', the Company is required to nominate a functional currency, being the currency in which the Company predominately operates. The Company has determined that sterling is the most appropriate functional currency, which is also the currency in which these accounts are presented. Transactions in foreign currencies are translated into sterling at the rates of exchange ruling on the date of the transaction. Foreign currency assets and liabilities are translated into sterling at the rates of exchange ruling at the balance sheet date. Profits and losses thereon are recognised in Capital Reserves.

8. Dividends – In accordance with FRS 21 'Events After the Balance Sheet Date', the final dividend payable on Ordinary Shares is recognised as a liability when approved by shareholders. Interim dividends are recognised only when paid. This is a change of accounting policy and results in a restatement of the prior year creditors and a consequential increase in the prior year net asset value.

9. Preference Stock – Following the introduction of FRS 25 'Financial Instruments: Disclosure and Presentation', the 3.65% Cumulative Preference Stock is now classified as a liability as the rights of the stockholders to receive dividend payments are not calculated by reference to the Company's profits. This is a change of accounting policy and prior year net assets have been restated accordingly as shown in Note 11.

Notes to the Accounts
for the year ended 31 January 2006

1. Income

	2006 £	2006 £	2005 £
Total income comprises:			
Income from investments:*			
Equity income from UK investments		24,206,347	22,463,026
Equity income from overseas investments		151,663	52,968
		24,358,010	22,515,994
Other income:			
Deposit interest	339,652		114,267
Underwriting commission	10,363		12,296
Stocklending fees	6,238		32,115
		356,253	158,678
Total income		24,714,263	22,674,672

*All equity income is derived from listed investments.

2. Investment Management Fee

	2006 £ Revenue	2006 £ Capital	2006 £ Total	2005 £ Revenue	2005 £ Capital	2005 £ Total
Investment management fee	823,956	1,530,205	2,354,161	722,446	1,341,685	2,064,131

The management contract with RCM (UK) Limited ('RCM'), terminable at one year's notice, provides for a management fee based on 0.35% (2005 – 0.35%) per annum of the value of the Company's assets calculated quarterly after deduction of current liabilities, short term loans under one year and any funds within the portfolio managed by RCM. The amounts stated include irrecoverable VAT of £350,620 (2005 – £307,423). Under the contract, RCM provides the Company with investment management, accounting, secretarial and administration services.

3. Expenses of Administration

	2006 £	2005 £
Directors' fees	69,388	68,236
Auditors' remuneration:		
for audit services	19,388	16,703
for non-audit services	7,050	–
Marketing costs of Share Plan	232,018	202,600
Other administrative expenses	294,034	306,311
	621,878	593,850

(i) The above expenses include value added tax where applicable.

(ii) Between 1 February 2004 and 31 May 2004, Directors' fees were paid at the rate of £11,000 per annum with an additional sum of £4,000 per annum paid to the Chairman and an additional sum of £3,000 per annum paid to the Chairman of the Audit Committee. Between 1 June 2004 and 31 January 2006, Directors' fees were paid at the rate of £12,000 per annum with an additional sum of £8,000 per annum paid to the Chairman and an additional sum of £3,000 per annum paid to the Chairman of the Audit Committee.

Notes to the Accounts
for the year ended 31 January 2006

4. Finance Costs: interest payable and similar charges

	2006 £ Revenue	2006 £ Capital	2006 £ Total	2005 £ Revenue (restated)	2005 £ Capital (restated)	2005 £ Total (restated)
On Stepped Rate Interest Loan repayable after more than five years	1,384,740	2,571,660	3,956,400	1,379,152	2,561,283	3,940,435
On Fixed Rate Interest Loan repayable after more than five years	1,321,650	2,454,493	3,776,143	1,322,399	2,455,885	3,778,284
On 4% Perpetual Debenture Stock repayable after more than five years	19,250	35,750	55,000	19,250	35,750	55,000
On 5.875% Secured Bonds repayable after more than five years	623,053	1,157,098	1,780,151	623,148	1,157,275	1,780,423
On 3.65% Cumulative Preference Stock repayable after more than five years	42,997	–	42,997	42,997	–	42,997
On Sterling overdraft	22,780	–	22,780	21,243	–	21,243
	3,414,470	6,219,001	9,633,471	3,408,189	6,210,193	9,618,382

5. Taxation

	2006 £ Revenue	2006 £ Capital	2006 £ Total	2005 £ Revenue (restated)	2005 £ Capital (restated)	2005 £ Total (restated)
Corporation tax	–	–	–	–	–	–
Current year tax charge	–	–	–	–	–	–
Reconciliation of current charge						
Return on ordinary activities before taxation	19,853,959	89,037,383	108,891,342	17,950,187	58,307,798	76,257,985
Tax on return on ordinary activities at 30% (2005 – 30%)	5,956,188	26,711,215	32,667,403	5,385,056	17,492,339	22,877,395
Reconciling factors:						
Non taxable income	(7,261,904)	–	(7,261,904)	(6,738,908)	(639,825)	(7,378,733)
Non taxable capital gains	–	(29,037,604)	(29,037,604)	–	(19,118,078)	(19,118,078)
Disallowable expenses	98,509	31,349	129,858	88,186	26,717	114,903
Excess of allowable expenses over taxable income	1,207,207	2,295,040	3,502,247	1,265,666	2,238,847	3,504,513
Current year tax charge	–	–	–	–	–	–

The Company's taxable income is exceeded by its tax allowable expenses, which include both the capital and revenue elements of the management fee and finance costs of borrowings. The Company has surplus expenses carried forward of £90.1m (2005 – £79.0m). Given the Company's current investment strategy, it is unlikely to generate sufficient UK taxable profits to relieve these expenses.

As at 31 January 2006 there is an unrecognised deferred tax asset, measured at the standard rate of 30%, of £27.0m (2005 – £23.6m). This deferred tax asset relates to the current and prior year unutilised expenses. It is considered unlikely that there will be a liability in the future against which the deferred tax asset can be offset. Therefore, the tax asset has not been recognised.

Due to the Company's status as an investment trust and the intention to continue meeting the conditions required to obtain approval in the foreseeable future, the Company has not provided deferred tax on any capital gains and losses arising on the disposal of investments.

Notes to the Accounts
for the year ended 31 January 2006

6. Dividends on Ordinary Shares

	2006 £	2005 £
Third interim dividend 4.5p paid 17 February 2005 (2004 – 4.5p)	4,594,677	4,594,677
Final dividend 4.5p paid 11 May 2005 (2004 – 4.5p)	4,594,677	4,594,677
First interim dividend 4.6p paid 18 August 2005 (2004 – 4.5p)	4,696,781	4,594,677
Second interim dividend 4.7p paid 10 November 2005 (2004 – 4.5p)	4,798,885	4,594,677
Uncollected dividend from prior years (2005 – nil)	(23,966)	–
	18,661,054	18,378,708

Dividends payable at the year end are not recognised as a liability under FRS 21 'Events After the Balance Sheet Date' (see page 20 – Statement of Accounting Policies). Details of these dividends are set out below.

	2006 £	2005 £
Third interim dividend 4.8p payable 17 February 2006 (2005 – 4.5p)	4,900,989	4,594,677
Final proposed dividend 4.8p payable 10 May 2006 (2005 – 4.5p)	4,900,989	4,594,677
	9,801,978	9,189,354

The proposed final dividend accrued is based on the number of shares in issue at the year end. However, the dividend payable will be based on the numbers of shares in issue on the record date and will reflect any purchases and cancellation of shares by the Company settled subsequent to the year end.

Ordinary dividends paid by the Company carry a tax credit at a rate of 10%. The credit discharges the tax liability of shareholders subject to income tax at less than the higher rate. Shareholders liable to pay tax at the higher rate will have further tax to pay.

7. Return per Ordinary Share

	2006 £ Revenue	2006 £ Capital	2006 £ Total Return	2005 £ Revenue (restated)	2005 £ Capital (restated)	2005 £ Total Return (restated)
Return attributable to Ordinary Shares	19,853,959	89,037,383	108,891,342	17,950,187	58,307,798	76,257,985
Return per Ordinary Share	19.44p	87.20p	106.64p	17.58p	57.11p	74.69p

The weighted average number of shares in issue during the year was 102,103,936 (2005 – 102,103,936).

Notes to the Accounts
for the year ended 31 January 2006

8. Fixed Asset Investments

	2006 £	2005 £
Listed on The London Stock Exchange at market valuation	621,905,781	535,053,754
Unlisted at fair value	42,489	41,240
Total fixed asset investments	621,948,270	535,094,994
Market value of investments brought forward	535,094,994	473,911,875
Adjustment from mid market to bid prices	(28,000)	–
Unrealised (gains) losses brought forward	(57,934,642)	9,233,782
Cost of investments held brought forward	477,132,352	483,145,657
Additions at cost	139,140,607	142,790,215
Disposals at cost	(112,429,239)	(148,803,520)
Costs of investments held at 31 January	503,843,720	477,132,352
Unrealised gains at 31 January	118,104,550	57,962,642
Market value of investments held at 31 January	621,948,270	535,094,994

Net gains on investments

	2006 £	2005 £
Net realised gains (losses) on historical costs	36,622,105	(3,469,498)
Adjustment for net unrealised (gains) losses recognised in previous years	(24,567,546)	32,135,599
Net realised gains based on carrying value at previous balance sheet date	12,054,559	28,666,101
Net unrealised gains arising in the year	84,737,454	35,060,825
Gains on investments before special dividends	96,792,013	63,726,926
Special dividends credited to capital	–	2,132,750
Net gains on investments	96,792,013	65,859,676

The Board considers that the Company's remaining unquoted investments are not material to the financial statements.

Transaction costs on purchases amounted to £888,492 (2005 – £985,840) and transaction costs on sales amounted to £302,257 (2005 – £286,962).

Stocklending

	2006	2005
Aggregate value of securities on loan at year-end	28.0m	12.5m
Maximum aggregate value of securities on loan during the year	72.0m	76.2m
Fee income from stocklending during the year	6,238	32,115

In respect of securities on loan at the year-end, the Company held £29.4m (2005 – £13.2) as collateral, the value of which exceeded the value of the loan securities by £1.4m (2005 – £0.7m)

In respect of the maximum aggregate value of securities of loan during the year, the Company held £75.6m (2005 – £80.1m) as collateral, the value of which exceeded the value of securities on loan by £3.6m (2005 – £3.9m).

Notes to the Accounts
for the year ended 31 January 2006

9. Investments in Subsidiary and Other Companies

Surrey Investments Inc. is a wholly owned subsidiary registered in the State of Delaware, USA with an issued share capital of US$300,000. It was formed to act as a Limited Partner in O'Connor Associates LP and a shareholder in JW O'Connor & Co. Inc., both of which are engaged in property development in the US. This company is now in the process of liquidation following the disposal of its interest in JW O'Connor & Co. Inc.

The Company has not produced consolidated accounts in view of the immaterial amounts involved. This subsidiary is deemed not material for the purposes of giving a true and fair view.

The Company held more than 10% of the share capital of the following companies, both of which are incorporated in Great Britain and registered in England and Wales:

Company	Total Net Assets* £	Class of Shares held	% of Class held	% Equity
First Debenture Finance PLC ('FDF')	(5,116,708)	'A' Shares	39.2	
		'B' Shares	59.2	49.2
		'C' Shares	45.6	
		'D' Shares	53.3	
Fintrust Debenture PLC ('Fintrust')	6,845	Ordinary	50.0	50.0

In the opinion of the Directors, the Company is not in a position to exert significant influence over the financial or operating policies of FDF or Fintrust, either through voting rights or through agreement with those companies' other shareholders, due to provisions in FDF and Fintrust's Articles of Association and in certain contracts between the Company and each of FDF and Fintrust. The aggregate share capital, reserves and results are immaterial to the Company's accounts. FDF and Fintrust are the lenders of the Company's Stepped Rate Loan and Fixed Rate Interest Loan, as detailed in Notes 10(i) and 10(ii), respectively. Apart from the finance costs, there were no other transactions between FDF, Fintrust and the Company during the year.

* As at the date of the latest published financial statements of FDF or Fintrust, as appropriate.

10. Current Assets and Creditors

	2006 £	2005 £
Debtors:		
Sales for future settlement	2,252,564	–
Accrued income	1,238,443	1,676,805
Other debtors	95,673	36,964
	3,586,680	1,713,769
Cash at bank:		
Current account	5,374,796	3,192,907

Notes to the Accounts
for the year ended 31 January 2006

10. Current Assets and Creditors (continued)

	Note	2006 £	2005 £ (restated)
Creditors: Amounts falling due within one year –			
Other creditors		1,523,883	830,541
Interest on borrowings	10(vi)	1,319,266	1,319,266
Dividend on 3.65% Cumulative Preference Stock		–	21,499
		2,843,149	2,171,306
Creditors: Amounts falling due after more than one year –			
Stepped Rate Interest Loan	10(i)	35,512,189	35,362,362
Fixed Rate Interest Loan	10(ii)	46,253,156	46,386,538
5.875% Secured Bonds 2029	10(iii)	29,035,056	29,017,556
4% Perpetual Debenture Stock	10(iv)	1,375,000	1,375,000
3.65% Cumulative Preference Stock	10(v)	1,178,000	1,178,000
		113,353,401	113,319,456

(i) The effective interest rate on the Stepped Rate Interest Loan over its terms is 11.28% per annum.

The Stepped Rate Interest Loan comprises adjustable Stepped Rate Interest Loan Notes of £5,133,520 and Stepped Rate Interest Bonds of £20,534,079 issued at 97.4%. These amounts are repayable on 2 January 2018 exclusive of any redemption expenses, together with a premium of £8,366,513.

The initial interest rate in 1987 on the Loan Notes and Bonds was 7.16% per annum. This increased annually by 7.5% compound until January 1998 when it reached its current rate of 14.75%. However, the combined effect of this interest charge and the accrual of the premium referred to above results in an effective interest rate of 11.28% per annum. Interest is payable in January and July each year.

Interest on the Loan Notes is variable in accordance with the terms of the agreement with the lender, First Debenture Finance PLC ('FDF').

The Company has guaranteed the repayment of £34,012,852, being its proportionate share (65.15%) of the required amount to enable FDF to meet all of its liabilities to repay principal and interest on its £52.2 million of 11.125% Severally Guaranteed Debenture Stock 2018. There is a floating charge on all the Company's present and future assets to secure this obligation. The Company has also agreed to meet its proportionate share of any expenses incurred by FDF, including any tax liability which may accrue to FDF as a result of the redemption or earlier transfer of the Stepped Rate Loan Notes and Bonds held by FDF. The accounting treatment adopted in respect of the stepped rate interest and redemption premiums is set out in the Statement of Accounting Policies.

(ii) The Fixed Rate Interest Loan of £42,000,000 is due to Fintrust Debenture PLC ('Fintrust'). This loan is repayable in 2023 and carries interest at the rate of 9.25125% per annum on the principal amount payable in arrears by equal half yearly installments in May and November in each year. As security for this loan, the Company has granted a floating charge over all its undertakings, property and assets in favour of the lender. This charge ranks pari passu with the floating charge noted in 10(i) above.

Following the liquidation of Kleinwort Overseas Investment Trust plc ('KOIT') in March 1998, the Company assumed £12,000,000 of KOIT's obligations to Fintrust. Both the interest cost and repayment terms of this additional borrowing were identical to the Company's existing loan of £30,000,000. In order that the finance costs on this new borrowing be comparable to existing market rates at that time, the Company also received a premium payment from KOIT of £5,286,564. This premium is being amortised over the remaining life of the loan, as set out in the Statement of Accounting Policies. At 31 January 2006, the unamortised premium included within the Fixed Rate Interest Loan balance of greater than one year amounted to £4,373,764 (2005 – £4,509,738).

The original loan from Fintrust is stated at net proceeds (being the principal amount of £30,000,000 less issue costs of £141,053) plus accrued finance costs.

Notes to the Accounts
for the year ended 31 January 2006

10. Current Assets and Creditors (continued)

(iii) The £30,000,000 5.875% Secured Bonds, repayable on 20 December 2029, carry interest at the rate of 5.875% per annum on the principal amount payable in arrears by equal half yearly instalments in June and December each year. As security for this loan the Company has granted a floating charge ranking pari passu with the floating charges referred to in Note 10(i) and 10(ii) above over the whole of the present and future undertakings, property, assets and rights of the Company.

The accounting treatment adopted in respect of the Bonds is set out in the Statement of Accounting Policies.

(iv) The 4% Perpetual Debenture Stock is secured by a floating charge on the assets of the Company, which ranks prior to any other floating charge. Interest is repayable in arrears by equal half yearly instalments in May and November.

(v) The 3.65% Cumulative Preference Stock is recognised as a creditor due after more than one year under the provisions of FRS25 'Financial Instruments: Disclosure and Presentation'. The right of the Stock to receive payments is not calculated by reference to the Company's profits and, in the event of a return of capital are limited to a specific amount, being £1,178,000. Dividends on the Preference Stock are payable half yearly on 1 August and 1 February.

(vi) Interest on outstanding borrowings consists of:

	2006 £	2005 £
Stepped Rate Interest Loan	313,728	313,728
Fixed Rate Interest Loan	783,545	783,545
5.875% Secured Bonds 2029	208,243	208,243
4% Perpetual Debenture Stock	13,750	13,750
	1,319,266	1,319,266

11. Restatement of opening balances

	2005 As previously stated £	2005 Adjustments £	2005 Restated £	2004 As previously stated £	2004 Adjustments £	2004 Restated £
Fixed Assets	535,094,994	–	535,094,994	473,911,875	–	473,911,875
Net Current (Liabilities) Assets	(6,453,984)	9,189,354[1]	2,735,370	(3,175,221)	9,189,354[1]	6,014,133
	528,641,010	9,189,354	537,830,364	470,736,654	9,189,354	479,926,008
Creditors: Amounts falling due after more than one year	(112,141,456)	(1,178,000)[2]	(113,319,456)	(112,116,377)	(1,178,000)[2]	(113,294,377)
Total Net Assets	416,499,554	8,011,354	424,510,908	358,620,277	8,011,354	366,631,631
Capital and Reserves						
Called up Share Capital: Ordinary	25,525,984	–	25,525,984	25,525,984	–	25,525,984
Called up Share Capital: Preference	1,178,000	(1,178,000)[2]	–	1,178,000	(1,178,000)[2]	–
Share Premium Account	39,809	–	39,809	39,809	–	39,809
Capital Redemption Reserve	56,250	–	56,250	56,250	–	56,250
Capital Reserves: Realised	322,240,327	–	322,240,327	331,128,953	–	331,128,953
Capital Reserves: Unrealised	57,962,642	–	57,962,642	(9,233,782)	–	(9,233,782)
Revenue Reserve	9,496,542	9,189,354[1]	18,685,896	9,925,063	9,189,354[1]	19,114,417
Shareholders' Funds	416,499,554	8,011,354	424,510,908	358,620,277	8,011,354	366,631,631
Net Asset Value per Ordinary Share	406.8p	9.0p	415.8p	350.1p	9.0p	359.1p

[1] Represents the effect of not recognising the 3rd and 4th quarter dividends (FRS 21 'Events After the Balance Sheet Date').

[2] Represents the effect of recognising the 3.65% Cumulative Preference Stock holding as a creditor due after more than one year and not non-equity Shareholder funds (FRS 25 'Financial Instruments: Disclosure and Presentation').

Notes to the Accounts
for the year ended 31 January 2006

12. Called up Share Capital

	2006 £	2005 £
Authorised		
107,431,248 Ordinary Shares of 25p	26,857,812	26,857,812
Allotted and fully paid		
102,103,936 Ordinary Shares of 25p	25,525,984	25,525,984

(i) The Directors are authorised by an ordinary resolution passed on 10 May 2005 to allot relevant securities, in accordance with Section 80 of the Companies Act 1985, up to a maximum aggregate nominal amount of £1,331,828. This authority, if not previously revoked or varied, expires five years from the date of the resolution.

The Directors are also authorised by a special resolution passed on 10 May 2005 to allot relevant securities for cash, in accordance with Section 95 of the Companies Act 1985, up to a maximum aggregate nominal amount of £1,273,746. This authority, if not previously revoked or renewed, expires at the forthcoming Annual General Meeting and a resolution will be proposed at that meeting for its renewal.

13. Capital Reserves

	Realised £	Unrealised £	Total £
Balance at 1 February 2005	322,240,327	57,962,642	380,202,969
Adjustment to record investments at bid value	–	(28,000)	(28,000)
Adjusted opening balance	322,240,327	57,934,642	380,174,969
Net gains on realisation of investments	12,054,559	–	12,054,559
Transfer on disposal of investments	24,567,546	(24,567,546)	–
Net unrealised gains arising in year	–	84,737,454	84,737,454
Investment management fee	(1,530,205)	–	(1,530,205)
Finance costs: interest payable and similar charges	(6,219,001)	–	(6,219,001)
Other capital charges	(5,424)	–	(5,424)
Balance at 31 January 2006	351,107,802	118,104,550	469,212,352

14. Revenue Reserve

	£ (restated)
Balance at 1 February 2005	18,685,896
Revenue for the year	19,853,959
Dividends on Ordinary Shares	(18,661,054)
Balance at 31 January 2006	19,878,801

Notes to the Accounts
for the year ended 31 January 2006

15. Net Asset Value per Share

The Net Asset Value per share was as follows:

	Net Asset Value per Share attributable 2006	2005 (restated)
Ordinary Shares of 25p	504.1p	415.8p

	Net Asset Value attributable 2006	2005 (restated)
Ordinary Shares of 25p	£514,713,196	£424,510,908

The Net Asset Value per Ordinary Share is based on 102,103,936 Ordinary Shares in issue at the year end (2005 – 102,103,936)

16. Contingent Liabilities and Commitments

At 31 January 2006 there were no outstanding contingent liabilities (2005 – £nil) in respect of underwriting commitments and calls on partly paid investments.

Details of the guarantee provided by the Company as part of the terms of the Stepped Rate Loan are provided in Note 10(i) 'Current Assets and Creditors' on page 27.

17. Reconciliation of Return on Ordinary Activities before Taxation to Net Cash Flow from Operating Activities

	2006 £	2005 £ (restated)
Total return before taxation	108,891,342	76,257,985
Add: Finance costs: interest payable and similar charges	9,633,471	9,618,382
Add: Special dividends credited to capital	–	2,132,750
Less: Net gains on investments at fair value	(96,792,013)	(65,859,676)
	21,732,800	22,149,441
Decrease in debtors	379,653	148,286
Increase in creditors	693,342	83,115
Net cash inflow from operating activities	22,805,795	22,380,842

Notes to the Accounts
for the year ended 31 January 2006

18. Reconciliation of Net Cash Flow to Movement in Net Debt

(i) Analysis of net debt

	Cash £	Stepped and Fixed Rate loans £	5.875% Secured Bonds 2029 £	4% Perpetual Debenture Stock £	3.65% Cumulative Preference Stock £	Net Debts £
At 1 February 2005	3,192,907	(81,748,900)	(29,017,556)	(1,375,000)	(1,178,000)	(110,126,549)
Movement in year	2,181,889	(16,445)	(17,500)	–	–	2,147,944
At 31 January 2006	5,374,796	(81,765,345)	(29,035,056)	(1,375,000)	(1,178,000)	(107,978,605)

(ii) Reconciliation of net cash flow to movement in net debt

	2006 £	2005 £ (restated)
Net cash inflow (outflow)	2,181,889	(3,040,195)
Increase in long term loans	(33,945)	(25,079)
Movement in net funds	2,147,944	(3,065,274)
Net debt brought forward	(110,126,549)	(107,061,275)
Net debt carried forward	(107,978,605)	(110,126,549)

Notes to the Accounts
for the year ended 31 January 2006

19. Financial Risk Management

The note below should be read in conjunction with the Financial Risk Management statements of the Company on page 13.

(a) Interest Rate Risk Profile

The tables below summarise in Sterling terms the assets and liabilities whose values are affected by changes in interest rates, together with the weighted average interest rates and periods for which rates are fixed on the fixed interest bearing assets and liabilities.

	Currency	2006 Fixed rate interest £000s	2006 Floating rate interest £000s	2006 Nil interest £000s	2006 Total £000s	2005 Fixed rate interest £000s (restated)	2005 Floating rate interest £000s (restated)	2005 Nil interest £000s (restated)	2005 Total £000s (restated)
Financial Assets									
Values not directly affected by changes in interest rates:									
Equities	Sterling	–	–	621,933	621,933	–	–	535,081	535,081
Equities	US Dollar	–	–	15	15	–	–	14	14
Cash	Sterling	–	5,375	–	5,375	–	3,193	–	3,193
Total Financial Assets		–	5,375	621,948	627,323	–	3,193	535,095	538,288
Financial Liabilities									
Values directly affected by changes in interest rates:									
First Debenture									
Finance loan	Sterling	(35,512)	–	–	(35,512)	(35,362)	–	–	(35, 362)
Fintrust loan	Sterling	(46,253)	–	–	(46,253)	(46, 386)	–	–	(46,386)
5.875% Secured									
Bonds 2029	Sterling	(29,035)	–	–	(29,035)	(29,018)	–	–	(29,018)
4% Perpetual									
Debenture Stock	Sterling	(1,375)	–	–	(1,375)	(1,375)	–	–	(1,375)
3.65% Cumulative									
Preference Stock	Sterling	(1,178)	–	–	(1,178)	(1,178)	–	–	(1,178)
Total Financial Liabilities		(113,353)	–	–	(113,353)	(113,319)	–	–	(113,319)
Net Financial (Liabilities) Assets		(113,353)	5,375	621,948	513,970	(113,319)	3,193	535,095	424,969
Short term debtors and creditors					744				(458)
Net Assets per Balance Sheet					514,714				424,511

Notes to the Accounts
for the year ended 31 January 2006

19. Financial Risk Management (continued)

The fixed rate interest bearing liabilities bear the following coupon and effective rates as at 31 January 2005 and 31 January 2006:

	Maturity date	Amount borrowed £	Coupon rate	Effective rate since inception[1]
First Debenture Finance loan – bonds	2/1/2018	20,534,079	14.75%	11.28%
First Debenture Finance loan – notes	2/1/2018	5,133,520	14.75%	11.28%
Fintrust – original loan	20/11/2023	30,000,000	9.25125%	9.51%
Fintrust – new loan	20/11/2023	12,000,000	9.25125%	6.00%
5.875% Secured Bonds 2029	20/12/2029	30,000,000	5.875%	6.23%
4% Perpetual Debenture Stock	n/a	1,375,000	4.00%	n/a
3.65% Cumulative Preference Stock	n/a	1,178,000	3.65%	n/a

[1]The effective rates are calculated in accordance with FRS 26 ‘Financial Instruments: Measurement’ as detailed in the Accounting Policies.

The weighted average effective rate of the Company’s fixed interest bearing liabilities (excluding the 4% Perpetual Debenture Stock and the 3.65% Cumulative Preference Stock) is 8.54% (2005 – 8.54%) and the weighted average period to maturity of these liabilities is 18.2 years (2005 – 19.2) years.

(b) Currency Risk Profile

As at 31 January 2006 £14,944 (2005 – £13,695) of the assets of the Company were denominated in US Dollars. Thus the total net assets and total return are not materially affected by currency movements.

(c) Fair Value Disclosures

The assets and liabilities of the Company are held at a fair value with the exception of the liabilities shown below:[2]

	2006 £ million Book value	2006 £ million Fair value	2005 £ million Book value	2005 £ million Fair value
First Debenture Finance Loan	35.5	52.3	35.3	50.1
Fintrust Loan	46.3	62.9	46.4	58.6
5.875% Secured Bonds 2029	29.0	34.1	29.0	28.7
4% Perpetual Debenture Stock	1.4	1.2	1.4	1.0
3.65% Cumulative Preference Stock	1.2	0.7	1.2	0.7

[2]The fair value is derived from the closing market value as at 31 January 2005 and 31 January 2006.

(d) Liquidity Profile

The maturity profile of the Company’s financial liabilities at 31 January 2006, (being the borrowings from Fintrust, First Debenture Finance, the 5.875% Secured Bonds and the 4% Perpetual Debenture Stock), is detailed in Note 10 ‘Current Assets and Creditors’ on pages 26 to 28. The undrawn committed borrowings facilities available to the Company at 31 January 2006 were £10,000,000.

(e) Hedging Instruments

At the year end the Company had no hedging arrangements in place (2005 – nil).

Independent Auditors' Report

Independent Auditors' Report to the Members of The Merchants Trust PLC

We have audited the accounts of the Merchants Trust PLC for the year ended 31 January 2006 which comprise the Income Statement, the Reconciliation of Movements in Shareholders' Funds, the Balance Sheet, the Cash Flow Statement, and the related notes. These accounts have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report and the accounts in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities. The Directors are also responsible for preparing the Directors' Remuneration Report.

Our responsibility is to audit the accounts and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the accounts give a true and fair view and whether the accounts and the part of the Directors' Remuneration Report to be audited have been 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 accounts, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited accounts. The other information comprises only the Chairman's Statement, the Investment Managers' Review, the Corporate Governance Statements, the unaudited part of the Directors' Remuneration Report and the Directors' Report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the accounts give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs at 31 January 2006 and of its net return and cash flows for the year then ended; and
- the accounts and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

6 April 2006

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the Accounts in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice. Company law requires the Directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the Company for that period. In preparing these accounts, 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 accounts;
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

The accounts are published on www.allianzglobalinvestors.co.uk, which is a website maintained by the Company's Investment Managers, RCM (UK) Limited. The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of the accounts may differ from legislation in other jurisdictions.

Corporate Governance

The Board has put in place a framework for corporate governance which it believes is appropriate for an investment trust company and which enables the Company to comply with the applicable provisions of the Combined Code on Corporate Governance ('the Combined Code').

The Board has also taken account of the AITC Code of Corporate Governance which was issued by the Association of Investment Trust Companies in July 2003. The Board has reviewed and applied the requirements of both codes except where stated otherwise.

The AITC has updated its Code of Corporate Governance and in March this year this new AITC Code was endorsed by the Financial Reporting Council (FRC). The FRC, which has oversight of the Combined Code, has confirmed that reporting against the AITC Code and following the AITC Guide to Corporate Governance should allow boards to meet fully their obligations under the Combined Code and in relation to the Listing Rules. The Board will report against the new AITC Code in the future.

The Board considers that the Company has complied with the applicable provisions of the Combined Code throughout the accounting period to 31 January 2005. Much of this statement describes how the relevant principles of governance are applied to the Company.

The Board

The Board currently consists of five Directors, all of whom are non-executive and independent of the Company's investment manager. Their biographies, on page 39, demonstrate a breadth of investment, industrial, commercial and professional experience.

The Chairman of the Company is a non-executive Director and Joe Scott Plummer was appointed as the Senior Independent Director in March 2005.

The Board follows the AITC Code and considers Sir John Banham and Sir Bob Reid to be independent, notwithstanding that each has served on the Board for more than nine years. The Board does not consider that length of service has diminished the independence of Sir John Banham or Sir Bob Reid and continues to be of the view that their extensive experience and active knowledge of industry is of great benefit to the Board.

The Board's tenure policy is that new Directors stand for election at the first Annual General Meeting following their appointment and then at least one third of Directors retire by rotation at each Annual General Meeting. Every Director is required to seek re-election at least every three years and annually after nine years' service. The names of the Directors retiring by rotation at this year's Annual General Meeting are given on page 42. The composition of the Board, which is reviewed regularly, has been unchanged for some time. In the Directors' view the stability of the Board has been a source of strength but they are nevertheless aware of the need to refresh the composition from time to time and steps are being taken to recruit one or more new directors over the current year.

The Board meets at least six times a year and convenes ad hoc meetings as and when required. Between meetings, regular contact with the investment managers is maintained. The Board has formally adopted a schedule of matters reserved for its approval to ensure that it maintains full and effective control over appropriate issues. These matters include approval of the Trust's investment policy, capital structure, share price and discount, committee membership and terms of reference, financial reporting, risk management, board appointments and removals, corporate governance, internal controls and contracts. A procedure has been adopted for Directors, in the furtherance of their duties, to take independent professional advice at the expense of the Company. The Directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are followed and that the Company complies with applicable rules and regulations. When a new Director is appointed there is an induction process carried out by the investment manager. Directors are provided, on a regular basis, with key information on the Company's regulatory and statutory requirements and internal financial controls. Changes affecting Directors' responsibilities are advised to the Board as they arise.

During the current year, the effectiveness of the Board was assessed through interviews conducted by the Chairman with each Director. In addition, the performance of the Directors was evaluated by each Director, followed by a discussion with the Chairman. The Chairman's own performance was evaluated by the other Directors, who met under the chairmanship of Joe Scott Plummer. The results of the effectiveness assessment and performance evaluation have been presented to the Nomination Committee.

The effectiveness assessment determined that the balance of the Board was satisfactory.

The Board has contractually delegated to the investment manager the management of the investment portfolio, and the day to day accounting and company secretarial requirements. This contract was entered into after full and proper consideration by the Board of the quality and cost of services offered, including the financial control systems in operation, in so far as they relate to the affairs of the Company. The Board receives and considers reports regularly from the investment manager and ad hoc reports and information are supplied to the Board as required. The Board's statement on its review of the management contract appears on page 43.

Corporate Governance

Attendance by Directors at formal Board and committee meetings during the year was as follows:

Director	Board	Audit Committee	Nomination Committee	Management Engagement Committee
No. of meetings	6	2	1	1
Sir John Banham	5	1	1	1
R. A. Barfield	6	2	1	1
Sir Bob Reid	6	2	1	1
P. J. Scott Plummer	5	2	1	1
H. A. Stevenson	6	2*	1	1

*Invited to attend meetings, although not a committee member.

Board Committees

Audit Committee

The Audit Committee consists of all of the independent non-executive Directors, with the exception of the Chairman of the Board, and has defined terms of reference and duties. The role of the Audit Committee is to assist the Board in relation to the reporting of financial information. The Audit Committee is chaired by Joe Scott Plummer. The committee considers that, collectively, its members have sufficient recent and relevant financial experience to discharge their responsibilities fully. The committee meets at least twice each year and reviews the annual accounts and interim report and considers the Auditors' report on the annual accounts, the planning and the process of the audit and the Auditors' independence and objectivity. It has also considered the non-audit services provided by the Auditors and determined that they have had no impact on the Auditors' independence and objectivity. The Audit Committee reviews the Company's accounting policies and considers their appropriateness. The Committee also reviews the terms of appointment of the Auditors together with their remuneration. It meets representatives of the Managers twice-yearly and receives reports on the internal controls maintained on behalf of the Company and reviews the effectiveness of these controls. The Audit Committee continues to believe that the Company does not require an internal audit function of its own as it delegates its day to day operations to third parties from whom it receives internal controls reports.

Nomination Committee

The Nomination Committee meets at least once each year and makes recommendations on the appointment of new Directors and the re-election of existing Directors by shareholders. The committee also determines the process for the annual evaluation of the Board. The committee is chaired by Hugh Stevenson, the Chairman of the Board. All Directors serve on the committee and consider nominations made in accordance with an agreed procedure.

Management Engagement Committee

The Management Engagement Committee meets at least once each year to review the Management Agreement and the Managers' performance. It has defined terms of reference and consists of the non-executive Directors and excludes any Directors previously employed by the Managers. It is chaired by Hugh Stevenson, the Chairman of the Board.

The Board has not constituted a Remuneration Committee; all Directors are non-executive and remuneration matters are dealt with by the whole Board.

The Terms of Reference for each of the committees may be viewed by shareholders on request.

Financial Reporting

The Statement of Directors' Responsibilities in respect of the accounts is on page 35.

Going Concern

After making enquiries, the Directors have a reasonable expectation 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 financial statements.

The Independent Auditors' Report can be found on page 34.

Internal Control

The Directors have overall responsibility for the Company's system of internal control. Whilst acknowledging their responsibility for the system of internal control, the Directors are aware that such a system is designed to manage rather than eliminate the risk of a failure to achieve business objectives and can provide only reasonable but not absolute assurance against material misstatement or loss.

The Board has established an ongoing process for identifying, evaluating and managing the significant risks faced by the Company. This process is subject to review by the Board and accords with the Internal Control Guidance for Directors in the Combined Code published in September 1999 ("the Turnbull guidance"). The process has been fully in place throughout the year under review and up to the date of signing of these Report and Accounts.

The key elements of the procedures that the Directors have established and which are designed to provide effective internal control are as follows:

- The Board, assisted by the Managers, undertook a full review of the Company's business risks and these are analysed and recorded in a risk matrix. Every six months the Board receives from the Managers a formal report which details any known internal controls failures, including those that are not directly the responsibility of the Managers. The Board continues to check that good systems of internal control and risk management are embedded in the operations and culture of the Company and its key suppliers.

Corporate Governance

- The appointment of RCM (UK) Limited ('RCM') as the Managers provides investment management, accounting and company secretarial services to the Company. The Managers therefore maintain the internal controls associated with the day to day operation of the Company. These responsibilities are included in the Management Agreement between the Company and the Managers. The Managers' system of internal control includes organisation arrangements with clearly defined lines of responsibility and delegated authority as well as control procedures and systems which are regularly evaluated by management and monitored by its internal audit department. RCM is regulated by the Financial Services Authority ('FSA') and its compliance department regularly monitors compliance with FSA rules. The Company, in common with other investment trusts, has no internal audit department, but the effectiveness of the Managers' internal controls is monitored by Allianz Global Investors' internal audit function.
- There is a regular review by the Board of asset allocation and any risk implications. There is also regular and comprehensive review by the Board of management accounting information including revenue and expenditure projections, actual revenue against projections and performance comparisons.
- Authorisation and exposure limits are set and maintained by the Board.
- The Audit Committee assesses the Managers' and Custodian's systems of controls and approves the appointment of any sub-custodians. The Audit Committee also receives reports from the Managers' and Custodian's internal auditors, compliance department and independent Auditors.
- The Board reviews the Internal Control reports of the Managers and third party service providers, including those of the Company's Registrars, Capita Registrars, and Custodian, HSBC Bank plc.

The Board has undertaken a full review of the aspects covered by the Turnbull guidance and believes that there is an effective framework substantially in place to meet the requirements of the Combined Code.

The Directors confirm that the Audit Committee has reviewed the effectiveness of the system of internal control.

As set out elsewhere in this report, the Managers provide certain services, including internal audit services, to the Company. Consequently, the Company does not have its own internal audit function.

Relations with Shareholders

The Board strongly believes that the annual general meeting should be an event which private shareholders are encouraged to attend. The annual general meeting is attended by the Chairman of the Board and the Chairman of the Audit Committee, and the Investment Manager makes a presentation at the meeting. The number of proxy votes cast in respect of each resolution will be made available at the annual general meeting.

The Managers meet with institutional shareholders on a regular basis and report to the Board on matters raised at these meetings.

All correspondence with shareholders is reviewed by the Board.

Shareholders who wish to communicate directly with the Chairman, the Senior Independent Director or other Directors may write care of the Company Secretary at 155 Bishopsgate, London EC2M 3AD.

The Notice of Meeting sets out the business of the meeting and special resolutions are explained more fully in the Directors' Report. Separate resolutions are proposed for each substantive issue.

Socially Responsible Investment and Environmental Policy

The Investment Managers have been directed by the Board to take account of companies' socially responsible investment and environmental performance when taking investment decisions.

Exercise of Voting Powers

The Company's investments are held in a nominee name. The Board has delegated discretion to discharge its responsibilities in respect of investments, including the exercise of voting powers on its behalf, to the Managers.

The Managers use a proxy voting service which casts votes in accordance with the guidelines of the National Association of Pension Funds (NAPF) research material, unless its clients request a very specific policy to be voted by its fund managers.

An extract from the Trust's voting record in the previous calendar year will be available for inspection at the annual general meeting each year.

Where Directors hold directorships on the boards of companies in which the Company is invested, they do not participate in decisions made concerning those investments.

Directors

Mr H. A. Stevenson (Chairman)
(Born September 1942) joined the Board in September 1999. Formerly Chairman of Mercury Asset Management Group plc, he is Chairman of Equitas Limited, Chairman of Standard Life Investments, a Director of Standard Life Assurance Company, a Non-Executive Director of the Financial Services Authority and a member of the Investment Committee of the Wellcome Trust.

Sir John Banham
(Born August 1940) joined the Board in August 1992. Formerly Controller of the Audit Commission and Director General of the Confederation of British Industry, Chairman of Tarmac plc, Kingfisher plc and until August 2005 he was Chairman of Whitbread PLC. He is Chairman of Johnson Matthey PLC and Spacelabs Healthcare Inc. He is also the Senior Non-Executive Director of Amvescap Plc and of Cyclacel Pharmaceuticals Inc.

Mr R. A. Barfield
(Born April 1947) joined the Board in May 1999. Formerly Chief Investment Manager of Standard Life Assurance Company, he is a Director of Equitas Limited, The Baillie Gifford Japan Trust PLC, JPMorgan Fleming Overseas Investment Trust PLC, The Edinburgh Investment Trust PLC, Standard Life Investments Property Income Trust Limited, Umbro PLC and other companies. He is a member of The Public Company Accounting Oversight Board.

Sir Bob Reid
(Born May 1934) joined the Board in January 1995. He was formerly Deputy Governor of the Bank of Scotland, Chairman of Shell (UK), British Rail, London Electricity plc and Sears PLC. He is Senior Non-Executive Director of HBOS plc.

Mr P. J. Scott Plummer (Senior Independent Director and Chairman of the Audit Committee)
(Born August 1943) is a Chartered Accountant and joined the Board in May 1997. He was until November 2005 Non-Executive Chairman of Martin Currie Limited. He was formally a Director of Martin Currie Portfolio Investment Trust PLC and Candover Investments PLC.

All the above Directors are non-executive and independent of the Managers.

Directors' Remuneration Report

This report is submitted in accordance with the Directors' Remuneration Report Regulations 2002 for the year ended 31 January 2006.

The Board

The Board of Directors is composed solely of non-executive Directors and the determination of the Directors' fees is a matter dealt with by the whole Board. The Board has not been provided with advice or services by any person to assist it to make its remuneration decisions, although the Directors carry out reviews from time to time of the fees paid to the directors of other investment trusts.

Policy on Directors' Remuneration

No Director has a service contract with the Company. The Company's policy is for the Directors to be remunerated in the form of fees, payable quarterly in arrears. There are no long term incentive schemes, bonuses, pension benefits, share options or other benefits and fees are not related to the individual Director's performance, nor to the performance of the Board as a whole.

The Company's Articles of Association limit the aggregate fees payable to the Board of Directors to a total of £100,000 per annum. Subject to this overall limit, it is the Board's policy to determine the level of Directors' fees having regard to the level of fees payable to non-executive Directors in the investment trust industry generally, the role that individual Directors fulfil, and the time committed to the Company's affairs. The Board believes that levels of remuneration should be sufficient to attract and retain non-executive directors to oversee the Company.

Directors' and officers' liability insurance cover is held by the Company. The Board is proposing a change to the Company's Articles of Association to enable the Company to grant indemnities to the Directors individually. Details of the proposed change are set out on page 45 and in the Notice of Meeting on page 46. When permitted, the Company will enter into deeds of indemnity with the Directors.

The following disclosures on Directors' remuneration have been audited as required by Part 3 of Schedule 7A of the Companies Act 1985.

Remuneration

The policy is to review Directors' fees from time to time, but reviews will not necessarily result in a change to the rates. In the year under review the Directors were paid at a rate of £12,000 per annum, with an additional £3,000 payable to the Audit Committee Chairman. The Chairman of the Board was paid at a rate of £20,000 per annum. These rates have been in place since 1 June 2004. In accordance with the policy on Directors' remuneration set out above, with effect from 1 June 2006 the Directors will be paid £15,000 per annum, with the Audit Committee Chairman receiving an additional £2,000, and the Chairman of the Board will be paid £25,000 per annum.

In order that the Board can have the freedom to recruit new directors, shareholders are being to be asked to approve a change to the Articles of Association to increase the limit on the aggregate fees payable to the Board of Directors, and a new total limit of £150,000 is being proposed, as set out on pages 45 and 46.

Directors' Emoluments

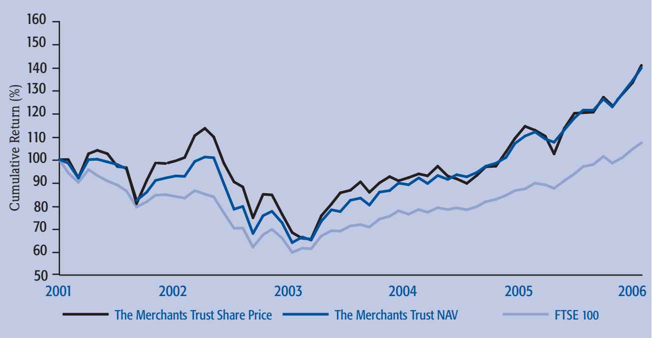
The Directors' Emoluments during the year and in the previous year are as follows:

	Directors' fees	
	2006	2005
	£	£
H. A. Stevenson	19,852	18,481
P. J. Scott Plummer	13,623	14,667
Sir John Banham	11,971	11,696
R. A. Barfield	11,971	11,696
Sir Bob Reid	11,971	11,696
Totals	69,388	68,236

Performance Graph

The graph below measures the Company's share price and net asset value performance against its benchmark index of the FTSE 100 Index.

The Company's performance is measured against the FTSE 100 Index as this is the most appropriate comparator in respect of its asset allocation. An explanation of the Company's performance is given in the Chairman's Statement and the Investment Managers' Review.



Source: Russell/Mellon

By Order of the Board
K. J. Salt
Secretary
6 April 2006

Directors' Report

Status

The Company is an investment company as defined in Section 266 of the Companies Act 1985.

The Company was approved by the Inland Revenue as an investment trust for the year ended 31 January 2005 and approval is expected to be given for the year ended 31 January 2006. In the opinion of the Directors, the Company has conducted its affairs so as to enable it to continue to obtain Section 842 approval.

Share Capital

The share capital of the Company is set out in Note 11 on page 28.

Payment Policy

It is the Company's payment policy for the forthcoming financial year to obtain the best terms for all business and therefore there is no consistent policy as to the terms used. In general, the Company agrees with its suppliers the terms on which business will take place and it is our policy to abide by these terms. The Company had no trade creditors at the year end (2005 – £nil).

Invested Funds

Sales of investments during the year resulted in net gains based on historical costs of £36,622,105 (2005 – £3,469,498 losses). Provisions contained in the Finance Act 1980 exempt approved Investment Trusts from corporation tax on their chargeable gains. Invested funds at 31 January 2006 had a value of £621,948,270 (2005 – £535,094,994) before deducting net liabilities of £107,235,074 (2005 – £118,584,086).

Net Asset Value

The Net Asset Value of the Ordinary Shares of 25p at the year end, after deducting the provision for the final dividend, was 504.1p as compared with a value of 415.8p at 31 January 2005.

Donations and Subscriptions

There were no charitable donations and subscriptions in respect of the year (2005 – £nil). No political donations were made during the year.

Historical Record

There is included on page 5 a schedule of the Company's thirty largest holdings. The distribution of total assets is shown on page 10, and the historical record of the Company's revenue, capital and invested funds over the past ten years is shown on page 4. Graphs appear on page 12 showing the performance on a total return basis over the past ten years of the Net Asset Value of the Company's Ordinary Shares against the Company's benchmark indices, the growth in net ordinary distributions made by the Company against the Retail Price Index, and the Company's discount to Net Asset Value over the same period.

Business Review

A review of the Company's activities is given in the Chairman's Statement on page 3 and in the Investment Managers' Review on pages 6 and 7.

Corporate Governance

The Corporate Governance statement is set out on pages 36 to 38.

Directors' Fees

A report on the Directors' remuneration is set out on page 40.

Subject to the final dividend being approved by shareholders at the Annual General Meeting, payment will be made on 10 May 2006 to shareholders on the Register of Members at the close of business on 7 April 2006 at the rate of 4.8p per Ordinary Share. Further details are provided in Note 6 on page 24.

Revenue

The return attributable to Ordinary Shareholders for the year amounted to £19,853,959.

Earnings per ordinary dividend amounted to 19.44p. The first and second interim dividends of 4.6p and 4.7p respectively have been paid during the year. Since the year end the third interim dividend of 4.8p has been paid. The final proposed dividend of 4.8p is payable on 10 May 2006. In accordance with FRS 21 'Events After the Balance Sheet Date', the third and final dividends are not recognised as liabilities within the accounts.

Substantial Shareholdings

In accordance with Section 198 of the Companies Act 1985 and the Disclosure of Interests in Shares (Amendment) (No. 2) Regulations 1993, as at the date of this report, the Company has been advised of the following substantial share interests in its preference stock and ordinary share capital:

3.65% Cumulative Preference Stock:
P. S. & . J M. Allen – 185,582 (15.75%)
Prudential pl c – 176,000 (14.9%);
Ecclesiastical Insurance Office plc – 134,690 (11.4%);
F&C Asset Management plc – 60,000 (5.1%)
D. J. Edwards – 50,000 (4.2%)
J. Y. Miller – 36,000 (3.0%)
Ordinary Shares:
Legal & General Group PLC – 3,276,048 (3.2%)

Directors' Report

Directors and Management

All Directors listed below served throughout the financial year under review.

The Directors retiring by rotation at the Annual General Meeting are Hugh Stevenson and Dick Barfield and both, having the full support of the Board, offer themselves for re-election.

Sir John Banham and Sir Bob Reid, having each held office for more than nine years, are subject to annual re-election under the provisions of the Combined Code, and accordingly each retires by rotation and offers himself for re-election. The Board considers Sir John Banham and Sir Bob Reid to be independent, notwithstanding their length of service, and continues to be of the view that their extensive experience and active knowledge of industry is a great benefit to the Board.

Sir Bob Reid attained the age of 71 years on 1 May 2005 and special notice has been received, pursuant to Sections 293 and 379 Companies Act 1985, of the intention to propose the resolution concerning his re-election.

The Board confirms confirmed that, since the year end, the performances of Sir John Banham and Sir Bob Reid have been subject to a formal evaluation, and that each continues to be effective in, and to demonstrate commitment to, his role.

Biographical details of the Directors are on page 39.

The current Directors and their beneficial interests in the share capital of the Company as at 31 January 2006 and 2005 are listed below:

	Ordinary Shares of 25p	
	2006	2005
Sir John Banham	2,000	2, 000
R. A. Barfield	2,259	2,183
Sir Bob Reid	5,000	500
P. J. Scott Plummer	1,000	1,000
H. A. Stevenson	25,000	25,000

Since the year end, Mr R. A. Barfield has acquired a further 19 Ordinary Shares.

No contracts of significance in which Directors are deemed to have been interested have subsisted during the year under review.

Contracts of service are not entered into with the Directors, who hold office in accordance with the Articles of Association.

Management Contract and Management Fee

The management contract with RCM (UK) Limited ('RCM') provides for a fee of 0.35% per annum (2005 – 0.35%) of the value of the assets, calculated quarterly, after deduction of current liabilities, short term loans under one year and any funds within the portfolio managed by RCM. The management contract is terminable at one year's notice (2005 – one year).

The Managers' performance under the contract and the contract terms are reviewed at least annually by the Management Engagement Committee. This committee consists of the Directors not employed by the management company in the past five years and therefore includes the entire Board. During the year, the

Analysis of Share Register

	Shareholder Accounts				Ordinary Shares held			
	Number		%		000's		%	
	2006	2005	2006	2005	2006	2005	2006	2005
Private holders*	8,439	8,954	65.6	62.5	22,018	23,378	21.6	23.0
Nominees	3,909	4,574	30.4	32.0	74,417	72,741	72.9	71.2
Limited Companies	191	220	1.5	1.5	2,261	2,799	2.2	2.7
Investment Trusts and Funds	132	163	1.0	1.1	870	1,003	0.9	1.0
Bank and Bank Nominees	13	9	0.1	0.1	1,772	378	1.7	0.4
Insurance Companies	12	25	0.1	0.2	73	398	0.1	0.4
Pension Funds	5	7	0.0	0.0	22	35	0.0	0.0
Other holders	167	366	1.3	2.6	670	1,371	0.6	1.3
	12,868	14,318	100.0	100.0	102,103	102,103	100.0	100.0

*Including PEP, ISA and Share Plan Nominees.

Based on an analysis of the Ordinary Share register at 3 April 2006 (2005 – 1 April).

Directors' Report

committee met the Managers to review the current investment framework, including the Trust's performance, marketing activity and total expense ratio.

The committee also reviewed the terms of the management contract and considered the level of the management fee, which it found to be appropriate. The committee was satisfied with its review and believes that the continuing appointment of the Managers is in the best interests of shareholders as a whole.

The Managers have discretion to exercise voting rights at the meeting of companies in which the Company is invested, and will usually do so. However, in cases of takeover, merger or other offer involving a corporate client of the Managers or any of its associated companies the voting rights may only be exercised with the approval of at least one independent Director of the Company. Similar approval must be sought in the case of any investment transactions in such companies or underwriting participations involving the securities of corporate clients of the Managers or any of its associated companies. The Managers do not have any discretion over any securities of Dresdner Bank AG or its subsidiaries that may be held by the Company.

The Company has entered into an annual agreement with Allianz Global Investors to operate the Investment Trust Share Plan. The cost to the Company for the year ending 31 January 2006 is £197,462 excluding VAT (2005 – £172,426 excluding VAT). The fee relates to generic costs and is partially calculated on a usage and market capitalisation basis.

Individual Savings Accounts/PEPs

The affairs of the Company are conducted in such a way as to meet the requirement of a qualifying investment trust to Personal Equity Plans and the requirements for an Individual Savings Account and it is the intention to continue to do so.

Directors' and Officers' Liability Insurance

The Company maintained Directors' and officers' liability insurance during the year.

Annual General Meeting

Increase in Authorised Share Capital

In Resolution 10 in the Notice of Meeting on page 46 the Board is proposing that the authorised share capital of the Company is increased by the creation of 42,972,499 Ordinary Shares of 25p each, an increase of 40% to the authorised Ordinary Share capital. Following this increase, the authorised but unissued share capital of the Company will be approximately £12,075,000 representing approximately 47% of the existing issued Ordinary Share capital. This increase will give the Board the ability to allot shares in accordance with usual institutional guidelines and the Board believes that this flexibility may allow it to take advantage of opportunities which may be presented.

Purchase of Own Shares

The Board is proposing that the Company should be given renewed authority to purchase Ordinary Shares in the market for cancellation. The Board believes that such purchases in the market at appropriate times and prices would be a suitable method of enhancing shareholder value. The Company would make either a single purchase or a series of purchases, when market conditions are suitable, with the aim of maximising the benefits to shareholders and within guidelines set from time to time by the Board.

Where purchases are made at prices below the prevailing net asset value of the Ordinary Shares, this will enhance net asset value for the remaining shareholders. It is therefore intended that purchases would only be made at prices below net asset value, with the purchases to be funded from the realised capital profits of the Company (which are currently in excess of £416 million). The rules of the UK Listing Authority ('Listing Rules') limit the price which may be paid by the Company to 105% of the average middle-market quotation for an Ordinary Share on the five business days immediately preceding the date of the relevant purchase. The minimum price to be paid will be 25p per Ordinary Share (being the nominal value). Additionally, the Board believes that the Company's continued ability to purchase its own shares should create additional demand for the Ordinary Shares in the market and that this increase in liquidity should assist shareholders wishing to sell their own Ordinary Shares. Overall, this proposed share buy-back authority, if used, should help to reduce the discount to net asset value at which the Company's shares currently trade.

The Board considers that it will be most advantageous to shareholders for the Company to be able to make such purchases as and when it considers the timing to be most favourable and therefore does not propose to set a timetable for making any such purchases.

The Company's Articles of Association permit the Company to redeem or purchase its own shares out of capital profits. Under the Listing Rules, the maximum number of shares which a listed company may purchase through the market pursuant to a general authority such as this is equivalent to 14.99% of its issued share capital. For this reason, the Company is limiting its renewed authority to make such purchases to 15,305,380 Ordinary Shares, representing 14.99% of the issued share capital, provided that there is no change in the issued share capital between the date of this report and the Annual General Meeting to be held on 9 May 2006.

Directors' Report

The authority will last until the Annual General Meeting of the Company to be held in 2007 or the expiry of 18 months from the date of the passing of this resolution, whichever is the earlier. The authority will be subject to renewal by shareholders at subsequent annual general meetings.

Allotment of New Shares and Disapplication of Pre-emption Rights

Approval is sought for the renewal of the Directors' authority to allot relevant securities, in accordance with Section 80 of the Companies Act 1985, up to a maximum aggregate nominal amount of £8,508,661, representing approximately 33% of the existing Ordinary Share capital. This authority would expire five years from the date of renewal, if not previously revoked or varied.

A resolution was passed at the Annual General Meeting held on 10 May 2005 to authorise the Directors to allot the unissued Ordinary Share capital for cash. The authority is renewable annually and expires at the conclusion of the Annual General Meeting in 2006. A Special Resolution is therefore proposed under special business at the forthcoming Annual General Meeting to renew this authority for a further year.

The power to allot new Ordinary Shares for cash, other than pro rata to existing shareholders, is limited to the aggregate nominal amount of £1,276,299 Ordinary Share capital, being approximately five per cent of the issued Ordinary Share capital of the Company as at the date of this report, provided that there is no change in the issued share capital between the date of this report and the Annual General Meeting to be held on 9 May 2006.

Whilst it is anticipated that allotments under this authority will normally be to the Allianz Global Investors Investment Trust Share Plan, the resolution allows for allotments of new shares at the discretion of the Directors and is not limited only to this Plan. The Directors confirm that no allotment of new shares will be made unless the lowest market offer price of the Ordinary Shares is at least at a premium to net asset value, valuing debt at market value.

Articles of Association

The Articles of Association form the contract between the shareholders and the company, and contain various detailed provisions as to how the company's affairs will be managed, in effect amounting to the company's constitution. The Articles were last reviewed fully in 2001, and certain changes are now required to update the Articles of Association.

The changes proposed are set out below. This resolution (which is to be proposed as a special resolution, requiring support from 75% of the votes cast) would have the effect of adopting new Articles of Association in place of the current version, replacing them in their entirety. The material differences between the current and the proposed new Articles of Association are summarised below. Changes of a minor or purely technical nature have not been mentioned specifically. Copies of the company's current and the proposed new Articles of Association of the company are available for inspection during normal business hours at the registered office of the company until the date of the AGM. Copies will be available at the AGM meeting venue on the morning of the meeting from 11.30 am until its conclusion.

Summary of the principal proposed changes to the Company's Articles of Association

2.1 Directors' Remuneration – new article 78

The New Articles provide for the cap on directors' remuneration being raised to a total sum not exceeding £150,000 (being divisible among all the directors). The Articles currently provide for a sum of £100,000.

2.2 Electronic Communications – various articles

The Companies Act 1985 (Electronic Communications) Order 2000 (the "Order") and the Electronic Communications Act 2000 set out a legislative regime which facilitates the use of electronic communications by companies (between the company and Companies House, from the company to its members and from the members to the company). Rather than relying generally on the provisions contained in the Order, the New Articles expressly provide for the company to take advantage of electronic communications and reflect the provisions of the Order by facilitating, but not requiring the use of, such communications.

2.3 Directors' Indemnities – new article 145

The Companies (Audit, Investigations and Community Enterprise) Act (the "Act") received Royal Assent on 28 October 2004. Amongst other things, the Act relaxed the existing prohibition in section 310 of the Companies Act 1985 on companies indemnifying their directors against costs and liabilities. The section 310 prohibition on indemnities no longer applies to directors and other officers of the company and now applies to the company's auditors. The more relaxed prohibition on companies indemnifying their directors is set out in sections 309A to 309C of the Companies Act 1985 and the provisions allowing companies to fund the defence of proceedings against a director are set out in a new section 337A of the Companies Act. The prohibition, currently in section 310, on companies indemnifying their company secretary and other

Directors' Report

managers has been removed completely. The proposed new article 145 is a general, permissive article, allowing the company to indemnify directors subject to the provisions of the Companies Act 1985 (as amended by the Act). The article refers generally to the granting of indemnities and does not contain any limits on the power of the company to grant indemnities but the company must comply with the limits in sections 309A-C of the Companies Act 1985. The new article will require the right of any director to an indemnity, and the extent of such an indemnity, to be dealt with in a contractual arrangement to be entered into between the company and the relevant director. All such arrangements will be subject to board review and will be disclosed in the annual Directors' Remuneration Report.

Auditors

The Directors will place a resolution before the Annual General Meeting to re-appoint PricewaterhouseCoopers LLP as Auditors for the ensuing year. A resolution to authorise the Directors to determine the Auditors' remuneration will also be proposed at the Annual General Meeting.

By Order of the Board
K. J. Salt
Secretary

6 April 2006

Notice of Meeting

Notice is hereby given that the Annual General Meeting of **The Merchants Trust PLC** will be held at **20 Moorgate, London EC2R 6DA**, on 9 May 2006 at 12.00 noon to transact the following business.

Routine Business

1 To receive and adopt the Report of the Directors and the Accounts for the year ended 31 January 2006 together with the Auditors' Report thereon.

2 To declare a final dividend of 4.8p per Ordinary Share.

3 To re-elect Mr H. A. Stevenson as a Director.

4 To re-elect Mr R. A. Barfield as a Director.

5 To re-elect Sir John Banham as a Director.

6 To re-elect Sir Bob Reid as a Director, special notice having been received of the intention to propose his re-election.

7 To approve the Directors' Remuneration Report.

8 To re-appoint PricewaterhouseCoopers LLP as Auditors of the Company, to hold office until the conclusion of the next general meeting at which accounts are laid before the Company.

9 To authorise the Directors to determine the remuneration of the Auditors.

Special Business

To consider and if thought fit to pass the following resolutions. Resolutions 10 and 12 will be proposed as Ordinary Resolutions and Resolutions 11, 13 and 14 as Special Resolutions:

10 That the authorised share capital of the Company be increased to £37,600,936 by the creation of 42,972,499 additional Ordinary Shares of 25p each.

11 That the Company be and is hereby generally and unconditionally authorised in accordance with Section 166 of the Companies Act 1985 (the 'Act') to make market purchases (within the meaning of Section 163 of the Act) of Ordinary Shares of 25p each in the capital of the Company ('Ordinary Shares'), provided that:

(i) the maximum number of Ordinary Shares hereby authorised to be purchased shall be 15,305,380;

(ii) the minimum price which may be paid for an Ordinary Share is 25p;

(iii) the maximum price which may be paid for an Ordinary Share is an amount equal to 105 per cent of the average of the middle-market quotations for an Ordinary Share taken from the London Stock Exchange Official List for the five business days immediately preceding the day on which the Ordinary Share is purchased or such other amount as may be specified by the London Stock Exchange from time to time;

(iv) the authority hereby conferred shall expire at the conclusion of the Annual General Meeting of the Company in 2007 or, if earlier, on the expiry of 18 months from the passing of this resolution, unless such authority is renewed prior to such time; and

(v) the Company may make a contract to purchase Ordinary Shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiration of such authority and may make a purchase of Ordinary Shares pursuant to any such contract.

12 That for the purposes of Section 80 of the Companies Act 1985 the Directors be generally and unconditionally authorised to exercise all the powers of the Company to allot relevant securities (within the meaning of the said Section) up to an aggregate nominal amount of £8,508,661 provided that:

(i) the authority granted shall expire five years from the date upon which this Resolution is passed but may be revoked or varied by the Company in general meeting and may be renewed by the Company in general meeting for a further period not exceeding five years; and

(ii) the authority shall allow and enable the Directors to make an offer or agreement before the expiry of that authority which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of any such offer or agreement as if that authority had not expired.

Notice of Meeting

13 That the Directors be empowered in accordance with Section 95 of the Companies Act 1985 to allot equity securities (within the meaning of Section 94 of the Act) for cash pursuant to the authority conferred by Resolution 12 as if sub-section (1) of Section 89 of the Act did not apply to any such allotment provided that:

(i) the power granted shall be limited to the allotment of equity securities wholly for cash up to an aggregate nominal amount of £1,276,299;

(ii) the power granted shall (unless previously revoked or renewed) expire at the conclusion of the next Annual General Meeting of the Company after the passing of this resolution; and

(iii) the said power shall allow and enable the Directors to make an offer or agreement before the expiry of that power which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offer or agreement as if that power had not expired.

14 That the amended Articles of Association of the Company in the form produced to the meeting and initialled by the Chairman for the purposes of identification be and are hereby adopted as the Articles of Association of the Company in place of and to the exclusion of the existing Articles of Association of the Company.

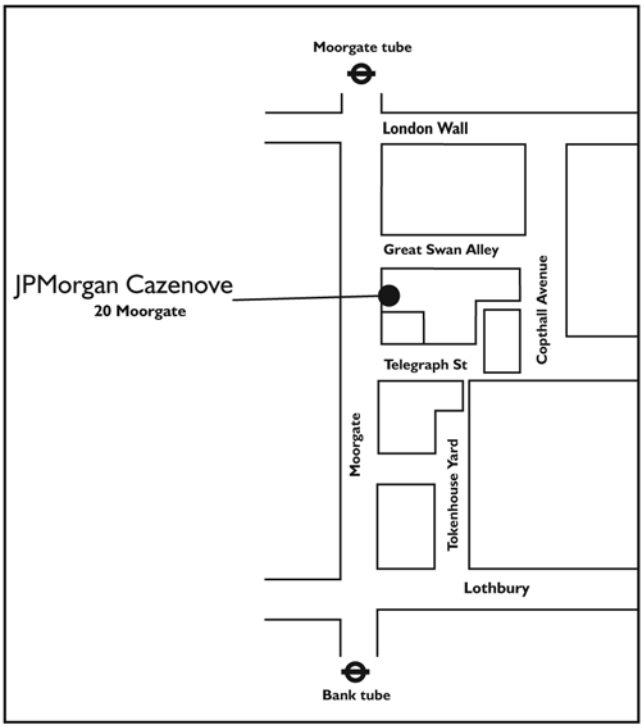
155 Bishopgate,	By Order of the Board
London EC2M 3AD	K. J. Salt
6 April 2006	Secretary

Notes: Members entitled to attend and vote at this Meeting may appoint one or more proxies to attend and, on a poll, vote in their stead. The proxy need not be a Member of the Company. Duly completed forms of proxy must reach the office of the Registrars at least 48 hours before the Meeting. A form of proxy is provided with the Annual Report. Completion of the enclosed form of proxy does not preclude a Member from attending the Meeting and voting in person.

To be entitled to attend and vote at the Meeting (and for the purpose of the determination by the Company of the number of votes they may cast), Members must be entered on the Company's Register of Members at 6 p.m. on 7 May 2006 ('the specified time'). If the Meeting is adjourned to a time not more than 48 hours after the specified time applicable to the original Meeting, that time will also apply for the purpose of determining the entitlement of Members to attend and vote (and for the purpose of determining the number of votes they may cast) at the adjourned Meeting. If, however, the Meeting is adjourned for a longer period then, to be so entitled, Members must be entered on the Company's Register of Members at the time which is 48 hours before the time fixed for the adjourned Meeting or, if the Company gives notice of the adjourned Meeting, at the time specified in that notice.

Contracts of service are not entered into with the Directors, who hold office in accordance with the Articles of Association.

Annual General Meeting Venue



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