The Merchants Trust PLC

Annual Financial Report for the year ended 31 January 2012

Information *advantage*

The Merchants Trust PLC

ANNUAL FINANCIAL REPORT
FOR THE YEAR ENDED
31 JANUARY 2012

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The Merchants Trust aims 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.

The Merchants Trust

The Merchants Trust was incorporated on 16 February 1889. It was launched by Robert Benson & Co., predecessors of the current Investment Manager, RCM (UK) Ltd, and originally invested mainly in American railroads. The initial capital was £2 million, of which half was subscribed.

Investment Policy

The Company's investment performance is assessed by comparison with other investment trusts within the UK Growth and Income sector. Performance is benchmarked against the FTSE 100 Index, reflecting the emphasis within the portfolio.

Financial Highlights

Net asset value per ordinary share	Earnings per ordinary share	Dividend
402.1p	22.0p	23.0p
2011 427.1p	2011 21.2p	2011 22.8p
-5.9%	**+3.7%**	**+0.9%**

Gearing

The Company's policy is to remain substantially fully invested. The Company has the facility to gear – borrow money – with the objective of enhancing future returns. Historically, the gearing has been in the form of long-term, fixed-rate debentures. The Board monitors the level of gearing and makes decisions on the appropriate action based on the advice of the Manager and the future prospects of the Company's portfolio. The Company's authorised borrowing powers set out in the Articles of Association state that the Company's borrowings may not exceed its called up share capital and reserves. In normal market conditions, it is unlikely that gearing (borrowings as a percentage of net assets) will exceed 35%.

Risk Diversification

The Company will aim to achieve a spread of investments, with no single investment representing more than 15% of assets. The Company will seek to diversify its portfolio into at least five market sectors, with no one sector comprising more than 35% of the portfolio.

Overview

Financial Summary

Revenue	For the year ended 31 January 2012	For the year ended 31 January 2011	% change
Income	£27,305,462	£25,740,859	+6.1
Net revenue return attributable to Ordinary Shareholders	£22,712,211	£21,900,146	+3.7
Net revenue return per Ordinary Share	22.00p	21.22p	+3.7
Ordinary dividends per Ordinary Share	23.00p	22.80p	+0.9

Assets	2012	2011	Capital return % change	Total return % change
Total Assets less Current Liabilities	£526,045,683	£552,031,290	-4.7	-
Net Assets	£415,024,704	£440,846,016	-5.9	-
Net Assets (Debt at market value)	£377,993,834	£420,377,881	-10.1	-
Net Asset Value per Ordinary Share	402.1p	427.1p	-5.9	-0.5*
Net Asset Value per Ordinary Share (Debt at market value)	366.2p	407.3p	-10.1	-5.5*
Ordinary Share Price	363.0p	406.9p	-10.8	-5.2
FTSE 100 Index	5,681.8	5,862.9	-3.1	0.4
FTSE 350 Higher Yield Index	3,050.2	3,087.2	-1.2	3.5
Discount of Ordinary Share Price to Net Asset Value	9.7%	4.7%	n/a	-
Discount (Debt at market value)	0.9%	0.1%	n/a	-

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

Performance Attribution Analysis against FTSE 100 Index	Capital Return %	Total Return %
Return of Index	-3.1	0.4
Relative return from portfolio	0.4	1.5
Return of portfolio	**-2.7**	**1.9**
Impact of gearing on portfolio	-0.9	-0.9
Revenue deficit*	-0.2	0.0
Expenses charged to capital	-1.7	-1.7
Other	-0.4	0.2
Change in Net Asset Value per Ordinary Share	**-5.9**	**-0.5**

* Dividends paid on Ordinary Shares amounted to £23,532,668 (refer to Note 6). This exceeds the revenue return for the period by £820,457.

Chairman's Statement

Dear Shareholder,

This is our thirtieth year of rising dividends, an important milestone in Merchants' history. The Trust has maintained this record during a period in which income has been impacted materially by the global financial crisis and the cut in BP's dividend in 2010. Our underlying income rose 6.1% during the year resulting in a significantly lower drawdown on reserves, despite the increased dividend pay out and despite last year benefiting from the release of a deferred tax provision.

Market Background

It has been a difficult year for financial markets with Western economies suffering from a combination of high debt levels and weak economic growth. Against that background the UK stock market produced an overall return close to zero after falling in the summer as the outlook deteriorated.

High yielding and relatively resilient shares, where Merchants has a large exposure, generally outperformed the broader index, whilst financials and economically cyclical shares fell back. Strong performance from government bonds, particularly in response to central bank liquidity injections have lowered borrowing costs and raised the market value of our debt.

Results

The investment portfolio produced a capital return of -2.7%, slightly ahead of the -3.1% return on the FTSE 100 Index. Including Income, the total return of the investment portfolio was +1.9% which was further ahead of the +0.4% total return on the FTSE 100 Index, reflecting the high yield nature of the portfolio. The Net Asset Value per share fell by 5.9% to 402.1p, reflecting principally the cost of finance and the impact of financial gearing. The net asset value total return per share, including dividends paid, was -0.5%.

With bond yields and interest rates falling over the year, the company's debt has increased in value and, using the market value of debt, the Net Asset Value per share declined by 10.1% or by 5.5% including dividends. The full performance breakdown is shown on page 20 of the Annual Financial Report. Over the year, the Trust's share price fell by 10.8% from 406.9p to 363.0p. The total return on the Trust's shares including dividends was -5.2%. At 29 March 2012, the Trust's ordinary shares yielded 6.0% compared with the yield on the FTSE 100 Index of 3.6%. There is more detail on the major contributors to our performance in our Investment Manager's Review starting on page 8 of the Annual Financial Report.

Net Revenue Return per share

Net Revenue Return per share rose by 3.7% to 22.00p. Excluding the release of the deferred tax liability provision of £862,086 in 2011 the underlying Net Revenue Return rose by 8.0%.

Dividends

The Board is recommending a final ordinary dividend of 5.8p per share, payable on 14 May 2012 to Shareholders on the register on 13 April 2012. This payment would give a total of 23.0p for the year, an increase of 0.9% over the total for the previous year. In order to meet the payment it has been necessary to transfer £1,026,885 (1.0p per share) from our revenue reserves, compared to a transfer of £1,632,522 (1.6p per share) last year. As at 31 January 2012 and after providing for this transfer, the Trust's revenue reserves amounted to £11,748,687 (11.4p per share).

The outlook for dividend growth is reasonable, with many companies having rebuilt their balance sheets and dividend cover since the economic downturn. The Board and the Manager continue to remain focused on providing long-term steady income growth.

Benchmark

The Board has reviewed the Benchmark indices that are used for assessing the company's performance in addition to a peer group comparison. Whilst the Board believes it is right to assess performance against both the FTSE 100 Index and the FTSE 350 Higher Yield Index, we think that the FTSE 100 Index should be regarded as the primary benchmark and the Higher Yield index should be a secondary benchmark. There are several reasons for this. The FTSE 100 index is more diversified, reflecting a wider range of investment opportunities as well as having a lower concentration

Chairman's Statement

(continued)

in the largest companies. This feature also makes it a preferable benchmark for the Fund Manager to set the portfolio's long term positioning against. The FTSE 100 Index is subject to less material constituent changes and thus does not encourage significant portfolio turnover when used as a benchmark, whereas the Higher Yield Index can change significantly at its June rebalancing each year, depending upon the yield on each large company. Also the FTSE 100 Index is more widely recognised and better understood.

We do not anticipate any alterations in the portfolio structure as a result of this change, which more closely reflects the way the portfolio is managed already. The investment objective remains unchanged.

Derivatives

As set out in the previous report, we have continued our policy of selectively writing call options on a limited number of the Trust's holdings. Writing options has provided helpful additional income in a period where revenues have been under pressure and has also been profitable. A more detailed explanation is set out in the Investment Manager's Review.

Retail Distribution Review

We anticipate great potential advantages in the Retail Distribution Review ('RDR') when investment trusts become available through investment platforms next year and we are working with our managers to identify ways of taking advantage of this development.

Gearing

The Trust continues to have long-term debt amounting to £111 million. This is all deployed in the market for investment purposes. At the end of the year our gearing level was 26.8% compared to 25.2% at the start of the year.

The Board

The current Board has four directors and although it is a small board, as you will see from our biographies on page 22, the directors have a range of professional and industrial backgrounds and experience. We meet annually specifically to consider strategy with our managers and advisers, covering topics such as investment policy and process, including the use of derivatives, dividends policy and reserves, our market position and peer group ratings and our share capital structure. We use these sessions to challenge the way we think and set objectives for ourselves and the managers.

Paul Yates was appointed to the Board in March 2011. Paul has over thirty years' experience in investment management having worked at UBS for much of his career. He was CEO of UBS Global Asset Management (UK) Ltd until 2005. Dick Barfield retired in May 2011, having been on the Board for twelve years. We thank Dick very much for his deep understanding of the investment markets and his invaluable contribution over many years.

We are each standing for re-election this year and will continue to do this annually.

Annual General Meeting

The Annual General Meeting of the Company will be held on Wednesday 9 May 2012 at 12.00 noon at Holborn Bars, 138-142 Holborn, London EC1N 2NQ and we look forward to seeing as many shareholders then as are able to attend.

Outlook

Although there is considerable uncertainty over the economic outlook with over-indebted governments and consumers, many businesses are in good shape. The larger, high yielding companies in the FTSE 100 Index, which represent a large proportion of your portfolio, generally have strong balance sheets, reasonable prospects and trade at realistic valuations. Income growth is expected to be healthy, supporting Merchants 30 year dividend growth track record. The Trust will continue to focus on delivering long-term growth in capital and income.

Simon Fraser
Chairman
29 March 2012

This is our thirtieth year of rising dividends, an important milestone in the history of The Merchants Trust.

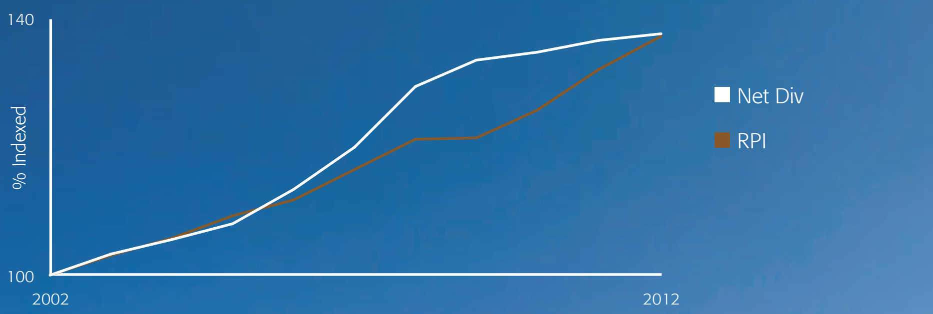
Investment Manager's *Review*

Merchants has paid increasingly higher dividends year-on-year for the last 30 years – from 4.2 pence per share in 1982 to 23 pence per share in 2012 – providing shareholders with a growing source of income in the form of regular quarterly payments.

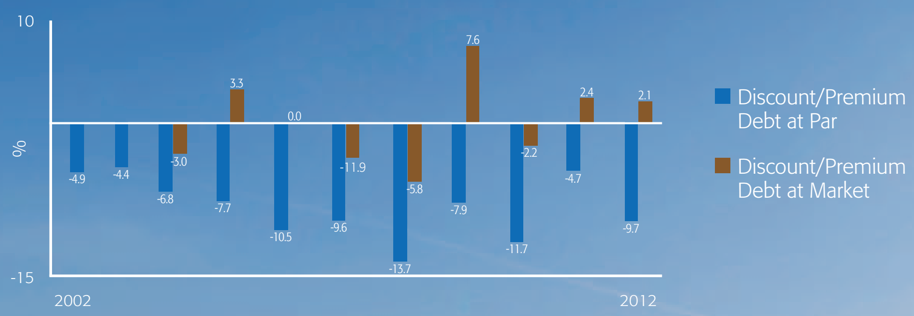
Performance Graphs

The Merchants Trust 10 Year Cumulative Return compared to key UK equity indicies*

The Merchants Trust 10 Year Net Dividend Growth compared to inflation**



The Merchants Trust 10 Year Discount/Premium to Net Asset Value as at 31 January**



[1] The Merchants Trust (Share Price) (TR) (GBP). [2] The Merchants Trust (NAV) (TR) (GBP). [3] FTSE 100 (TR) (GBP).
[4] FTSE 350 HY (TR) (GBP). *Source: RCM / Datastream in GBP. ** Source: RCM / Datastream.

Investment Manager's Review

Economic Background

In the 1993 film Groundhog Day, weatherman Bill Murray is forced to re-live the same day over and over again, struggling to find a way out of his repetitive existence. This bears a striking resemblance to financial markets in recent years. Periodic bouts of optimism that politicians and central bankers can agree a rescue package for the Eurozone periphery, the banking system or the US housing market are followed by a realisation that the problems are even more intractable than originally believed and that lower growth expectations are exacerbating the fundamental problem of over-indebtedness.

The debt problems started in the consumer, housing and property development sectors in the US, UK and several European countries but quickly spread to the banking system which financed the borrowing. In turn the banking system had to be supported and bailed out by governments and central banks. In the last year, the governments themselves became the focus of concerns regarding debt levels and solvency. Clearly peripheral European countries like Greece are in a desperate situation but even the USA and France have lost their coveted Standard & Poor's AAA credit ratings.

Economic growth has generally been modest against this difficult background, with the USA showing signs of improvement in activity and employment in recent months after a weaker patch in the middle of 2011. Europe has generally seen weak growth expectations reduced even further over the last year, particularly in the peripheral Eurozone countries, with the UK slipping back into contraction in the last quarter of 2011. Even Germany, which had shown robust growth earlier in the year has slowed in recent months. Emerging markets have fared better but have not been immune to the environment, with growth rates slowing in China, India and Brazil.

Simon Gergel is Head of the RCM Value & Income Team based in London.

"There was a clear divergence between investment styles during the year, with lower risk, defensive and high dividend yield shares performing better, as shown by the +3.5% return on the FTSE 350 Higher yield Index."

Investment Manager's Review
(continued)

Market trends

The UK stock market traded in a narrow range for the first half of the year, as concerns about the difficult economic environment and the continuing Eurozone crisis were counterbalanced by low share valuations and robust company results. However fears gained the upper hand in August, as poor US economic data releases raised the spectre of a double-dip contraction in this key economy. The market fell sharply and remained volatile until late November when a fragile recovery in risk appetite began. Towards the end of the year the pendulum swung back towards the optimistic camp with markets buoyed by a huge liquidity injection into the European banking system, hopes of an agreement on the Greek sovereign debt problem and a modest improvement in US economic statistics. The FTSE 100 index closed the year close to its starting point and produced a total return, including income, of +0.4%.

There was a clear divergence between investment styles during the year, with lower risk, defensive and high dividend yield shares performing better, as shown by the +3.5% return on the FTSE 350 Higher yield Index. Conversely higher risk, cyclical and financial shares and smaller companies performed worse, with the FTSE 250 Mid Cap Index (ex. Investment Trusts) returning -3.3%. The polarisation between high and low risk shares reversed somewhat in the last two months of the year with the rebound in investor optimism.

The best performing sectors were tobacco, beverages and pharmaceuticals, whilst the laggards included banks, financial services, food retail and mining.

The FTSE 100 index closed the year close to its starting point and produced a total return, including income, of +0.4%.

Investment Manager's Review

(continued)

Investment Performance

The Merchants Trust portfolio produced a capital return of -2.7%, compared to the capital return of -3.1% on the FTSE 100 Index. The portfolio yield is significantly higher than the yield in the broader stock market. Including income received, the total return was +1.9% compared to the total return of +0.4% on the FTSE 100 Index. The portfolio's outperformance reflected its higher yield bias and defensive positioning. The largest active stock positions made a significant contribution to this outperformance, with **GlaxoSmithKline**, **Unilever**, **SSE** and **National Grid** all producing double digits returns. The other major performance driver was having only a modest exposure to the mining and banks sectors as they both fell heavily, depressing the index returns.

Whilst the overall portfolio return was strong, a nervous stock market de-rated many cyclical companies and severely punished companies disappointing market expectations. The Trust was not immune to this factor with **Man Group**, **Inmarsat** and **Mothercare** being hit hard in response to trading issues. Also certain economically sensitive, medium sized companies were derated, including **Hays**, **Premier Farnell**, **DMGT** and **UBM**. The final material negative contributors were **Diageo**, **SABMiller** and **Autonomy**, which were not owned and performed well.

The portfolio's performance lagged the FTSE 350 Higher Yield Index return reflecting the particular structure of this benchmark and the strong outperformance of high dividend stocks. This index is highly concentrated in a few sectors like oil, pharmaceuticals and tobacco and benefitted last year from having no mining shares or domestically focused banks which were particularly poor performers.

Contribution to Investment Performance relative to FTSE 100 Index

Positive Contribution	%	Over/under weight	Negative Contribution	%	Over/under weight
GlaxoSmithKline	0.9	+	Man Group	-0.7	+
Lloyds Banking Group	0.6	-	Inmarsat	-0.7	+
Xstrata	0.4	-	Hays	-0.4	+
Unilever	0.4	+	Diageo	-0.4	-
Rio Tinto	0.4	-	SABMiller	-0.4	-
SSE	0.4	+	Mothercare	-0.3	+
Anglo American	0.4	-	Premier Farnell	-0.3	+
National Grid	0.3	+	DMGT	-0.3	+
Barclays	0.3	-	UBM	-0.3	+
Bunzl	0.3	+	Autonomy	-0.2	-

Over / under weight: Whether proportion of portfolio in stock is higher (+) or lower (-) than its weighting in the FSTE 100 Index.

Investment Manager's Review

(continued)

Portfolio Changes

In the first half of the year, with the market range-bound, most of the activity was driven by stock specific considerations. As reported in the interim report we sold out of a number of cyclical companies, taking profits on **WPP**, **Melrose** and **British Land**. We accepted the takeover offer for **Brit Insurance** and cut the holding in **Home Retail Group** following a change in view. We also introduced three companies **Carnival**, **London & Stamford Property** and **Mothercare** and we have continued to build up these positions.

Early in the second half of the year, as economic news from the USA in particular started to deteriorate, we positioned the portfolio more defensively, reducing positions in the mining, industrial and financial sectors and adding to food retailers and utilities. In particular we added **Sainsbury (J)** to the portfolio as the business was performing well with a quality and value offering that was gaining traction in a difficult environment. The valuation and yield were attractive with the shares further supported by a considerable property portfolio.

The other new investment, later in the year, was **Close Brothers**, a diversified financial services company. The core of the business is a specialist bank which is conservatively financed and focused on niche asset backed lending, generating high returns with significant barriers to competition. It is seeing reduced competition as large banks retrench and pull money out of non-core activities. Close was lowly valued despite an excellent record, with a well covered 7% dividend yield which has been maintained through the financial crisis and grown over the long term.

There were two other complete sales from the portfolio. Both had been disappointing investments and were relatively small positions that were not paying a dividend. **Pendragon** was sold after a rights issue challenged our hope that shareholders would benefit from a turnaround strategy without recourse to external funds. **Lloyds Banking Group** was also sold towards the end of the year. Although the valuation of the bank was low, there was considerable risk to the business from the regulatory and economic background and little hope for a meaningful dividend in the medium term.

Largest Net Purchases		Largest Net Sales	
Company	£m	Company	£m
Sainsbury (J)	8.1	Aviva	7.0
Centrica	8.0	BHP Billiton	6.8
Britvic	7.7	GlaxoSmithKline	6.5
BP	5.5	Unilever	6.3
London & Stamford Property	4.9	British Land	6.2
Carnival	4.9	British American Tobacco	5.6
UBM	4.6	AstraZeneca	5.4
Reckit Benckiser	4.6	Royal Dutch Shell 'B'	5.4
Mothercare	4.1	Brit Insurance	4.7
Tesco	4.1	WPP	4.4

Investment Manager's Review
(continued)

As well as new investments we added to companies with sound long term prospects that were oversold on trading concerns. These included **UBM**, **DMGT** and **Britvic**. We built up the position in **BT Group**, where we have confidence in the turnaround strategy, and in **BP**, where the shares were still over-discounting the likely impact from the Macondo incident in the Gulf of Mexico.

In contrast, we took profits on many defensive shares particularly later the year as they had performed well and offered less value. Such partial sales included **GlaxoSmithKline**, **British American Tobacco**, **Royal Dutch Shell**, **SSE** and **Unilever**. However there were exceptions. After initially selling out of **Centrica**, we made significant purchases later in the year as the valuation fell to more attractive levels and it lagged other defensive, high yielding shares. Similarly we increased **Reckitt Benckiser**, **Reed Elsevier** and **Tesco** which had also lagged their peers and were lowly valued. The Tesco position was reduced this January after their profit warning challenged our fundamental view of the company's competitive positioning.

Other significant sales included taking profits on part of the holding in cyclicals such as **BHP Billiton** and **Meggitt** and reducing exposure to some of the higher risk financials including Aviva and Barclays. We also reduced the position in pharmaceutical stock **AstraZeneca** on concerns about a deteriorating medium term outlook, with several key products losing patent protection over the next five years.

Derivatives Strategy

The Trust operates a covered call overwriting strategy on a limited proportion of the portfolio to generate additional income. In "writing" or selling an option, the Trust gives the purchaser the right to buy a specific number of shares in a company at an agreed "strike" price within a fixed period. In exchange the Trust receives an option premium which is taken to the income account. The Trust gets the full benefit of any move in the share price up to the strike price but not beyond. If the share price rises above the strike price, there is a potential "opportunity" cost (but not cash cost) to the Trust as the option holder can exercise their option to buy the shares at the strike price.

We built up the position in BT Group, where we have confidence in the turnaround strategy, and in BP, where the shares were still over-discounting the likely impact from the Macondo incident in the Gulf of Mexico.

Investment Manager's Review

(continued)

In its second year, the call overwriting strategy has again generated both income and a net profit for the Trust. Additional income of around £1,860,000 has been accrued and a net profit of just over £950,000 earned taking into account the opportunity cost associated with any exercised options. Our approach to option writing is selective and driven by the investment fundamentals on each stock rather than by a separate derivatives rationale. We write calls on portions of share holdings that we would be happy to sell at the strike price, provided that the premium income received is sufficiently attractive. The options written are typically short dated with most under 4 months duration. The total exposure is closely monitored and limited to 15% of the portfolio value with all option positions "covered" by shares held within the portfolio. From a holistic view it can be argued that the overwriting strategy slightly reduces the Trust's gearing to the equity market, neutralising some of the financial leverage.

The valuations of defensive shares have risen significantly. Whilst a year ago many of these stocks traded on low absolute valuation metrics and offered clear value compared to the wider market, the situation has changed.

Constructing a portfolio - achieving the right balance

Constructing a portfolio in the current environment has particular challenges. As described in the Investment Manager's Review, share price movements have polarised with sharply divergent performance between perceived defensive and cyclical equities as investors have reacted to macro-economic news in "risk-on" and "risk-off" phases. There is a strong argument that it is best to focus on classically defensive companies with robust balance sheets, strong cash flow and globally diversified exposures. Indeed the Trust has held a significant bias towards these businesses over the last year. However there are also several arguments for looking more broadly for investment opportunities.

The defensive industries themselves are not risk free, particularly as governments and consumers struggle to balance their spending against limited incomes. Risks include rising excise duties on tobacco and alcohol, greater pressure from governments on pharmaceutical pricing, utility taxes and competitive pricing pressure in telecommunications. These risks are compounded by the limited diversification available from a relatively small number of perceived defensive sectors.

The valuations of defensive shares have risen significantly. Whilst a year ago many of these stocks traded on low absolute valuation metrics and offered clear value compared to the wider market, the situation has changed. Currently many defensive shares trade close to their long term average valuations and at a premium to the wider market. The shares may not be expensive in absolute terms but their relative attractions are less clear cut.

Another consideration relates to the macroeconomic and market outlook. Whilst our central view is cautious, it is possible that we are wrong and that a stronger economic recovery takes hold, or a workable solution is found for the Eurozone region. Even without that happening, stock markets could rally significantly as valuations are not high and many other asset classes look expensive. If we see a sharp stock market rally it is likely that defensive shares would lag most cyclical and financial stocks.

Ultimately however, the main reason for looking at more cyclical investments is that we are finding specific companies which have robust competitive positions trading on attractive valuations due to the de-rating of these businesses over the last year. We focus our analysis in these situations on the long term potential and the operating or financial risks to the business model.

Investment Manager's Review

(continued)

Future Policy

Following the theme of Groundhog Day, the current outlook is in many ways similar to last year. Once again industrial confidence surveys and unemployment trends seem to be improving, at least in the USA. The financial system is still functioning after huge liquidity injections. The peripheral Eurozone countries are putting a strain on the stronger core, whilst Middle East tensions (in Syria and Iran rather than Egypt and Libya) are keeping the oil price high. However just like last year, the problem of the debt burden has not been addressed in a convincing and sustainable way.

Whilst tentative signs of recovery in the US economy and its depressed housing industry are to be welcomed, there is political deadlock in Washington ahead of this year's election with an almost guaranteed drag from austerity next year. The UK and major European economies are showing little if any growth with even Germany recently reporting a negative quarter. Despite the recent Greek debt agreement, the situation remains unpredictable and there remains the risk of contagion into Portugal and elsewhere. Rising social pressures, youth unemployment and income inequalities are causing a backlash against business, banking and mainstream politicians. This raises the risk of populist economic policies being pursued and the worrying prospect of increasingly influential extremist groups.

The outlook for emerging markets is better than in the West but they have their own challenges and they are not immune to the wider global trade environment. Japan is caught in its own endless cycle of stuttering growth with high debt levels. Our overall view remains that growth in the UK and Western economies will be below trend, at best, for a considerable period as the huge debt burden is worked off. Furthermore the risks seem asymmetrically biased to the downside due to austerity measures and rising social and political tensions.

The outlook for emerging markets is better than in the West but they have their own challenges and they are not immune to the wider global trade environment.

"We have recently been taking a more balanced approach to stock selection and where possible adding specific cyclical or financial companies which meet our investment criteria."

Investment Manager's Review

(continued)

In sharp contrast to the economic outlook, most of the non-financial corporate sector is surprisingly robust with modest debts and high levels of profitability. The large UK companies which make up the FTSE 100 index are globally spread and diversified across industries, many of which are in good health. Valuations have increased recently but remain fair on a longer term basis, with low interest rates and government bond yields making equities look attractive in relative terms. The problem for equities is the challenging outlook. The European Union and the USA are important end markets for most large British businesses and pressures in these regions provide a difficult backdrop. In addition, the oil, mining and related industrial sectors make up around a third of the stock market value and have benefitted from high commodity prices and strong resources demand. The outlook for these industries would be worse if Chinese growth disappoints expectations.

Looking at the overall portfolio structure, we continue to favour large, diversified and strongly financed shares in defensive industries like pharmaceuticals and food producers given our concerns over the economic outlook. However, as set out in 'Constructing a portfolio - achieving the right balance' on page 13, we have recently been taking a more balanced approach to stock selection and where possible adding specific cyclical or financial companies which meet our investment criteria.

Themes within the portfolio include a preference for companies able to deliver above average growth, for example through exposure to emerging markets. Also, we continue to find opportunities amongst defence and construction companies as we feel the clear pressures on public expenditure are widely understood and more than priced into many shares.

Within the media industry the Trust owns several lowly priced, cash generative companies with strong competitive positions. They have exposure to a corporate sector that is in robust financial health and thus likely to gradually increase spending on activities like exhibitions, data information and marketing.

The Trust also owns selected consumer related companies. The outlook for the consumer is difficult, with a severe squeeze on disposable incomes. However the squeeze should incrementally improve from here if food and utility price inflation subsides and the companies in the portfolio have strong market positions, clear and successful strategies and trade at attractive valuations.

Areas where the portfolio has relatively limited exposure include the mining industry where we remain concerned about the sustainability of commodity prices in a tough economic environment and where dividend yields are low. Also there is only a small exposure to the domestic banks, where the outlook remains particularly uncertain and dividends are restricted, although there is a large holding in **HSBC** which has a strong funding position and attractive emerging market exposure. We see good value in many other high yielding financial stocks across a diversity of end markets, including real estate, insurance and investment management.

Simon Gergel
RCM (UK) Limited

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Listed Holdings

at 31 January 2012

Equities

Name	Value (£)	% of Listed holdings	Principal Activities
Royal Dutch Shell 'B'	43,822,256	8.6	Oil & Gas Producers
GlaxoSmithKline	37,196,705	7.3	Pharmaceuticals & Biotechnology
BP	37,185,224	7.3	Oil & Gas Producers
HSBC	33,494,513	6.5	Banks
Vodafone	29,664,971	5.8	Mobile Telecommunications
BAE Systems	18,892,589	3.7	Aerospace & Defence
SSE	17,460,300	3.4	Electricity
Unilever	16,470,300	3.2	Food Producers
British American Tobacco	16,460,339	3.2	Tobacco
National Grid	16,166,020	3.2	Gas, Water & Multiutilities
Top Ten Holdings	**266,813,217**	**52.2**	
BT Group	15,606,415	3.1	Fixed Line Telecommunications
Reed Elsevier	14,140,957	2.8	Media
Resolution	13,936,637	2.7	Life Insurance
Reckitt Benckiser	12,982,200	2.5	Household Goods & Home Construction
UBM	11,390,486	2.2	Media
Britvic	11,319,664	2.2	Beverages
Compass Group	11,191,000	2.2	Travel & Leisure
Centrica	10,793,440	2.1	Gas, Water & Multiutilities
BHP Billiton	9,909,740	1.9	Mining
Daily Mail & General Trust 'A'	9,786,560	1.9	Media
AstraZeneca	9,357,417	1.8	Pharmaceuticals & Biotechnology
Imperial Tobacco	7,941,500	1.6	Tobacco
Sainsbury (J)	7,757,960	1.5	Food & Drug Retailers
Bunzl	6,870,427	1.3	Support Services
Tesco	6,392,000	1.2	Food & Drug Retailers
Balfour Beatty	6,378,408	1.2	Construction & Materials
Cobham	6,032,400	1.2	Aerospace & Defence
IG Group	6,000,140	1.2	General Financial
Aviva	5,939,800	1.2	Life Insurance
Greene King	5,413,100	1.1	Travel & Leisure
Carnival	4,536,000	0.9	Travel & Leisure
Hammerson	4,506,345	0.9	Real Estate Investment Trust
Premier Farnell	4,373,560	0.9	Support Services
Inmarsat	4,206,265	0.8	Mobile Telecommunications

Listed Holdings *(continued)*

at 31 January 2012

Name	Value (£)	% of Listed holdings	Principal Activities
Meggitt	4,132,967	0.8	Aerospace & Defence
London & Stamford Property	4,129,684	0.8	Real Estate Investment Trust
Hiscox	3,810,000	0.7	Non-life Insurance
Man Group	3,809,999	0.7	General Financial
Barclays	3,442,500	0.7	Banks
Catlin Group	3,360,670	0.7	Non-life Insurance
Close Brothers	3,262,586	0.6	General Financial
Legal and General	3,098,880	0.6	Life Insurance
Interserve	2,716,175	0.5	Support Services
Ashmore Group	2,333,212	0.5	General Financial
Hays	2,244,375	0.4	Support Services
Mothercare	2,124,900	0.4	General Retailers
Total Equities	**512,041,586**	**100.0**	

Written Call Options

As at 31 January 2012, the market value of the outstanding options positions was £(291,625), resulting in an underlying exposure to 7.1% of the portfolio (valued at strike price).

Distribution of Total Assets

Total Assets (less creditors due within one year) £526,045,683 (2011 - £552,031,290)

	Percentage of total assets at 31 January 2012	Percentage of total assets at 31 January 2011
Oil & Gas		
Oil & Gas Producers	15.4	14.3
	15.4	**14.3**
Basic Materials		
Mining	1.9	3.3
	1.9	**3.3**
Industrials		
Aerospace & Defence	5.5	6.0
Construction & Materials	1.2	1.3
Industrial Engineering	-	0.7
Support Services	3.1	4.2
	9.8	**12.2**
Consumer Goods		
Beverages	2.2	0.9
Food & Drug Retailers	2.7	0.9
Food Producers	3.1	3.6
Household Goods & Home Construction	2.5	1.5
Tobacco	4.6	4.8
	15.1	**11.7**
Health Care		
Pharmaceuticals & Biotechnology	8.9	9.2
	8.9	**9.2**
Consumer Services		
General Retailers	0.4	0.7
Media	6.7	6.2
Travel & Leisure	4.0	2.7
	11.1	**9.6**

Distribution of Total Assets *(continued)*

	Percentage of total assets at 31 January 2012	Percentage of total assets at 31 January 2011
Telecommunications		
Fixed Line Telecommunications	3.0	2.0
Mobile Telecommunications	6.4	6.4
	9.4	**8.4**
Utilities		
Electricity	3.3	3.6
Gas, Water & Multiutilities	5.1	3.7
	8.4	**7.3**
Financials		
Banks	7.0	9.1
General Financial	2.9	3.0
Life Insurance	4.4	5.7
Non-Life Insurance	1.4	2.2
Real Estate	1.6	2.4
	17.3	**22.4**
Total Investments	**97.3**	**98.4**
Net Current Assets	**2.7**	**1.6**
Total Assets	**100.0**	**100.0**

Historical Record

year ended 31 January 2012

Revenue and Capital	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Income (£'000s)	22,101	22,247	22,675	24,714	27,750	28,495	31,730	23,687	25,741	27,305
Net Revenue Return per Ordinary Share	17.26p	17.34p	17.58p	19.44p	22.17p	22.86p	27.25p	18.91p	21.22p	22.00p
Dividends per Share	17.20p	17.60p	18.00p	18.90p	20.00p	21.60p	22.80p	22.50p	22.80p	23.00p
Ordinary Dividend per Share	17.20p	17.60p	18.00p	18.90p	20.00p	21.60p	22.30p	22.50p	22.80p	23.00p
Special Dividend per Share	-	-	-	-	-	-	0.50p	-	-	-
Tax Credit per Share	1.91p	1.96p	2.00p	2.10p	2.22p	2.40p	2.53p	2.50p	2.53p	2.56p
Gross Dividend per Share	19.11p	19.56p	20.00p	21.00p	22.22p	24.00p	25.33p	25.00p	25.33p	25.56p
Total Net Assets attributable to Ordinary Capital (£'000s)	273,407	357,442	424,511†	514,713	588,835	506,187	314,804	384,747	440,846	415,025
Net Asset Value per Ordinary Share	267.8p	350.1p	415.8p†	504.1p	567.5p	492.3p	306.2p	372.8p	427.1p	402.1p
NAV Total Return (%)*	-30.9	+37.3	+20.8†	+25.6	+16.4	-9.6	-33.4	+29.2	+20.7	-0.5
Retail Price Index Increases (%)**	+2.7	+2.4	+2.1	+2.3	+4.2	+4.1	+0.1	+4.6	+5.1	+3.9

Notes

* 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.

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

Directors' *Review*

Directors, Investment Manager and Advisers

Directors

The current Directors' details are set out below. All Directors are non-executive and independent of the Manager.

Simon Fraser (Chairman)

Joined the Board in August 2009. He is Chairman of Foreign & Colonial Investment Trust PLC and a non-executive director of Barclays PLC, Barclays Bank PLC, Ashmore Group plc, Fidelity European Values PLC and Fidelity Japanese Values PLC. He spent his career at Fidelity International Limited, where he held a number of positions, including Chief Investment Officer from 1999-2005, President of Fidelity International's European and UK Institutional business and latterly President of the Investment Solutions Group. He stepped down from executive responsibilities at the end of 2008.

Mike McKeon
(Chairman of the Audit Committee)

Joined the Board in May 2008. He is Group Finance Director of Severn Trent plc and prior to that, from 2000 until 2005, he was Group Finance Director of Novar plc. He held various senior roles at Rolls-Royce plc from 1997 to 2000. He has extensive experience in a number of overseas positions, having worked at CarnaudMetalbox, Elf Atochem and PricewaterhouseCoopers. He is a Chartered Accountant.

Henry Staunton
(Senior Independent Director)

Joined the Board in May 2008. He is Vice-Chairman and the Senior Independent Director of Legal & General Group plc and a non-executive director of Standard Bank Plc, Capital and Counties Properties plc and W H Smith PLC. He was previously Finance Director at ITV plc and Granada Group plc. He was also a non-executive director of Ladbrokes plc, Emap plc, BSkyB, Independent Television News Limited, Vector Hospitality plc and Ashtead Group plc, of which he was also Chairman between 2001 and 2004. He is a Chartered Accountant.

Paul Yates

Joined the Board in March 2011. He is a non-executive partner of 33 St James's and is a non-executive director of Edinburgh UK Tracker Trust plc. He has had a long career in investment management beginning at Samuel Montagu & Co in 1980. He joined Phillips and Drew in 1985 – the year that it was acquired by UBS. He held a number of positions at UBS, covering management, portfolio management, pensions, strategy and client service. He was CEO of UBS Global Asset Management (UK) Ltd between 2001 and 2005. After undertaking a number of global roles at UBS he retired in 2007.

Investment Manager
RCM (UK) Limited

Represented by Simon Gergel, Portfolio Manager, and Melissa Gallagher, Head of Investment Trusts

Secretary and Registered Office

Kirsten Salt BA (Hons) ACIS,
155 Bishopsgate,
London EC2M 3AD.
Telephone: 020 7065 1513,
Email: kirsten.salt@uk.rcm.com

Independent Auditors

PricewaterhouseCoopers LLP,
Chartered Accountants and Statutory Auditors
7 More London Riverside,
London SE1 2RD

Bankers

HSBC Bank, Barclays Bank

Stockbroker

JPMorgan Securities Limited

Legal Advisers

Herbert Smith LLP

Directors' Report

The Directors present their report and the audited financial statements of the Company for the year ended 31 January 2012.

Business Review

Business and Status of the Company

The Company is an investment company as defined in Section 833 of the Companies Act 2006.

The Company carries on business as an investment trust and was approved by HM Revenue & Customs as an investment trust in accordance with Section 1158 of the Corporation Tax Act 2010 for the year ended 31 January 2011. In the opinion of the Directors, the Company has subsequently conducted its affairs so that it should continue to qualify. The Company will continue to seek approval under Section 1158 of the Corporation Taxes Act 2010 each year. The Company is not a close company for taxation purposes.

Regulatory Environment

The Company is listed on the London Stock Exchange and is subject to UK company law, financial reporting standards, listing rules, tax law and its own Articles of Association. In addition to annual and half yearly financial reports published under these rules, the Company announces net asset values per share on a daily basis for the information of investors. It provides more detailed information on a monthly basis to the Association of Investment Companies, of which the Company is a member, in order for brokers and investors to compare its performance with its peer group. The Board of Directors is charged with ensuring that the Company complies with its own objectives as well as these rules. The Board has been advised of changes to the regulatory environment in the year ahead and the Company is preparing itself for implementation of the Alternative Investment Fund Managers Directive (AIFMD), the Retail Distribution Review (RDR) and the Foreign Account Tax Compliance Act (FATCA). The Board has appointed RCM (UK) Limited to carry out investment management, accounting, secretarial and administration services on behalf of the Company. The Company has no employees or premises of its own.

Investment Objective and Policies

The Company's objective is 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. 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.

The Company pays quarterly dividends and the Board has a policy of making these progressive from year to year, in keeping with the Company's stated objective to provide an above average level of income and income growth. Together with the proposed dividend, the dividend has increased every year for the past thirty years and details of historic dividend payments are set out on page 20.

Performance

In the year to 31 January 2012 the NAV per Share fell by 5.9%. This compares with the capital return on the Company's benchmark, FTSE 100 Index, of -3.1%. At 31 January 2012 the value of the Company's investment portfolio was £512.1m. The Investment Manager's review on pages 8 to 15 includes a review of developments during the year as well as information on investment activity within the Company's portfolio.

Key Performance Indicators ("KPIs")

The Board uses certain financial KPIs to monitor and assess the performance of the Company. The principal KPIs are:

- **Performance against the benchmark indices**
  The Company's performance is benchmarked against the FTSE 100 Index. This is the most important KPI by which performance is judged.
- **Performance against the Company's peers**
  The Board also monitors the Company's performance with reference to its investment trust peer group.
- **Performance Attribution**
  The performance attribution is considered at each Board Meeting and enables the Directors to judge how the Company achieved its performance relative to the benchmark index and to see the impact on the Company's relative performance of factors including stock and sector allocation. A Performance Attribution Analysis for the year ended 31 January 2012 is given on page 3.
- **Discount to net asset value ("NAV")**
  The Board has a share buy back programme which has a role to play in enhancing the NAV for existing shareholders, as shares are bought back at a discount, and in minimising the volatility of movements in the discount. In the year to 31 January 2012 the shares traded between a discount of -0.9% and a premium of 12.3% with debt at fair value.
- **Total expense ratio ("TER")**
  The most significant expense for the Company is the cost of the management

Directors' Report

(continued)

fee and the costs of interest on the Company's borrowings. Other expenses include the costs of investment transactions, directors' fees and insurance, professional advice and regulatory fees and the costs of production of the reports to shareholders. The TER is calculated by dividing operating expenses, that is, the Company's management fee and all other operating expenses (including tax relief where allowable, but excluding interest payments and investment management fee VAT refund) as a percentage of total assets less current liabilities at the year end. The TER for the year ended 31 January 2012 was 0.47% (2011 – 0.46%).

Revenue

The net return attributable to Ordinary Shareholders for the year amounted to £22,712,211 (2011 – £21,900,146).

Net revenue return per ordinary share amounted to 22.00p. The first and second interim dividends of 5.7p and 5.7p respectively have been paid during the year. Since the year end the third interim dividend of 5.8p has been paid. The final proposed dividend of 5.8p is payable on 14 May 2012. In accordance with FRS 21 'Events after the Balance Sheet Date', the third dividend and final dividend are not recognised as liabilities within the financial statements on the basis that they have not been paid and approved, respectively, by the shareholders.

Historical Record

The distribution of total assets is shown on pages 18 and 19, and the historical record of the Company's revenue, capital and invested funds over the past ten years is shown on page 20. Graphs appear on page 7 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.

Invested Funds

Sales of investments during the year resulted in net gains based on historical costs of £4,753,833 (2011 – gains of £25,156,875). Provisions contained in the Finance Act 2010 exempt approved Investment Trusts from corporation tax on their chargeable gains.

Share Buy Back

There were no shares bought back during the year (2011– nil).

Future Development

The future development of the Company is dependent on the success of the Company's investment strategy against the economic environment and market developments. The investment manager discusses his view of the outlook for the Company's portfolio in his report beginning on page 8.

The Board also believes that the Retail Distribution Review offers opportunities to generate more interest in investment trusts and to demonstrate the advantages over open-ended investments. This should lead to the Company raising its profile with new investors.

Going Concern

The Directors have considered the Company's investment objective and capital structure and, having noted that the portfolio consists mainly of securities which are readily realisable, have concluded that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason the Directors continue to adopt the going concern basis in preparing the financial statements.

Net Asset Value

The Net Asset Value of the Ordinary Shares of 25p at the year end was 402.1p as compared with a value of 427.1p at 31 January 2011.

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 (2011 – £nil).

Donations and Subscriptions

There were no charitable donations and subscriptions in respect of the year (2011 – £nil). No political donations were made during the year.

Final Dividend

Subject to the final dividend being approved by shareholders at the Annual General Meeting, payment will be made on 14 May 2012 to shareholders on the Register of Members at the close of business on 13 April 2012 at the rate of 5.8p per Ordinary Share. Further details are provided in Note 6 on page 51.

Capital Structure

The Company's capital structure is summarised on page 55. The details of the 4% Perpetual Debenture Stock and the 3.65% Cumulative Preference Stock are provided in Notes 10(iv) and 10(v) respectively on page 55.

Directors' Report

(continued)

Principal Risks and Uncertainties

The principal risks identified by the Board are set out in the table on this page, together with the actions taken to mitigate these risks. A more detailed version of this table, in the form of a Risk Matrix, is reviewed and updated by the Board twice yearly. The principal risks and uncertainties faced by the Company relate to the nature of its objectives and strategy as an investment company and the markets in which it operates.

Description	Mitigation
Investment Activity and Strategy An inappropriate investment strategy, e.g., asset allocation or the level of gearing, may lead to under-performance against the Company's benchmark index and peer group companies, and also in the Company's shares trading on a wider discount.	The Board manages these risks by diversification of investments through its investment restrictions and guidelines which are monitored and on which the Board receives reports. RCM (UK) Limited ("RCM") provides the Directors with management information including performance data and reports and shareholder analyses. The Board monitors the implementation and results of the investment process with the investment manager, who attends all board meetings, and reviews data which show risk factors and how they affect the portfolio. The Board reviews investment strategy, including gearing, at each board meeting.
Corporate Governance and Shareholder Relations Shareholder discontent could arise if there is weak adherence to best practice in corporate governance and which could result in potential reputational damage to the Company.	The Board receives reports on shareholder activity and on shareholder sentiment on a regular basis and contact is maintained with major shareholders. Details of the Company's compliance with Corporate Governance best practice, including information on relations with shareholders, are set out in the Corporate Governance Statement on pages 27 to 31.
Financial	The financial risks associated with the Company include market risk (price and yield), interest rate risk, liquidity risk and credit risk. Further analysis of these risks can be found in Note 18 on pages 58 to 63.

In addition to the specific principal risks identified in the table above, the Company faces risks to the provision of services from third parties and more general risks relating to compliance with accounting, tax, legal and regulatory requirements, which could have an impact on reputation and market rating. These risks are formally reviewed by the Board twice each year. Details of the Company's compliance with Corporate Governance best practice, including information on relations with shareholders, are set out in the Corporate Governance Statement within the Directors' Report beginning on page 27.

The Board's reviews of the risks faced by the Company also include an assessment of the residual risks after mitigating action has been taken.

Directors' Report
(continued)

Voting Rights in the Company's Shares
The voting rights at 29 March 2012 were:

Share class	Number of shares issued	Voting rights per share	Total Voting Rights
Ordinary Shares of 25p	103,213,464	1	103,213,464
3.65% Cumulative Preference Stock of £1	1,178,000	1	1,178,000
Total	**104,391,464**		**104,391,464**

Every member on a show of hands has one vote. On a poll every member who is present in person or by proxy or representative has one vote for every £1 in nominal amount of Preference Stock or one vote for every Ordinary Share of 25p.

There are no restrictions concerning the transfer of securities in the Company; no special rights with regard to control attached to securities; no agreements between holders of securities regarding their transfer known to the Company; no agreements which the Company is party to that might affect its control following a takeover bid; and no agreements between the Company and its directors concerning compensation for loss of office.

Interests in the Company's Share Capital
As at 29 March 2012 the following had declared a notifiable interest in the Company's issued share capital:

Ordinary Shares

Name	Number of shares	Percentage of Voting Rights
Legal & General Group PLC	4,099,823	3.97
Lloyds Banking Group PLC	4,086,614	3.96
Axa SA	3,664,667	3.55

This represents no significant change since the year end.

Directors
Biographical details of the current Directors are shown on page 22 and, except where noted, all Directors served throughout the financial year under review.

All of the Directors are retiring by rotation at the Annual General Meeting ('AGM') and each offers himself for re-election. The Board considers each director to be independent of the Manager and has the full support of the Board in standing for re-election. The Board confirms that, since the year end, the performances of all of the Directors have been subject to a formal evaluation and that each continues to be effective, have the appropriate skills and have demonstrated commitment and the necessary time to his role.

All Directors attended all board and relevant committee meetings during the year.

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.

Directors' and officers' liability insurance cover is held by the Company and deeds of indemnity have been entered into with the Directors.

Directors' Report

(continued)

The current Directors and their beneficial interests in the share capital of the Company as at 31 January 2012 and 31 January 2011 are listed below:

	Ordinary shares of 25p	
	2012	2011
Simon Fraser	20,000	20,000
Mike McKeon	450	450
Henry Staunton	10,000	10,000
Paul Yates*	10,000	-

* Joined the Board in March 2011 and held 1,000 shares on appointment.

Dick Barfield held 2,440 Ordinary Shares at 31 January 2011 and at his retirement on 10 May 2011.

There have been no changes to directors' interests since the year end.

Management Contract and Management Fee

The management contract with RCM (UK) Limited ('RCM') provides for a fee of 0.35% per annum (2011 – 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 (2011 – one year).

The Manager's 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 committee met the Manager 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. The committee was satisfied with its review and believes that the continuing appointment of the Manager is in the best interests of shareholders as a whole.

Individual Savings Accounts

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

Corporate Governance Statement

The Board has considered the principles and recommendations of the AIC Code of Corporate Governance ("AIC Code") and been guided by the AIC Corporate Governance Guide for Investment Companies ("AIC Guide"). Both documents can be found on the AIC website www.theaic.co.uk. As confirmed by the Financial Reporting Council following the AIC Corporate Governance Guide enables investment company boards to meet their obligations under the UK Corporate Governance Code and Listing Rules. The Company has complied with the recommendations of the AIC Code and the relevant provisions of UK Corporate Governance Code, except in relation to the UK Corporate Governance Code provisions relating to: the role of the chief executive; executive directors' remuneration; and the remuneration committee. For the reasons set out in the AIC Guide, and in the preamble to the UK Corporate Governance Code, the Board considers these provisions are not relevant to the Company as it is an externally managed investment company. The Company has therefore not reported further in respect of these provisions.

Directors' Report

(continued)

	AIC Code Principles	How the principles are applied
	THE BOARD	
1	The chairman should be independent.	Simon Fraser joined the Board as a non-executive director in August 2009 and he has been Chairman of the Company since May 2010. The Board, under the leadership of the Senior Independent Director, Henry Staunton, formally reviews the Chairman each year and it considers that Simon Fraser is independent both in character and in judgement and that there are no relationships or circumstances which are likely to affect, or could appear to affect, his judgement. The Senior Independent Director can provide a sounding board for the Chairman and serve as an intermediary for the other directors when necessary.
2	A majority of the board should be independent of the manager.	The Board is composed of four non-executive directors and all are considered to be independent of the Manager. None of the directors has any former association with the Manager and each is considered to be independent in character and judgement.
3	Directors should be submitted for re-election at regular intervals. Nomination for re-election should not be assumed but be based on disclosed procedures and continued satisfactory performance.	All directors will stand for re-election at each Annual General Meeting. The Board reviews the composition of the Board and board committees every year. Further information on the activities of the Nomination Committee is on page 32.
4	The board should have a policy on tenure, which is disclosed in the annual report.	Directors' appointments are reviewed annually. No director has a contract of service and a director may resign by notice in writing to the board at any time. A performance review of the board and the individual directors is conducted annually. The Company is a member of the FTSE 350 Index and therefore complies with the AIC Code principle concerning the annual re-election of all directors. The Board aims to refresh its composition from time to time; a new appointment was made in March 2011 and there is a plan to make further changes over the next two years.
5	There should be full disclosure of information about the board.	The directors' biographies on page 22 demonstrate a breadth of investment, industrial commercial and professional experience and expertise.

Directors' Report
(continued)

	AIC Code Principles	How the principles are applied
6	The board should aim to have a balance of skills, experience, length of service and knowledge of the company.	The composition and balance of the Board is continuously under review and these matters are taken into account as part of every recruitment process.
7	The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.	During the year, the effectiveness of the Board was assessed through interviews conducted by the Chairman with each director. The Chairman also discussed individual training and development needs with each director. The Chairman's own performance was evaluated by the other directors who met under the leadership of Henry Staunton, the Senior Independent Director. The results of the effectiveness assessment, performance evaluation and development planning have been presented to the Board. The Board will consider the use of external facilitators to carry out Board evaluation in the future.
8	Director remuneration should reflect their duties, responsibilities and the value of their time spent.	The Directors' Remuneration Report is on pages 38 and 39.
9	The independent directors should take the lead in the appointment of new directors and the process should be disclosed in the annual report.	The Nomination Committee, composed of all the independent directors and therefore the full current board, considers the recruitment of new directors and all directors will meet a shortlist of candidates. As part of the most recent recruitment process, consultants were appointed to draw up a shortlist to include as wide a spectrum of candidates as possible, including taking gender into account.
10	Directors should be offered relevant training and induction.	When a new director is appointed there is an induction process carried out by the 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.
11	The chairman (and the board) should be brought into the process of structuring a new launch at an early stage.	This principle does not apply to the Company as it is a long established investment company.

Directors' Report
(continued)

	AIC Code Principles	How the principles are applied
	BOARD MEETINGS AND THE RELATIONSHIP WITH THE MANAGER	
12	Boards and managers should operate in a supportive, co-operative and open environment.	The Board met six times in the year and also held an annual strategy meeting. Representatives of the Manager, including senior executives of the management company and the investment managers, together with the Company Secretary attend every meeting and other investment professionals and marketing executives join the meetings from time to time. The Chairman encourages participation and discussion at the meetings.
13	The primary focus at regular board meetings should be a review of investment performance and associated matters such as gearing, asset allocation, marketing/investor relations, peer group information and industry issues.	Full investment and performance reports are received and discussed at every board meeting and matters such as gearing, asset allocation, marketing and investor relations, peer group information and industry issues are all matters that are covered by the agenda.
14	Boards should give sufficient attention to overall strategy.	The Board conducts a formal strategy review each year and continues to monitor the matters discussed throughout the year.
15	The board should regularly review both the performance of, and contractual arrangements with, the manager.	The Management Engagement Committee considers the performance of the manager and the contractual terms of engagement. Further information on the activities of the Committee are on page 32.
16	The board should agree policies with the manager covering key operational issues.	The investment management contract covers the provision of operational matters and the Board discusses with the manager and agrees policies concerning key operational matters such as corporate governance issues and voting in respect of portfolio holdings, performance reporting methodology including matters such as benchmarking, gearing, share buy backs and investment restrictions.
17	Boards should monitor the level of the share price discount or premium (if any) and, if desirable, take action to reduce it.	The share price is monitored and the net asset value is reported on a daily basis. The Board receives reports on these issues at each Board meeting. The Company has a share buy back programme which includes in its aims the intention to reduce discount volatility. The Company has also taken powers to issue limited numbers of shares in certain circumstances (see page 34).
18	The board should monitor and evaluate other service providers.	The Audit Committee receives and considers internal controls reports from third party service providers and the manager and Company Secretary report to the Committee on their monitoring and evaluation of these services.

Directors' Report

(continued)

	AIC Code Principles	How the principles are applied
	SHAREHOLDER COMMUNICATIONS	
19	The board should regularly monitor the shareholder profile of the company and put in place a system for canvassing shareholder views and for communicating the board's views to shareholders.	The Chairman works with the manager to ensure that there is effective communication with the Company's shareholders. There is a process for monitoring and analysing the shareholder register and this is reported at each Board meeting. Visits to institutional shareholders and private client brokers are offered and carried out in a rolling programme. There is an opportunity for shareholders to meet and communicate with the directors and managers at the Company's Annual General Meeting, at which the portfolio manager gives a presentation. The Senior Independent Director provides another point of contact for Shareholders.
20	The board should normally take responsibility for, and have a direct involvement in, the content of communications regarding major corporate issues even if the manager is asked to act as spokesman.	The Board, or a Committee of the Board, reviews all major communications by the Company.
21	The board should ensure that shareholders are provided with sufficient information for them to understand the risk:reward balance to which they are exposed by holding the shares.	The Board agrees with the Manager every year a budget for and programme of marketing activity to communicate with investors and to reach a wider audience. In addition to the Annual and half-yearly report, both of which are sent to all shareholders and those others who have registered to receive them, the Company publishes online and makes available in hard copy a monthly factsheet and publishes daily on its website (www.merchantstrust.co.uk) the net asset value of the Company's shares and many other details of interest to investors.

Attendance by the current 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
Simon Fraser	6	2†	1	1
Mike McKeon	6	2	1	1
Henry Staunton	6	2	1	1
Paul Yates	6	2	1	1

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

Dick Barfield attended all meetings during the year until his retirement from the Board on 10 May 2011.

Directors' Report
(continued)

Special Rights Disclosure
There are no restrictions concerning the transfer of securities in the Company; no special rights with regard to control attached to securities; no agreements between holders of securities regarding their transfer known to the Company; no agreements which the Company is party to that might affect its control following a takeover bid; and no agreements between the Company and its directors concerning compensation for loss of office.

The Company is not aware of any agreements between holders of securities with regard to control of the Company which may result in restrictions on voting rights.

Conflicts of Interest
The Companies Act 2006 sets out directors' general duties. A director must avoid a situation where he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the Company's interests. Directors are able to authorise these conflicts and potential conflicts. The Board reports annually on the Company's procedures for ensuring that its powers of authorisation of conflicts are operated effectively and that the procedures have been followed.

Each of the Directors has provided a statement of all conflicts of interest and potential conflicts of interest relating to the Company. These statements have been considered and approved by the Board. The Directors have undertaken to notify the Chairman and Company Secretary of any proposed new appointments and new conflicts or potential conflicts for consideration, if necessary, by the Board. The Board has agreed that only Directors who have no interest in the matter being considered will be able to take the relevant decision and that in taking the decision the Directors will act in a way they consider, in good faith, will be most likely to promote the Company's success. The Board is able to impose limits or conditions when giving authorisation if it thinks this is appropriate.

The Board confirms that its powers of authorisation are operating effectively and that the agreed procedures have been followed.

Board Committees
Audit Committee
The Audit Committee Report is on page 37.

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 Simon Fraser, the Chairman of the Board. All Directors serve on the committee and consider nominations made in accordance with an agreed procedure. The recruitment process for new directors is for the Board to appoint external consultants to nominate candidates for the committee to consider.

The Board has issued a statement giving support to the intention of the Davies Review 'Women on Boards' to encourage diversity on the boards of companies. There are four directors on the board and as each has served no more than four years there are no current plans to recruit new directors. In the last recruitment exercise, as described in the previous annual report, the Board sought to identify a wide spectrum of candidates and to take gender into account. The Board's aim is to continue with a policy of shortlisting women in the search for new directors.

Management Engagement Committee
The Management Engagement Committee meets at least once each year to review the Management Agreement and the Manager's performance. It has defined terms of reference and consists of the non-executive Directors and would exclude any Directors previously employed by the Manager. It is chaired by Simon Fraser, the Chairman of the Board.

Terms of Reference
The Terms of Reference for each of the committees may be viewed by shareholders on request and are published on the website www.merchantstrust.co.uk.

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

Financial Reporting
The Statement of Directors' Responsibilities in respect of the financial statements is on page 36. The Independent Auditor's Report can be found on page 41.

Auditors' Information
Each of the persons who is a Director at the date of approval of this report confirms that:

(a) in so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and

(b) the Director has taken all the steps he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418(2) of the Companies Act 2006.

Directors' Report

(continued)

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 Audit Committee and accords with the Turnbull guidance and it is believed that the appropriate framework is in place to meet the requirements of the AIC Code. The process has been fully in place throughout the year under review and up to the date of signing of this Annual Financial Report.

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 Manager, undertook a full review of the Company's business risks and these are analysed and recorded (see page 25). Every six months the Board receives from the Manager a formal report which details any known internal controls failures, including those that are not directly the responsibility of the Manager. 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.
- The appointment of RCM (UK) Limited ('RCM') as the Manager provides investment management, accounting and company secretarial services to the Company. The Manager therefore maintains 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 Manager. The Manager's 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 receives reports at least annually from the manager on its internal controls. The Company, in common with other investment trusts, has no internal audit department, but the effectiveness of the Manager's 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 Manager's and Custodian's systems of controls by reviewing Internal Control reports provided by the Managers and third party service providers, including those of the Company's Registrars, Capita Registrars, and Custodian, HSBC Bank plc.

The Audit Committee has received reports from each of its service providers on the anti-bribery policies of these third parties. It receives reports at each meeting on compliance with the Manger's anti-bribery policy.

The Directors confirm that the Audit Committee has reviewed the effectiveness of the system of internal control. During the course of its review of the system of internal control, the Board has not identified nor been advised of any failings or weaknesses which it has determined to be significant.

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 Manager meets with institutional shareholders on a regular basis and reports to the Board on matters raised at these meetings. The Chairman and, where appropriate, other Directors, are available to meet with shareholders to discuss governance and strategy and to understand their issues and concerns. 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.

Directors' Report

(continued)

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.

The UK Stewardship Code and 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 Manager, RCM (UK) Limited (RCM). The UK Stewardship Code sets out good practice on engagement with investee companies. It provides an opportunity to bring together UK and overseas investors committed to the high quality dialogue with companies needed to underpin good governance.

By creating a sound basis of engagement it should create a much needed stronger link between governance and the investment process, and support the concept of "comply or explain" as applied by listed companies. The FRC therefore sees it as complementary to the UK Corporate Governance Code for listed companies. The Company's Manager, RCM (UK)'s policy statement on the Stewardship Code can be found on its website: www.rcm.com/london/pdf/Stewardship_Policy.pdf. The Board has reviewed this policy statement and is satisfied that the Company's delegated voting powers are being properly executed and is working with RCM (UK) to assess the effectiveness of the Stewardship Code in practice.

The Board has noted the Manager's statement of its corporate governance aims and objectives, summarised as:

"Our primary corporate aim is to maximise shareholder value through the securing of corporate performance whilst protecting this value through operating within established rules of conformance.

Our primary investment management aim is to meet or exceed our clients' expectations through generating first class returns within the constraint of their risk tolerance.

RCM votes in all markets wherever possible, and strives actively to encourage both improved levels of disclosure among companies and proper voting infrastructure among custodians and agents globally."

In the UK, RCM is a member of the National Association of Pension Funds (NAPF) and the International Corporate Governance Network (ICGN), and abides by these organisations' founding principles. These guidelines also take into account international codes of corporate governance from a number of sources, including Employment Retirement Income Security Act (ERISA) legislation and Department of Labor recommendations in the U.S. where appropriate.

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.

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

Annual General Meeting

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 551 of the Companies Act 2006, up to a maximum number of 34,401,047 Ordinary Shares, representing approximately 33% of the existing Ordinary Share capital. This authority is renewable annually and will expire at the conclusion of the Annual General Meeting in 2013.

A resolution was passed at the Annual General Meeting held on 10 May 2011 in accordance with Section 570 of the Companies Act 2006, to authorise the Directors to allot Ordinary Shares for cash other than pro rata to existing shareholders. The authority is renewable annually and expires at the conclusion of the Annual General Meeting in 2012. A Special Resolution is therefore proposed under special business at the forthcoming Annual General Meeting to renew this authority for a further year. This power is limited to a maximum number of 10,321,346 Ordinary Shares, being approximately 10% 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 2012.

Directors' Report

(continued)

The Directors may allot shares under these authorities to take advantage of opportunities in the market as they arise but only if they believe it would be advantageous to the Company's existing shareholders to do so. 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.

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 are 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 capital reserves of the Company (which are currently in excess of £380 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). 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 continue 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.

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 15,471,698 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 2012.

The authority in accordance with Section 701 of the Companies Act 2006, will last until the Annual General Meeting of the Company to be held in 2013 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.

Independent Auditors

The Directors will place a resolution before the Annual General Meeting to re-appoint PricewaterhouseCoopers LLP as statutory 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
Kirsten Salt
Secretary
29 March 2012

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Financial Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Company law also requires that the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the net return of the company for that period. In preparing these financial statements, the directors are required to:

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

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006. 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 financial statements are published on www.merchantstrust.co.uk, which is a website maintained by the Company's investment manager, RCM (UK) Limited. The Directors are responsible for the maintenance and integrity of the company's website. The work undertaken by the Auditor does not involve consideration of the maintenance and integrity of the website and, accordingly, the Auditor accepts no responsibility for any changes that have occurred to the financial statements since they were initially presented on the website. Visitors to the website need to be aware that legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Statement under DTR 4.1.12

The Directors at the date of approval of this Report, each confirm to the best of their knowledge that:

- the financial statements, which have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), give a true and fair view of the assets, liabilities, financial position and net return of the company; and
- the Annual Financial Report includes a fair review of the development and performance of the Company and the position of the Company, together with a description of the principal risks and uncertainties that it faces.

For and on behalf of the Board
Simon Fraser
Chairman
29 March 2012

Audit Committee Report

The principal role of the Audit Committee is to assist the Board in relation to the reporting of financial information, the review of financial controls and the management of risk. The committee has defined terms of reference and duties and the terms of reference are published on the Company's website. These include responsibility for the review of the annual financial report and the half yearly financial report, the nature and scope of the external audit and the findings therefrom and the terms of appointment of the auditors, including their remuneration and the provision of any non-audit services by them. Non-audit services of £3,500 in the year were for the Auditors' certification of borrowing covenants (2011 - £3,020). These fees are considered by the Audit Committee to be proportionate to the fees for audit services of £23,056 (2011 - £23,949).

The Board reviews the composition of the Audit Committee and considers that, collectively, the committee members have sufficient recent and relevant financial experience to discharge their responsibilities fully. The Audit Committee consists of all of the independent non-executive Directors, with the exception of the Chairman, and has defined terms of reference and duties. The committee considers that, collectively, its members have sufficient recent and relevant financial experience to discharge their responsibilities fully: two of the three committee members are Chartered Accountants. During the year the committee met twice during which the annual financial report and the half yearly financial report respectively were reviewed in detail. These meetings were attended by representatives of the Manager including their Compliance Officer. At each meeting the committee received a report from the Compliance Officer on the operation of financial controls relating to the Company and the proper conduct of its business in accordance with the regulatory environment in which both the Company and the Manager operate. The committee also considered 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 believes the performance of the Auditors is satisfactory and recommended their reappointment to the Board. 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. 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.

As the Company has no employees it does not have a formal policy concerning the raising, in confidence, of any concerns about improprieties, whether in matters of financial reporting or otherwise, for appropriate independent investigation. However, any matters concerning the Company may be raised with the Chairman or the Senior Independent Director. The Audit Committee has, however, received and noted the Manager's policy on this matter.

Mike McKeon
Audit Committee Chairman
29 March 2012

Directors' Remuneration Report

This report is submitted in accordance with the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008, Schedule 8, for the year ended 31 January 2012. An ordinary resolution for the approval of this report will be put to shareholders at the forthcoming Annual General Meeting.

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 half-yearly 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 £150,000 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.

Remuneration

During the year the Chairman's fees were £30,000 per annum, the Directors' fees were £20,000 per annum and an additional £3,000 was paid to the Audit Committee Chairman.

These fees have been in place since 1 February 2011 and prior to that the Chairman had been paid at the rate of £27,500, and the Directors at £18,000 per annum, with a further £3,000 for the Audit Committee Chairman. Since the year end the Board reviewed the fees and in order for the directors' remuneration to keep pace and remain competitive with the fees in the peer group and wider investment company sector, the fees have been increased with effect from 1 February 2012, to £31,500 for the Chairman, £21,000 for the other directors and an additional £3,250 for the Chairman of the Audit Committee.

Directors' Remuneration Report

(continued)

Directors' Emoluments (Audited)

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

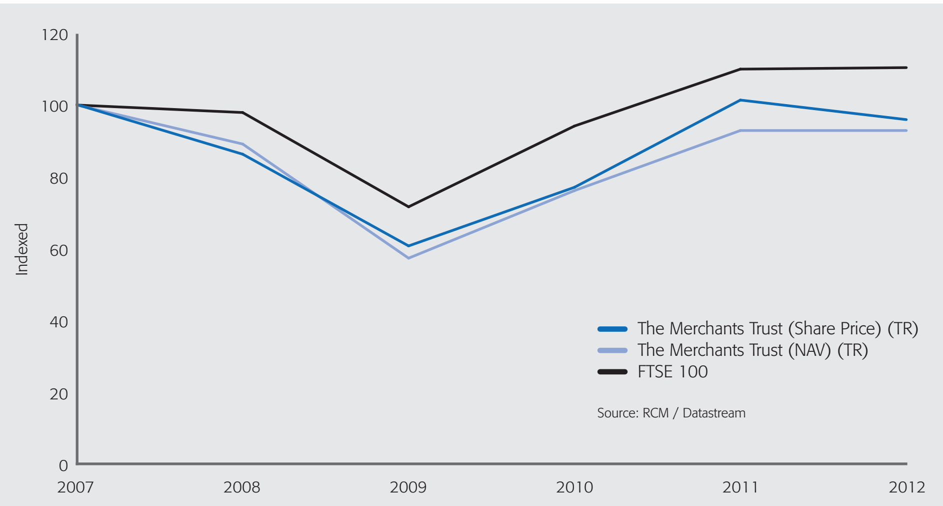
	Directors' fees	
	2012 £	2011 £
Simon Fraser	31,883*	24,543
Mike McKeon	23,000	20,115
Henry Staunton	20,000	18,000
Paul Yates**	17,359	-
Dick Barfield~	5,538	18,000
Lord Sassoon#	-	6,556
Sir Hugh Stevenson#	-	7,615
Totals	**97,780**	**94,829**

* Includes a National Insurance Contributions refund of £1,883. ** Appointed to the Board March 2011.
~ Retired from the Board May 2011. # Retired from the Board May 2010.

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 and is re-based to 100.

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 Manager's Review.



By Order of the Board
Kirsten Salt
Secretary
29 March 2012

Financial *Statements*

Independent Auditor's Report to the Members of The Merchants Trust PLC

We have audited the financial statements of The Merchants Trust PLC (the "company") for the year ended 31 January 2012 which comprise the Income Statement, the Reconciliation of Movements in Shareholders' Funds, the Balance Sheet, the Cash Flow Statement, the Statement of Accounting Policies and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 36, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, 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.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual financial report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 January 2012 and of its net return and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, set out on page 24, in relation to going concern;
- the parts of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on directors' remuneration.

Kelvin Laing-Williams
(Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP, Chartered Accountants and Statutory Auditor, London
29 March 2012

Income Statement

for the year ended 31 January

	Notes	2012 Revenue £	2012 Capital £	2012 Total Return £	2011 Revenue £	2011 Capital £	2011 Total Return £
Net (losses) gains on investments at fair value	8	-	(17,682,904)	(17,682,904)	-	63,626,410	63,626,410
Income	1	27,305,462	-	27,305,462	25,740,859	-	25,740,859
Investment management fee	2	(657,637)	(1,221,325)	(1,878,962)	(634,796)	(1,178,909)	(1,813,705)
Administration expenses	3	(611,230)	(2,641)	(613,871)	(714,775)	(3,442)	(718,217)
Net return before finance costs and taxation		**26,036,595**	**(18,906,870)**	**7,129,725**	**24,391,288**	**62,444,059**	**86,835,347**
Finance costs: interest payable and similar charges	4	(3,324,384)	(6,093,985)	(9,418,369)	(2,491,142)	(4,815,949)	(7,307,091)
Net return on ordinary activities before taxation		**22,712,211**	**(25,000,855)**	**(2,288,644)**	**21,900,146**	**57,628,110**	**79,528,256**
Taxation	5	-	-	-	-	-	-
Net return on ordinary activities attributable to Ordinary Shareholders		**22,712,211**	**(25,000,855)**	**(2,288,644)**	**21,900,146**	**57,628,110**	**79,528,256**
Net return per Ordinary Share (basic and diluted)	7	**22.00p**	**(24.22)p**	**(2.22)p**	**21.22p**	**55.83p**	**77.05p**

Dividends in respect of the financial year ended 31 January 2012 total 23.00p (2011 - 22.80p), amounting to £23,739,096 (2011- £23,532,668). Details are set out in Note 6 on page 51.

The total return column of this statement is the profit and loss account of the Company. The supplementary revenue return and capital return columns are both prepared under the guidance published by the Association of Investment Companies.

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 46 to 64 form an integral part of these Financial Statements.

Reconciliation of Movements in Shareholders' Funds

for the year ended 31 January

	Notes	Called up Share Capital £	Share Premium Account £	Capital Redemption Reserve £	Capital Reserve £	Revenue Reserve £	Total £
Net Assets at 31 January 2010		25,803,366	8,523,195	292,853	324,056,586	26,071,214	384,747,214
Revenue Return		-	-	-	-	21,900,146	21,900,146
Dividends on Ordinary Shares	6	-	-	-	-	(23,429,454)	(23,429,454)
Capital Return		-	-	-	57,628,110	-	57,628,110
Net Assets at 31 January 2011		**25,803,366**	**8,523,195**	**292,853**	**381,684,696**	**24,541,906**	**440,846,016**
Net Assets at 31 January 2011		25,803,366	8,523,195	292,853	381,684,696	24,541,906	440,846,016
Revenue Return		-	-	-	-	22,712,211	22,712,211
Dividends on Ordinary Shares	6	-	-	-	-	(23,532,668)	(23,532,668)
Capital Return		-	-	-	(25,000,855)	-	(25,000,855)
Net Assets at 31 January 2012		**25,803,366**	**8,523,195**	**292,853**	**356,683,841**	**23,721,449**	**415,024,704**

The Notes on pages 46 to 64 form an integral part of these Financial Statements.

Balance Sheet

at 31 January

	Notes	2012 £	2012 £	2011 £
Fixed Assets				
Investments held at fair value through profit or loss	8		512,069,555	543,239,476
Current Assets				
Debtors	10	3,047,069		2,034,330
Cash at bank		13,398,772		9,257,041
		16,445,841		**11,291,371**
Creditors – Amounts falling due within one year	10	(2,178,088)		(2,191,610)
Derivative financial instruments	8	(291,625)		(307,947)
		(2,469,713)		**(2,499,557)**
Net Current Assets			13,976,128	8,791,814
Total Assets less Current Liabilities			**526,045,683**	**552,031,290**
Creditors – Amounts falling due after more than one year	10		(111,020,979)	(111,185,274)
Net Assets			**415,024,704**	**440,846,016**
Capital and Reserves				
Called up Share Capital	11		25,803,366	25,803,366
Share Premium Account	12		8,523,195	8,523,195
Capital Redemption Reserve	12		292,853	292,853
Capital Reserve	12		356,683,841	381,684,696
Revenue Reserve	12		23,721,449	24,541,906
Total Shareholders' Funds	**13**		**415,024,704**	**440,846,016**
Net Asset Value per Ordinary Share (basic and diluted)	**13**		**402.1p**	**427.1p**

The financial statements of The Merchants Trust PLC, company number 28276, were approved and authorised for issue by the Board of Directors on 29 March 2012 and signed on its behalf by:

Simon Fraser
Chairman

The Notes on pages 46 to 64 form an integral part of these Financial Statements.

Cash Flow Statement

for the year ended 31 January

	Notes	2012 £	2012 £	2011 £
Net cash inflow from operating activities	**16**		**23,792,303**	**22,695,223**
Return on investment and servicing of finance				
Interest paid		(9,545,602)		(9,537,094)
Dividends on Cumulative Preference Stock		(42,996)		(21,498)
Net cash outflow from servicing of finance			**(9,588,598)**	**(9,558,592)**
Capital expenditure and financial investment				
Purchases of fixed asset investments		(114,624,382)		(131,542,358)
Sales of fixed asset investments		128,095,076		142,181,040
Net cash inflow from capital expenditure and financial investment			**13,470,694**	**10,638,682**
Dividends paid on Ordinary Shares	6		(23,532,668)	(23,429,454)
Increase in cash	**17**		**4,141,731**	**345,859**

The Notes on pages 46 to 64 form an integral part of these Financial Statements.

Statement of Accounting Policies

for the year ended 31 January

1 **The financial statements** have been prepared under the historical cost basis, except for the measurement at fair value of investments and derivative financial instruments, 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 and Venture Capital Trusts' (SORP) issued in January 2009 by the Association of Investment Companies (AIC).

In order to better reflect the activities of an investment trust company and in accordance with guidance issued by the AIC, supplementary information which analyses the Income Statement between items of a revenue and capital nature has been presented alongside the Income Statement. In accordance with the Company's status as a UK investment trust company under Sections 833 and 834 of the Companies Act 2006, net capital returns may not be distributed by way of a dividend.

The accounting policies adopted in preparing the current year's financial statements are consistent with those of previous years.

The Directors believe that it is appropriate to continue to adopt the going concern basis in preparing the financial statements as the assets of the Company consist mainly of securities which are readily realisable and significantly exceed liabilities. Accordingly, the Directors believe that the Company has adequate financial resources to continue in operational existence for the foreseeable future. The Company's business, the principal risks and uncertainties it faces, together with the factors likely to affect its future development, performance and position are set out in the Directors' Report, Business Review section on pages 23 to 34.

FRS 29 'Financial Instruments: Disclosures' introduces additional disclosures relating to financial instruments. This standard does not have any impact on the classification and/or valuation of the Company's financial instruments. The additional disclosures provided in accordance with the requirements of the standard are set out in Note 18 of the financial statements. Comparatives are not required.

2 **Revenue** – Franked, unfranked and overseas dividends received on equity shares are accounted for on an ex-dividend basis. UK dividends are shown net of tax credits.

Special dividends are recognised on an ex-dividend basis and treated as a capital or revenue item depending on the facts and circumstances of each dividend. The Board review special dividends and their treatment at each meeting.

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. Commissions in respect of underwriting are recognised when the underwritten issue closes and are generally recognised within the Income Statement as revenue. Where, however, the Company is required to take up a proportion of the shares underwritten, the same proportion of the commission received is recognised as capital, with the balance recognised as revenue.

3 **Investment management fees and administration expenses** – The investment management fee is calculated on the basis set out in Note 2 to the financial statements 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. The split is reviewed annually. Other administration expenses are charged in full to revenue, except custodian handling charges on investment transactions which are charged to capital. All expenses are recognised on an accrual basis.

4 **Valuation** - As the Company's business is investing in financial assets with a view to profiting from their total return in the form of increases in fair value, financial assets are designated as held at fair value through profit or loss in accordance with FRS 26 'Financial Instruments: Recognition and Measurement'. The Company manages and evaluates the performance of these investments on a fair value basis in accordance with its investment strategy, and information about the investments is provided on this basis to the Board of Directors.

Investments held at fair value through profit or loss are initially recognised at fair value. After initial recognition, these continue to be measured at fair value, which for quoted investments is either

Statement of Accounting Policies *(continued)*

for the year ended 31 January

the bid price or the last traded price depending on the convention of the exchange on which the investment is listed. Gains or losses on investments are recognised in the capital column of the Income Statement. Purchases and sales of financial assets are recognised on the trade date, being the date which the Company commits to purchase or sell the assets.

5 **Derivatives** – Options may be purchased or written over securities held in the portfolio for generating or protecting capital returns, or for generating or maintaining revenue returns. Where the purpose of the option is the maintenance of capital the premium is treated as a capital item. The value of the option is subsequently marked to market to reflect the fair value of the option based on traded prices. When an option is closed out or exercised the gain or loss is accounted for as capital.

Where the purpose of the option is the generation of income, the premium is treated as a revenue item. The value of the option is subsequently marked to market to reflect the fair value of the option based on traded prices. Premiums received on written options are amortised to revenue over the period to expiry. Unamortised premiums on exercise date are taken to capital.

6 **Finance costs** – In accordance with the FRS 25 'Financial Instruments: Disclosure and Presentation' and FRS 26 'Financial Instruments: Recognition and Measurement', long term borrowings are stated at the amortised cost being the amount of net proceeds on issue plus accrued finance costs to date. Finance costs are calculated over the term of the debt on the effective interest rate basis.

Where debt is issued at a premium, the premium is amortised over the term of the debt on the effective interest rate basis.

Finance costs net of amortised premiums are charged to capital and revenue in the ratio 65:35 to reflect the Board's investment policy and prospective split of capital and revenue returns.

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

7 **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.

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax or a right to pay less tax in the future have occurred. Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements.

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.

8 **Foreign currency** – In accordance with FRS 23 'The Effect of changes in Foreign Currency Exchanges Rates', the Company is required to nominate a functional currency, being the currency in which the Company predominately operates. The functional and reporting currency is sterling, reflecting the primary economic environment in which the Company operates. Transactions in foreign currencies are translated into sterling at the rates of exchange ruling on the date of the transaction. Foreign currency monetary 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 the capital column of the Income Statement and taken to the Capital Reserve.

9 **Dividends** – In accordance with FRS 21 'Events After the Balance Sheet Date', the final dividend proposed on Ordinary Shares is recognised as a liability when approved by shareholders. Interim dividends are recognised only when paid.

10 **Shares repurchased and subsequently cancelled** – Share Capital is reduced by the nominal value of the shares repurchased, and the Capital Redemption Reserve is correspondingly increased in accordance with Section 733 Companies Act 2006. The full cost of the repurchase is charged to the Capital Reserve within Gains (Losses) on Sales of Investments.

11. **Shares issued** – Share Capital is increased by the nominal value of shares issued. The proceeds net of expenses are allocated to the Share Premium Account.

Notes to the Financial Statements

for the year ended 31 January

1. Income

	2012 £	2012 £	2011 £
Income from Investments *			
Franked equity dividends from UK investments #		24,789,614	22,729,612
Unfranked dividends from UK investments		295,060	205,075
Equity dividends from overseas investments		344,320	580,702
		25,428,994	**23,515,389**
Other Income			
Premiums on derivative contracts	1,858,059		2,059,837
Underwriting commission	18,409		165,633
		1,876,468	**2,225,470**
Total income		**27,305,462**	**25,740,859**

* All equity dividends are derived from listed investments.
\# Includes special dividend of £694,730 (2011 - £nil)

During the year, the Company received premiums totalling £1,998,313 (2011 - £2,124,301) for writing covered call options for the purpose of revenue generation, of which £1,858,059 were amortised to income (2011 - £2,059,837). All derivatives transactions were based on FTSE 100 stocks or the related index. At the year end there were fourteen open positions with a liability value of £291,625 (2011 - £307,947).

2. Investment Management Fee

	2012 Revenue £	2012 Capital £	2012 Total £	2011 Revenue £	2011 Capital £	2011 Total £
Investment management fee	657,637	1,221,325	1,878,962	634,796	1,178,909	1,813,705
Total	**657,637**	**1,221,325**	**1,878,962**	**634,796**	**1,178,909**	**1,813,705**

The management contract with RCM (UK) Limited ('RCM'), terminable at one year's notice, provides for a management fee based on 0.35% (2011 - 0.35%) per annum of the value of the Company's assets calculated monthly after deduction of current liabilities, short term loans under one year and any funds within the portfolio managed by RCM. Under the contract, RCM provides the company with investment management, accounting, secretarial and administration services.

VAT has not been charged on management fees since May 2007.

Notes to the Financial Statements *(continued)*

for the year ended 31 January

3. Administration Expenses

	2012 £	2011 £
Auditors' remuneration		
for audit services	23,056	23,949
for certification of borrowing covenants	3,500	3,020
VAT on auditors' remuneration	5,311	5,294
	31,867	**32,263**
Directors' fees	97,780	94,829
Marketing costs	170,814	234,451
Other administration expenses	310,769	353,232
	611,230	**714,775**

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

(ii) Directors' fees are set out in the Directors' Remuneration Report on page 39.

(iii) In addition to the above, custodian handling charges of £2,641 were charged to capital (2011 - £3,442).

4. Finance Costs: Interest Payable and Similar Charges

	2012 Revenue £	2012 Capital £	2012 Total £	2011 Revenue £	2011 Capital £	2011 Total £
On Stepped Rate Interest Loan repayable after more than five years	1,335,440	2,480,103	3,815,543	1,361,040	2,527,647	3,888,687
Release of provision (see below)	-	-	-	(862,086)	(1,331,625)	(2,193,711)
	1,335,440	**2,480,103**	**3,815,543**	**498,954**	**1,196,022**	**1,694,976**
On Fixed Rate Interest Loan repayable after more than five years	1,301,309	2,416,717	3,718,026	1,304,676	2,422,970	3,727,646
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	625,377	1,161,415	1,786,792	625,265	1,161,207	1,786,472
On 3.65% Cumulative Preference Stock repayable after more than five years	42,997	-	42,997	42,997	-	42,997
On Sterling overdraft	11	-	11	-	-	-
	3,324,384	**6,093,985**	**9,418,369**	**2,491,142**	**4,815,949**	**7,307,091**

The prior year charge for the stepped rate interest benefited from the release of a provision in respect of a deferred tax liability accruing to First Debenture Finance ('FDF') in the year ended 31 January 2011. The release of this frozen tax charge was a result of the election by the directors of FDF to be taxed under the Securitisation Companies Regulations 2006 for the accounting period commencing 1 October 2007 and all subsequent accounting periods. Amounts of £862,086 and £1,331,625 were released to income and capital respectively.

Notes to the Financial Statements *(continued)*

for the year ended 31 January

5. Taxation

	2012 Revenue £	2012 Capital £	2012 Total £	2011 Revenue £	2011 Capital £	2011 Total £
(i) Analysis of tax charge for the year						
Overseas taxation	-	-	-	-	-	-
Current tax charge	**-**	**-**	**-**	**-**	**-**	**-**

(ii) Factors affecting current tax charge for the year

The tax assessed for the year is lower than the standard rate of corporation tax in the UK (26.33%) (2011 – 28%).

	2012 Revenue £	2012 Capital £	2012 Total £	2011 Revenue £	2011 Capital £	2011 Total £
Reconciliation of tax charge						
Return on ordinary activities before taxation	22,712,211	(25,000,855)	(2,288,644)	21,900,146	57,628,110	79,528,256
Tax on return on ordinary activities at 26.33% (2011 - 28%)	5,980,125	(6,582,725)	(602,600)	6,132,041	16,135,871	22,267,912
Reconciling factors						
Non taxable income	(6,617,765)	-	(6,617,765)	(6,526,888)	-	(6,526,888)
Non taxable capital losses (gains)	-	4,655,909	4,655,909	-	(17,815,395)	(17,815,395)
Accrued income taxable on receipt	20,537	-	20,537	-	-	-
Disallowable expenses	12,270	1,460	13,730	(220,590)	(357,433)	(578,023)
Excess of allowable expenses over taxable income	604,833	1,925,356	2,530,189	615,437	2,036,957	2,652,394
Current tax charge	**-**	**-**	**-**	**-**	**-**	**-**

The Company's taxable income is exceeded by its tax allowable expenses, which include both the revenue and capital elements of the management fee and finance costs. As at 31 January 2012, the Company had accumulated surplus expenses of £152.4 million (2011 - £142.8 million).

As at 31 January 2012 the Company has not recognised a deferred tax asset of £36.6 million (2011 - £38.5 million) in respect of the accumulated expenses, based on a prospective corporation tax rate of 24% (2010 – 27%). The reduction in the standard rate of corporation tax was substantively enacted on 26 March 2012 and is effective from 1 April 2012. Further reductions to the main rate are proposed to reduce the rate by 1% each year down to 22% by April 2014. Provided the Company continues to maintain its current investment profile, it is unlikely that these expenses will be utilised and that the Company will obtain any benefit from this asset.

The Company will continue to seek approval under Section 1158 of the Corporation Tax Act 2010 for the current year and the foreseeable future. The Company has not therefore provided for deferred tax on any capital gains and losses arising on the disposals of investments.

Notes to the Financial Statements *(continued)*

for the year ended 31 January

6. Dividends on Ordinary Shares

	2012 £	2011 £
Dividends on Ordinary Shares of 25p		
Third interim dividend 5.7p paid 18 February 2011 (2010 - 5.6p)	5,883,167	5,779,954
Final dividend 5.7p paid 13 May 2011 (2010 - 5.7p)	5,883,167	5,883,166
First interim dividend 5.7p paid 17 August 2011 (2010 - 5.7p)	5,883,167	5,883,167
Second interim dividend 5.7p paid 11 November 2011 (2010 - 5.7p)	5,883,167	5,883,167
	23,532,668	**23,429,454**

Dividends payable at the year end are not recognised as a liability under FRS 21 'Events After Balance Sheet Date' (see page 47 - Statement of Accounting Policies). Details of these dividends are set out below.

	2012 £	2011 £
Third interim dividend 5.8p paid 23 February 2012 (2011 - 5.7p)	5,986,381	5,883,167
Final proposed dividend 5.8p payable 14 May 2012 (2011 - 5.7p)	5,986,381	5,883,167
	11,972,762	**11,766,334**

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 cancellations 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 or additional rate will have further tax to pay.

7. Net Return per Ordinary Share

	2012 Revenue £	2012 Capital £	2012 Total Return £	2011 Revenue £	2011 Capital £	2011 Total Return £
Net return after taxation attributable to Ordinary Shareholders	22,712,211	(25,000,855)	(2,288,644)	21,900,146	57,628,110	79,528,256
Net return per Ordinary Share (basic and diluted)	22.00p	(24.22)p	(2.22)p	21.22p	55.83p	77.05p

The weighted average number of shares in issue during the year was 103,213,464 (2011 - 103,213,464).

Notes to the Financial Statements *(continued)*

for the year ended 31 January

8. Investments

	2012 £	2011 £
Listed on the London Stock Exchange at market valuation	512,041,586	543,212,051
Unlisted at fair value	27,969	27,425
Fixed asset investments	**512,069,555**	**543,239,476**
Derivative financial instruments - written call options	(291,625)	(307,947)
Total investments	**511,777,930**	**542,931,529**
Market value of investments brought forward	542,931,529	488,295,791
Investment holding (gains) losses brought forward	(38,259,082)	476,634
Derivative holding losses brought forward	155,017	216,723
Cost of investments held brought forward	**504,827,464**	**488,989,148**
Additions at cost	114,624,382	130,908,403
Disposals at cost	(123,392,280)	(115,070,087)
Cost of investments held at 31 January	**496,059,566**	**504,827,464**
Investment holding gains at 31 January	15,724,039	38,259,082
Derivative holding losses at 31 January	(5,675)	(155,017)
Market value of investments held at 31 January	**511,777,930**	**542,931,529**
Net (losses) gains on investments		
Net gains on sales of investments based on historical costs	4,753,833	25,156,875
Adjustment for net investment holding gains recognised in previous years	(6,942,954)	(2,001,815)
Net (losses) gains on sales of fixed asset investments based on carrying value at previous balance sheet date	**(2,189,121)**	**23,155,060**
Net losses on derivative financial instruments	(51,037)	(327,887)
Net (losses) gains on sales of investments based on carrying value at previous balance sheet date	**(2,240,158)**	**22,827,173**
Net investment holding (losses) gains arising in the year	(15,592,088)	40,737,531
Net derivative holding gains arising in the year	149,342	61,706
Net (losses) gains on investments	**(17,682,904)**	**63,626,410**

Transaction costs and stamp duty on purchases amounted to £750,078 (2011 - £773,955) and transaction costs on sales amounted to £158,471 (2011 - £154,872).

Notes to the Financial Statements *(continued)*

for the year ended 31 January

9. Investments in other companies

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	Class of Share held	% Equity
First Debenture Finance PLC ('FDF')	'A' Shares	50.0
	'B' Shares	50.0
	'C' Shares	50.0
	'D' Shares	50.0
Fintrust Debenture PLC ('Fintrust')	Ordinary Shares	50.0

In the opinion of the Directors, the Company is not in a position to exert significant influence over the financial 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. Accordingly, FDF and Fintrust are not considered to be associate undertakings as per FRS 9 and are therefore included in the balance at the Director's valuation. FDF and Fintrust are the lenders of the Company's Stepped Rate Interest 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.

10. Current Assets and Creditors

	2012 £	2011 £
Debtors		
Accrued income	3,015,885	1,995,817
Other debtors	31,184	38,513
	3,047,069	**2,034,330**

	2012 £	2011 £
Creditors: Amounts falling due within one year		
Other creditors	843,259	850,846
Interest on borrowings	1,334,829	1,340,764
	2,178,088	**2,191,610**

Notes to the Financial Statements *(continued)*

for the year ended 31 January

Interest on outstanding borrowings consists of:			
Stepped Rate Interest Loan		312,004	313,728
Fixed Rate Interest Loan		780,470	783,545
5.875% Secured Bonds 2029		207,105	208,243
4% Perpetual Debenture Stock		13,751	13,750
3.65% Cumulative Preference Stock		21,499	21,498
		1,334,829	**1,340,764**
Creditors: Amounts falling due after more than one year			
Stepped Rate Interest Loan	10(i)	34,034,109	34,034,112
Fixed Rate Interest Loan	10(ii)	45,268,411	45,457,833
5.875% Secured Bonds 2029	10(iii)	29,165,459	29,140,329
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
		111,020,979	**111,185,274**

(i) The Stepped Rate Interest Loan of £34,034,109 (2011- £34,034,112) comprises adjustable Stepped Rate Interest Loan Notes of £5,133,520 and Stepped Rate Interest Bonds of £20,534,079. The Loan Notes and Bonds were issued in 1987 at 97.4% and are repayable on 2 January 2018, together with a premium of £8,366,510.

The initial interest rate 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%. This stepped interest rate, when combined with the accrual of the premium, results in an effective interest rate of 11.28% per annum.

Interest on the Loan Notes and bonds 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').

FDF has a liability to its Debenture Stockholders to repay principal and interest on its £52.2 million of 11.125% Severally Guaranteed Debenture Stock 2018. The Company has guaranteed the repayment of principal and interest on £34.0 million of FDF's Debenture Stock. This is in proportion to the principal amounts raised by the Company in 1987 in respect of the Loan Notes and Bonds. 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.

(ii) The Fixed Rate Interest Loan of £42,000,000 is due to Fintrust Debenture PLC ('Fintrust'). It comprises a loan of £30,000,000 taken out in 1993, and a further amount of £12,000,000 assumed in 1998 from another of Fintrust's borrowers. This loan is repayable on 20 May 2023 and carries interest at 9.25125% per annum on the principal amount. Interest is payable in May and November each year.

As security for this loan, the Company has granted a floating charge over its assets in favour of the lender. This charge ranks pari passu with the floating charge noted in 10(i) above.

The loan of £30,000,000 taken out in 1993 is stated at £29,901,038 (2011 - £29,896,568), being the net proceeds of £29,858,947 plus accrued finance cost of £42,091 (2011 - £37,621). The effective interest rate of this portion of the loan is 9.51%.

Notes to the Financial Statements *(continued)*

for the year ended 31 January

On assuming the additional loan of £12,000,000 in 1998, the Company also received a premium of £5,286,564 to ensure that the finance costs on this additional loan were comparable to existing market interest rates. This premium is being amortised over the remaining life of the loan. At 31 January 2012, the loan is stated at £15,367,373 (2011 - £15,561,265), being the principal amount of £12,000,000 plus the unamortised premium of £3,367,373 (2011 - £3,561,265). The effective interest rate of this portion of the loan is 6.00%.

(iii) The £30,000,000 of 5.875% Secured Bonds is stated at £29,165,459 (2011 - £29,140,329), being the net proceeds of £28,942,800 plus accrued finance costs of £222,659 (2011 - £197,529). The Bonds are repayable on 20 December 2029 and carry interest at 5.875% per annum on the principal amount. Interest is payable in June & December each year. The effective interest rate of this loan is 6.23% per annum.

As security for this loan, the Company has granted a floating charge over its assets ranking pari passu with the floating charges referred to in Note 10(i) and 10(ii) above.

(iv) The 4% Perpetual Debenture Stock of £1,375,000 is secured by a floating charge on the assets of the Company, which ranks prior to any other floating charge. Interest is payable on 1 May and 1 November each year.

(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 Preference Stock holders to receive payments is not calculated by reference to the Company's net return and, in the event of a return of capital is limited to a specific amount, being £1,178,000. Dividends on the Preference Stock are payable on 1 August and 1 February each year.

11. Called up Share Capital

	2012 £	2011 £
Allotted and fully paid		
103,213,464 Ordinary Shares of 25p (2011 - 103,213,464)	25,803,366	25,803,366

The directors are authorised by an ordinary resolution passed on 10 May 2011 to allot relevant securities, in accordance with Section 551 of the Companies Act 2006, up to a maximum of 34,401,044 Ordinary Shares of 25p each. This authority expires on 9 May 2012 and accordingly a renewed authority will be sought at the Annual General Meeting on 9 May 2012.

During the year the Company did not repurchase any Ordinary Shares for cancellation or holding in treasury, nor have any Ordinary Shares been repurchased since the year end.

Notes to the Financial Statements *(continued)*

for the year ended 31 January

12. Reserves

			Capital Reserve*		
	Share Premium Account £	Capital Redemption Reserve £	Gains (Losses) on sales of Investments £	Investment Holding Gains (Losses) £	Revenue Reserve £
Balance at 1 February 2011	8,523,195	292,853	343,580,631	38,104,065	24,541,906
Net losses on sales of fixed asset investments	-	-	(2,189,121)	-	-
Net losses on derivative financial instruments	-	-	(51,037)	-	-
Net movement in fixed asset investment holding losses	-	-	-	(15,592,088)	-
Net movement in derivative holding gains	-	-	-	149,342	-
Transfer on sale of investments	-	-	6,942,954	(6,942,954)	-
Investment management fee	-	-	(1,221,325)	-	-
Finance costs of borrowings	-	-	(6,093,985)	-	-
Other capital expenses	-	-	(2,641)	-	-
Dividends appropriated in the year	-	-	-	-	(23,532,668)
Revenue retained for the year	-	-	-	-	22,712,211
Balance at 31 January 2012	**8,523,195**	**292,853**	**340,965,476**	**15,718,365**	**23,721,449**

*Under the terms of the Company's Articles of Association the Capital Reserve is distributable only by way of redemption or purchase of the Company's own shares, for so long as the Company carries on business as an Investment Company. The Institute of Chartered Accountants in England and Wales (ICAEW), in its technical guidance TECH 02/10, states that investment holding gains arising out of a change in fair value of assets may be recognised as realised provided they can be readily converted into cash. Securities listed on a stock exchange are generally regarded as being readily convertible into cash and hence profits in respect of such securities, currently included within the Investment Holding Losses of the Capital Reserve above, may be regarded as realised under Company Law.

13. Net Asset Value per Share

	Net Asset Value per Share attributable 2012	2011
Ordinary Shares of 25p	402.1p	427.1p

	Net Asset Value attributable 2012	2011
Ordinary Shares of 25p	£415,024,704	£440,846,016

The net asset value per ordinary share is based on 103,213,464 ordinary shares in issue at the year end (2011 - 103,213,464).

14. Contingent Assets

At 31 January 2012 there were no outstanding contingent assets (2011 - nil).

Notes to the Financial Statements *(continued)*

for the year ended 31 January

15. Contingent Liabilities and Commitments

At 31 January 2012 there were no outstanding contingent liabilities or capital commitments (2011 - nil).

Details of the guarantee provided by the Company as part of the terms of the Loans are provided in Note 10(i), 10(ii) and 10(iii) 'Current Assets and Creditors' on pages 54 and 55.

16. Reconciliation of Net Return on Ordinary Activities before Finance Costs and Taxation to Net Cash Flow from Operating Activities

	2012 £	2011 £
Net return before finance costs and taxation	7,129,725	86,835,347
Less: Net losses (gains) on investments at fair value	17,682,904	(63,626,410)
	24,812,629	**23,208,937**
Increase in debtors	(1,012,739)	(634,973)
(Decrease) Increase in creditors	(7,587)	121,259
Net cash inflow from operating activities	**23,792,303**	**22,695,223**

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

	Cash £	Stepped and Fixed Rate Loans £	5.875% Secured Bonds 2029 £	4% Perpetual Debenture Stock £	3.65% Preference Stock £	Net Debt £
(i) Analysis of net debt						
At 31 January 2011	9,257,041	(79,491,945)	(29,140,329)	(1,375,000)	(1,178,000)	(101,928,233)
Movement in year	4,141,731	189,425	(25,130)	-	-	4,306,026
At 31 January 2012	**13,398,772**	**(79,302,520)**	**(29,165,459)**	**(1,375,000)**	**(1,178,000)**	**(97,622,207)**

	2012 £	2011 £
(ii) Reconciliation of net cash flow to movement in net debt		
Net cash inflow	4,141,731	345,859
Decrease in long term loans	164,295	2,272,998
Movement in net funds	**4,306,026**	**2,618,857**
Net debt brought forward	(101,928,233)	(104,547,090)
Net debt carried forward	**(97,622,207)**	**(101,928,233)**

Notes to the Financial Statements *(continued)*

for the year ended 31 January

18. Financial Risk Management Policies and Procedures

The Company invests in equities and other investments in accordance with its investment policy as stated on page 1. In pursuing its investment policy, the Company is exposed to certain inherent risks that could result in either a reduction in the Company's net assets or a reduction in the profits available for distribution by way of dividends.

The main risks arising from the Company's financial instruments are: market price risk, market yield risk, liquidity risk and credit risk. The Directors determine the objectives and agree policies for managing each of these risks, as set out below. The Investment Manager, in close co-operation with the Directors, implements the Company's risk management policies. The Company's policy allows the use of derivative financial instruments to moderate risk exposure and to generate additional revenue. These policies have remained substantially unchanged during the current and preceding period.

(a) Market Risk

The Investment Manager assesses the exposure to market risk when making each investment decision, and monitors the risk on the investment portfolio on an ongoing basis. Market risk comprises market price risk, market yield risk, foreign currency risk and interest rate risk.

(i) 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.

Where call options are sold (written), in all cases a sufficient position is maintained in the underlying equity to cover any potential option exercise. Whilst the option value can be volatile, price movements should to some extent be offset by opposing movements in the value of the underlying equity. If options are retained until expiry they will either expire worthless or be exercised. The effect of any option exercise is to sell the underlying shares at the strike price of the option. A schedule of the Company's listed holdings is shown on pages 16 and 17.
Where put options are purchased, the market value of such options can be volatile but the maximum loss on any contract is limited to the original investment cost.

Further explanation of this derivative strategy is included in the Investment Manager's Review on pages 12 and 13.

Falls in stock market valuations lead to changes in gearing ratios. The Board's procedure for monitoring the gearing of the company is set out in Note 19 on page 63. This takes into account the Investment Manager's view on the market, covenant requirements and the future prospects of the Company's performance.

Market price risk sensitivity

The value of the Company's listed investments (i.e fixed asset investments, excluding unlisted equities) which were exposed to market price risk as at 31 January 2012 was as follows:

	2012 £	2011 £
Listed investments held at fair value through profit or loss	512,041,586	543,212,051
Derivative financial instruments - written call options	(291,625)	(307,947)
Total listed investments	**511,749,961**	**542,904,104**

The following table illustrates the sensitivity of the return after taxation for the year and the net assets to an increase or decrease of 20% (2011: 20%) in the fair values of the Company's listed investments. This level of change is considered to be reasonably possible based on observation of market conditions in recent years. The sensitivity analysis on the net return after tax is based on the impact of a 20% increase or decrease in the value of the Company's listed equity investments at each closing balance sheet date and the consequent impact on the investment management fees for the year, with all other variables held constant.

Notes to the Financial Statements *(continued)*

for the year ended 31 January

	2012 20% Increase in fair value £	2012 20% Decrease in fair value £	2011 20% Increase in fair value £	2011 20% Decrease in fair value £
Revenue return				
Investment management fees	(125,450)	125,450	(133,087)	133,087
Capital return				
Net gains (losses) on investments at fair value	102,349,992	(102,349,992)	108,580,821	(108,580,821)
Investment management fees	(232,979)	232,979	(247,161)	247,161
Change in net return and net assets	**101,991,563**	**(101,991,563)**	**108,200,573**	**(108,200,573)**

Management of market price risk

The Directors meet regularly to consider the asset allocation of the portfolio in order to minimise the risk associated with particular industry sectors. A dedicated investment manager has the responsibility for monitoring the existing portfolio selection in accordance with the Company's investment objectives and to ensure that individual stocks meet an acceptable risk reward profile. Call options are only written on stock owned within the portfolio with a maximum exposure of 15% of gross assets at the time of writing the call.

(ii) Market Yield Risk

Market yield risk arises from the uncertainty about the Company's ability to maintain its income objectives due to systematic decline in corporate dividend levels.

Management of market yield risk

The Directors regularly review the current and projected yield of the investment portfolio, and discuss with the Investment Manager the extent to which it will enable the Company to meet its investment income objective.

(iii) Foreign Currency Risk

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

Management of foreign currency risk

The Company invests predominantly in UK listed equities and has no significant exposure to currencies other than sterling (2011 - no significant exposure).

Any income denominated in foreign currency is converted into sterling on receipt. The Company does not hedge against foreign currency exposure.

(iv) 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.

Notes to the Financial Statements *(continued)*

for the year ended 31 January

Interest Rate Exposure

The table below summarises in sterling terms the financial assets and financial liabilities whose values are directly affected by changes in interest rates.

	2012 Fixed rate interest £	2012 Floating rate interest £	2012 Nil interest £	2012 Total £	2011 Fixed rate interest £	2011 Floating rate interest £	2011 Nil interest £	2011 Total £
Financial Assets	-	13,398,772	512,069,555	525,468,327	-	9,257,041	543,239,476	552,496,517
Financial Liabilities	(111,020,979)	-	(291,625)	(111,312,604)	(111,185,274)	-	(307,947)	(111,493,221)
Net Financial (Liabilities) Assets	**(111,020,979)**	**13,398,772**	**511,777,930**	**414,155,723**	**(111,185,274)**	**9,257,041**	**542,931,529**	**441,003,296**
Short term debtors and creditors				868,981				(157,280)
Net Assets per the Balance Sheet				**415,024,704**				**440,846,016**

As at 31 January 2012, the interest rates received on cash balances or paid on bank overdrafts, was nil and 1.35% per annum respectively (2011 - nil and 1.35% per annum).

The fixed rate interest bearing liabilities bear the following coupon and effective rates as at 31 January 2012 and 31 January 2011.

	Maturity date	Amount borrowed £	Coupon rate	Effective rate since inception*
First Debenture Finance PLC ('FDF') - Bonds	02/01/2018	5,133,520	14.75%	11.28%
First Debenture Finance PLC ('FDF') - Notes	02/01/2018	20,534,079	14.75%	11.28%
Fintrust Debenture PLC ('Fintrust') - Original Loan	20/11/2023	30,000,000	9.25125%	9.51%
Fintrust Debenture PLC ('Fintrust) - Additional 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%	4.00%
3.65% Cumulative Preference Stock	n/a	1,178,000	3.65%	3.65%
		100,220,599		

* The effective rates are calculated in accordance with FRS 26 'Financial Instruments: Recognition and Measurement' as detailed in the Statement of Accounting Policies.

The details in respect of the above loans have remained unchanged since the previous accounting period.

The weighted average effective rate of the Company's fixed interest bearing liabilities (excluding the 3.65% Cumulative Preference Stock and the 4% Perpetual Debenture Stock) is 8.54% (2011 - 8.54%) and the weighted average period to maturity of these liabilities is 12.2 years (2011 - 13.2 years).

The above year end amounts are reasonably representative of the exposure to interest rates during the year, as the level of exposure does not change materially. Therefore the Company's net return and net assets, are not significantly affected by changes in interest rates.

Notes to the Financial Statements *(continued)*

for the year ended 31 January

Management of interest rate risk

The Company invests predominantly in equities, the values of which are not directly affected by changes in prevailing market interest rates. In the year to 31 January 2012, the Company held no fixed interest securities. The Company's policy is to remain substantially fully invested and thus does not expect to hold significant cash balances. The financial assets have minimal exposure to interest rate risk.

The Company finances its operations through a mixture of share capital, retained revenue and long term borrowings. Movement in interest rates will not have a material effect on the finance costs and financial liabilities of the Company, as presented in the accounts, as all the borrowings of the Company are subject to fixed rates of interest.

(b) Liquidity risk

Liquidity risk relates to the capacity to meet liabilities as they fall due and is dependent on the liquidity of the underlying assets.

Maturity of financial liabilities

The table below presents the future cash flows payable by the Company in respect of its financial liabilities.

Cash flows in respect of the principal and interest on the Stepped Rate Interest Loan, Fixed Rate Interest Loan and 5.875% Secured Bonds 2029 reflect the maturity dates as set out in Note 10 on pages 54 and 55. The loans are each governed by a trust deed and only if the covenants are breached would early repayment be enforced. Therefore their repayment is not considered to be a likely short term liquidity issue. Cash flows in respect of the 4% Perpetual Debenture Stock and 3.65% Cumulative Preference Stock, which have no fixed repayment date, assumes maturity of 20 years from the balance sheet date. Cash flows have not been discounted.

2012	3 months or less £	Not more than one year £	Between one and five years £	More than five years £	Total £
Creditors - Amounts falling due within one year					
Finance costs of borrowings	21,499	9,510,471	-	-	9,531,970
Other creditors	843,259	-	-	-	843,259
Derivative financial instruments	291,625	-	-	-	291,625
Creditors - Amounts falling due after more than one year					
Amounts payable on maturity of borrowings	-	-	-	108,587,109	108,587,109
Finance costs of borrowings	-	-	38,127,880	55,307,929	93,435,809
	1,156,383	**9,510,471**	**38,127,880**	**163,895,038**	**212,689,772**

2011	£	£	£	£	£
Creditors - Amounts falling due within one year					
Finance costs of borrowings	-	9,531,970	-	-	9,531,970
Other creditors	850,846	-	-	-	850,846
Derivative financial instruments	307,947	-	-	-	307,947
Creditors - Amounts falling due after more than one year					
Amounts payable on maturity of borrowings	-	-	-	108,587,112	108,587,112
Finance costs of borrowings	-	-	38,170,877	64,796,902	102,967,779
	1,158,793	**9,531,970**	**38,170,877**	**173,384,014**	**222,245,654**

Other creditors includes trade creditors only, no accrued finance costs are included.

Notes to the Financial Statements *(continued)*

for the year ended 31 January

Management of liquidity risk

Liquidity risk is not considered to be significant as 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. As at the 31 January 2012, the Company had an undrawn committed borrowing facility of £10 million (2011 - £10 million).

(c) Credit Risk

Credit risk is the risk of default by a counterparty in discharging its obligations under transactions that could result in the Company suffering a loss

Management of credit risk

Outstanding settlements are subject to credit risk. Credit risk is mitigated by the Company through its decision to transact with counterparties of high credit quality. The Company only buys and sells investments through brokers which are approved counterparties, thus minimising the risk of default during settlement. The credit ratings of brokers are reviewed quarterly by the Investment Manager.

The Company is also exposed to credit risk through the use of banks for its cash position. Bankruptcy or insolvency of banks may cause the Company's rights with respect to cash held by banks to be delayed or limited. The Company's cash balances are held by HSBC Bank PLC, rated Aa2 by Moody's rating agency. The Directors believe the counterparties the Company has chosen to transact with are of high credit quality, therefore the Company has minimal exposure to credit risk.

The table below summarises the credit risk exposure of the Company as at 31 January:

	2012 £	2011 £
Debtors		
Accrued income	3,015,885	1,995,817
Other debtors	31,184	38,513
	3,047,069	**2,034,330**
Cash at bank	13,398,772	9,257,041
	16,445,841	**11,291,371**

Fair Values of Financial Assets and Financial Liabilities

With the exception of those financial liabilities measured at amortised cost, the financial assets and financial liabilities, are either carried at their fair value or the balance sheet amount is a reasonable approximation of their fair value. The financial liabilities measured at amortised cost including interest on outstanding borrowings due within one year have the following fair values*:

	2012 Book value £	2012 Fair value £	2011 Book value £	2011 Fair value £
Stepped Rate Interest Loan	34,346,113	48,862,727	34,347,840	46,039,027
Fixed Rate Interest Loan	46,048,881	63,590,059	46,241,378	56,017,459
5.875% Secured Bonds 2029	29,372,564	35,127,308	29,348,572	29,323,808
4% Perpetual Debenture Stock	1,388,751	1,016,707	1,388,750	908,553
3.65% Cumulative Preference Stock	1,199,499	789,877	1,199,498	705,326
	112,355,808	**149,386,678**	**112,526,038**	**132,994,173**

The net asset value per Ordinary Share with debt at fair value is 366.2p (2011 - 407.3p).

* The fair value has been derived from the closing market value as at 31 January 2012 and 31 January 2011.

Notes to the Financial Statements *(continued)*

for the year ended 31 January

FRS 29 'Financial Instruments: Disclosures' has been expanded to include a fair value hierarchy for the disclosure of fair value measurement of financial instruments.

As at 31 January 2012, the financial assets at fair value through profit and loss of £511,777,930 (2011 - £542,931,529) are categorised as follows:

	2012 £	2011 £
Level 1	511,749,961	542,904,104
Level 2	-	-
Level 3	27,969	27,425
	511,777,930	**542,931,529**

Categorisation within the hierarchy has been determined on the basis of the lowest level input that is significant to the fair value measurement of the relevant assets as follows:

Level 1 – valued using quoted prices in active markets.

Level 2 – valued by reference to valuation techniques using observable inputs other than quoted prices included in level 1.

Level 3 – valued by reference to valuation techniques using inputs that are not based on observable market data.

19. Capital Management Policies and Procedures

The Company's objective is to provide an above average level of income and income growth together with long term capital growth.

The Company's capital at 31 January comprises:

	2012 £	2011 £
Debt		
Creditors: Amounts falling due after more than one year	111,020,979	111,185,274
	111,020,979	**111,185,274**
Equity		
Called up Share Capital	25,803,366	25,803,366
Share Premium Account and Other Reserves	389,221,338	415,042,650
	415,024,704	**440,846,016**
Total Capital	**526,045,683**	**552,031,290**
Debt as a percentage of total capital	21.1%	20.1%

Notes to the Financial Statements *(continued)*

for the year ended 31 January

The Board, with the assistance of the Investment Manager, monitors and reviews the broad structure of the Company's capital on an ongoing basis. The level of gearing is monitored, taking into account the Investment Manager's view on the market and the future prospects of the Company's performance. Capital management also involves reviewing the difference between the net asset value per share and the share price (i.e. the level of share price discount or premium) to assess the need to repurchase shares for cancellation.

The Company is subject to several externally imposed capital requirements; the bank borrowings under the overdraft facility are not to exceed £10m, and as a public company the minimum share capital is £50,000. The Company's objective, policies and processes for managing capital are unchanged from the preceding accounting period, and the Company has complied with them. The terms of the debenture trust deeds have various covenants which prescribe that moneys borrowed should not exceed the adjusted total of the capital and reserves. These are measured in accordance with the policies used in the annual financial statements. The Company has complied with these.

20. Transaction with the Investment Manager and related parties

The amounts paid to the Investment Manager together with details of the investment management contract are disclosed in Note 2. The existence of an independent board of directors demonstrates that the Company is free to pursue its own financial and operating policies and therefore, under FRS8: Related Party Disclosures, the Investment Manager is not considered to be a related party.

The Company's related parties are its directors. Fees paid to the Company's Board are disclosed in the Directors Remuneration Report on page 39.

There are no other identifiable related parties at the year end, an as of 29 March 2012.

Investor *Information*

Investor Information

The Manager

RCM (UK) Limited, which is authorised and regulated by the Financial Services Authority, is part of Allianz Global Investors, one of the largest fund managers in the world. As at 31 December 2011, Allianz Global Investors had combined assets under management of €1,499 billion. RCM (UK), through its predecessors, has a heritage of investment trust management expertise in the UK stretching back to the nineteenth century and at 31 March 2012 it had £1.07 billion assets under management in a range of investment trusts.

Website: www.rcm.co.uk

Registered Number

28276

Financial Calendar

Year end 31 January.

Full year results announced and Annual Financial Report posted to Shareholders in April.

Annual General Meeting held in May.

Interim Management Statements announced in May and November.

Full year results announced and Half-Yearly Financial Report posted to Shareholders in September.

Ordinary Dividends

It is anticipated that dividends will be paid as follows:

1st Quarterly	August
2nd Quarterly	November
3rd Quarterly	February
Final	May

Preference Dividends

Payable half-yearly 30 June and 31 December.

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 daily and published through 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 from the Investment Manager's Investors Helpline on 0800 389 4696 or via the Manager's website: www.rcm.com/investmenttrusts.

Share Price

The share price for 31 January 2012 was 363.0p.

Website

Further information about the The Merchants Trust PLC, including monthly fact sheets, daily share prices and performance, is available on the Manager's website: www.rcm.com, which can also be reached via www.merchantstrust.co.uk.

How to invest

Alliance Trust Savings Limited ("ATS") is one of a number of providers offering a range of products and services, including Share Plans, ISAs and pension products. ATS also maintains services including online and telephone-based dealing facilities and online valuations. More information is available from Allianz Global Investors either via Investor Services on 0800 389 4696 or on the Managers' website: www.rcm.com/investmenttrusts, or from Alliance Trust Savings Customer Services Department on 01382 573737 or by e-mail: contact@alliancetrust.co.uk

A list of other providers can be found on the RCM Investment Trusts website: www.rcm.com/investmenttrusts

The Company's Ordinary Shares are listed on the London Stock Exchange. The market price range, gross yield and net asset value are shown daily in the Financial Times and The Daily Telegraph under the headings 'Investment Companies' and 'Investment Trusts', respectively.

Investor Information

(continued)

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. 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.

Dividend Reinvestment Plan for Ordinary Shareholders

A Dividend Reinvestment Plan is operated by the Company's Registrars, Capita Registrars. The Plan offers Ordinary Shareholders the opportunity to use their cash dividend to buy further shares in the Company under a low-cost dealing arrangement. Capita enclose a copy of the Terms and Conditions and a personalised application form with each dividend payment.

Share Dealing Services and Share Portal

Capita Registrars, the Company's Registrars, operate both on-line and telephone dealing facilities for UK resident shareholders with share certificates.

For further information on these services please contact: www.capitadeal.com for on-line dealing or 0871 664 0454 for telephone dealing. Lines are open 8.00 a.m. to 4.30 p.m. Monday to Friday. Calls to the 0871 664 0454 number are charged at 10 pence per minute plus any of your service providers' network extras. Different charges may apply to calls made from mobile telephones and calls may be recorded and monitored randomly for security and training purposes.

Capita Registrars also offers shareholders an on-line service called The Share Portal, enabling shareholders to access a comprehensive range of shareholder related information. Through The Share Portal, shareholders can: view their current and historical shareholding details; obtain an indicative share price and valuation; register for e-comms, amend address details; view details of dividend payments; and apply for dividends to be paid directly to a bank or to change existing bank details.

Shareholders can access these services at www.capitashareportal.com and selecting Share Portal (Shareholders) from the drop down menu, or alternatively via the Portals: Quick Links, and selecting Share Portal. Shareholders will need to register for a Share Portal Account by completing an on-screen registration form. An email address is required.

Registrars and Shareholders' Enquiries

Capita Registrars The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU 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 the registrars on 0871 664 0300 or +44 20 8639 3399 if calling from overseas. Lines are open 8.30 a.m. to 5.30 p.m. (London time) Monday to Friday. Calls to the 0871 664 0300 number are charged at 10 pence per minute plus any of your service providers' network extras. Calls to the helpline number from outside the UK are charged at applicable international rates. Different charges may apply to calls made from mobile telephones and calls may be recorded and monitored randomly for security and training purposes. Capita Registrars can also be contacted by email: ssd.capitaregistrars.com.or by Facsimile: 020 8639 2342. Their website is www.capitaregistrars.com.

Capita Registrars offer shareholders a free online service called The Share Portal, enabling shareholders to access a comprehensive range of shareholder related information.

Investor Information

(continued)

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. Telephone: 020 7065 1513. Email: kirsten.salt@uk.rcm.com

International Payment Services

Capita Registrars, the Company's registrars, operate an international payment service for shareholders, whereby they can elect either for their dividend to be paid by foreign currency draft or they can request an international bank mandate. This service is only available for dividend payments of £10 or more.

The International Payment Service will generally cost less than the fees charged by your local bank to convert your sterling dividend into your local currency. A £5 administration fee per dividend payment applies. Your dividends are paid as cleared funds directly into your bank or sent to you as a draft.

Capita Registrars, working in partnership with Travelex, will arrange for your dividend to be exchanged into your local currency at competitive rates based on actual market rates.

To use this service you will need to register online at: www.capitaregistrars.com/international or by contacting Capita Registrars as detailed below.

For further information on these services please contact: +44 20 8639 3405 (from outside of the UK) or 0871 664 0385 (in the UK) (Calls cost 10p per minute plus network extras. Lines are open between 9.00am and 5.30pm, Monday to Friday) or email IPS@capitaregistrars.com.

CREST Proxy Voting

Shares held in uncertificated form (i.e., in CREST) may be voted through the CREST Proxy Voting Service in accordance with the procedures set out in the CREST manual.

Association of Investment Companies (AIC)

The Company is a member of the AIC, 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 AIC, 9th Floor, 24 Chiswell Street, London EC1Y 4YY, or at www.theaic.co.uk.

AIC Category: UK Growth and Income.

Warning to Shareholders

We are aware that some shareholders may have received unsolicited telephone calls or correspondence concerning investment matters. These are typically from overseas based organisations who target UK shareholders offering to sell them what often turn out to be worthless or high risk shares in US or UK investments. They can be extremely persistent and extremely persuasive. Shareholders are therefore advised to be very wary of any unsolicited advice or offers to buy shares at a discount.

Please note that it is most unlikely that either the Company or the Company's Registrar, Capita Registrars, would make unsolicited telephone calls to shareholders. Any such calls would only ever relate to official documentation already circulated to shareholders and never in respect of investment 'advice'.

If you are in any doubt about the veracity of an unsolicited telephone call, please call either the Company Secretary or the Registrar on the numbers provided above.

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

Investor Information

(continued)

Analysis of Share Register

	Shareholder Accounts				Ordinary Shares held			
	Number		%		000's		%	
	2012	2011	2012	2011	2012	2011	2012	2011
Private holders	6,640	6,970	71.3	67.3	18,288	18,904	17.7	18.3
Nominees	2,471	3,147	26.5	30.4	79,347	78,787	76.9	76.3
Limited Companies	112	132	1.2	1.3	3,081	2,758	3.0	2.7
Investment Trusts and Funds	25	28	0.3	0.3	416	445	0.4	0.4
Bank and Bank Nominees	9	10	0.1	0.1	1,764	1,651	1.7	1.6
Insurance Companies	7	8	0.1	0.1	43	48	0.0	0.1
Pension Funds	4	3	0.0	0.0	15	13	0.0	0.0
Other holders	44	53	0.5	0.5	259	607	0.3	0.6
	9,312	**10,531**	**100.0**	**100.0**	**103,213**	**103,213**	**100.0**	**100.0**

Based on an analysis of the Ordinary Share register at 22 March 2012 (2011 – 31 March).

Notice of Meeting

Notice is hereby given that the Annual General Meeting of The Merchants Trust PLC will be held at Holborn Bars, 138-142 Holborn, London EC1N 2NQ on Wednesday 9 May 2012 at 12 noon to transact the following business.

Routine Business

1 To receive and adopt the Report of the Directors and the Financial Statements for the year ended 31 January 2012 together with the Auditors' Report thereon.

2 To declare a final dividend of 5.8p per Ordinary Share.

3 To re-elect Simon Fraser as a Director.

4 To re-elect Mike McKeon as a Director.

5 To re-elect Henry Staunton as a Director.

6 To re-elect Paul Yates as a Director.

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 financial statements 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. Resolution 10 will be proposed as an Ordinary Resolution and Resolutions 11 and 12 as Special Resolutions:

10 That for the purposes of Section 551 of the Companies Act 2006 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 a maximum number of 34,401,047 Ordinary Shares provided that:

(i) the authority granted shall expire one year 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 one year; 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.

11 That the Directors be empowered in accordance with Section 570 of the Companies Act 2006 to allot equity securities (within the meaning of Section 560 of the Act) for cash pursuant to the authority conferred by Resolution 10 as if sub-section (1) of Section 561 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 a maximum number of 10,321,346 Ordinary Shares;

(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.

12 That the Company be and is hereby generally and unconditionally authorised in accordance with Section 701 of the Companies Act 2006 (the 'Act') to make market purchases (within the meaning of Section 693(4) 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 15,471,698;

(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% 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 2013 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

Notice of Meeting

(continued)

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.

155 Bishopsgate, London, EC2M 3AD
29 March 2012

By Order of the Board
Kirsten Salt
Secretary

Notes:

1. Members entitled to attend and vote at this Meeting may appoint one or more proxies to attend, speak and vote in their stead by completion of a personalised form of proxy. Full details on how to complete the form of proxy are set out on the form of proxy. The proxy need not be a Member of the Company.

2. A proxy must vote in accordance with any instructions given by the member by whom the proxy is appointed. A proxy has one vote on a show of hands in all cases (including where one member has appointed multiple proxies), except where he is appointed by multiple members who instruct him to vote in different ways, in which case he only has one vote for and one vote against the resolution.

3. A personalised form of proxy is provided with the Annual Financial Report. Any replacement forms must be requested direct from the Registrar.

4. Completion of the form of proxy does not exclude a Member from attending the Meeting and voting in person.

5. Duly completed forms of proxy must reach the office of the Registrars at least 48 hours (excluding non-business days) before the Meeting.

6. Shares held in uncertificated form (i.e. in CREST) may be voted through the CREST Proxy Voting Service in accordance with the procedures set out in the CREST manual on the Euroclear website (www.euroclear.com/CREST).

7. To be entitled to attend and vote at the Meeting (and for the purpose of determination by the Company of the number of votes they may cast), Members must be entered on the Company's Register of Members by close of business on Friday 4 May 2012 ("the record date").

8. If the Meeting is adjourned to a time not more than 48 hours after the record date 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 new notice of the adjourned Meeting, at the record date specified in that notice.

9. The right to appoint a proxy does not apply to persons whose shares are held on their behalf by another person and who have been nominated to receive communications from the Company in accordance with Section 146 of the Companies Act 2006 ("nominated persons"). Nominated persons may have a right under an agreement with the registered shareholder who holds the shares on their behalf to be appointed (or to have someone else appointed) as a proxy. Alternatively, if nominated persons do not have such a right, or do not wish to exercise it, they may have a right under such an agreement to give instructions to the person holding the shares as to the exercise of voting rights. Nominated persons should contact the registered member by whom they were nominated in respect of these arrangements.

10. Corporate representatives are entitled to attend and vote on behalf of the corporate member in accordance with Section 323 of the Companies Act 2006. Pursuant to the Companies (Shareholders' Rights) Regulations 2009 (SI 2009/1632), multiple corporate representatives appointed by the same corporate member can vote in different ways provided they are voting in respect of different shares.

11. Members have a right under Section 319A of the Companies Act 2006 to require the Company to answer any question raised by a member at the AGM, which relates to the business being dealt with at the meeting, although no answer need be given (a) if to do so would interfere unduly with the preparation of the meeting or involve disclosure of confidential information; (b) if the answer has already been given on the Company's website; or (c) it is undesirable in the best interests of the Company or the good order of the meeting.

Notice of Meeting
(continued)

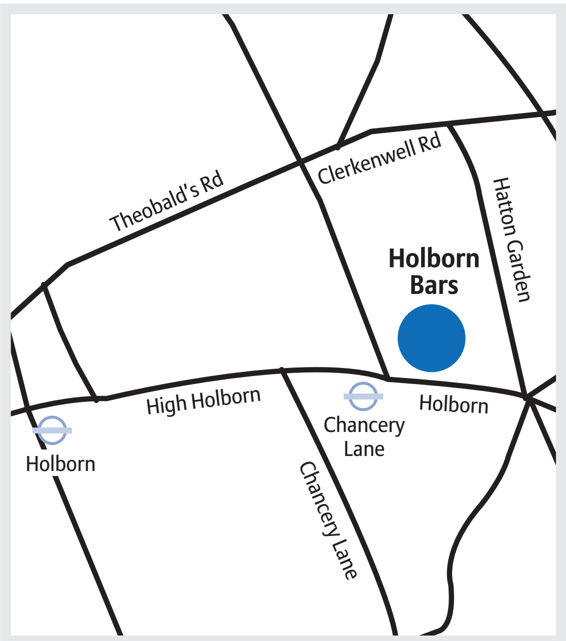
12. Members satisfying the thresholds in Section 527 of the Companies Act 2006 can require the Company, at its expense, to publish a statement on the Company website setting out any matter which relates to the audit of the Company's accounts that are to be laid before the meeting. Any such statement must also be sent to the Company's auditors no later than the time it is made available on the website and must be included in the business of the meeting.

13. As at 29 March 2012, the latest practicable date before this Notice is given, the total number of Ordinary Shares and Preference Stock in the Company in respect of which members are entitled to exercise voting rights was 103,213,464 Ordinary Shares of 25p each and 1,178,000 3.65% Cumulative Preference Stock of £1 each. Each carries the right to one vote and therefore, the total number of voting rights in the Company is 104,391,464.

14. Further information regarding the meeting which the Company is required by Section 311A of the Companies Act 2006 to publish on a website in advance of the meeting (including this Notice), can be accessed at www.rcm.com/investmenttrusts.

15. 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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