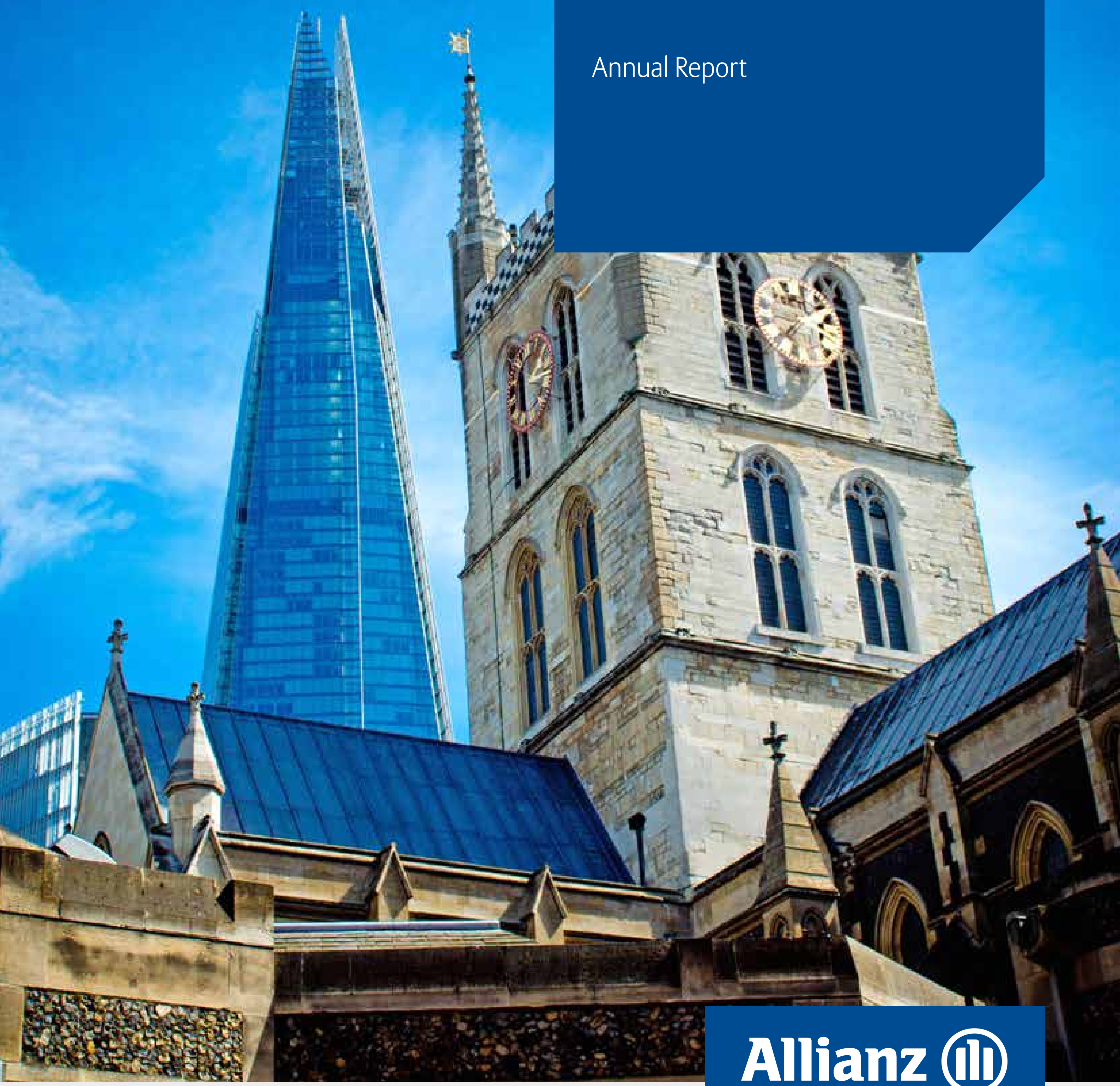
31 January 2017

The Merchants Trust PLC

Annual Report



Allianz
Global Investors

www.merchantstrust.co.uk

Contents

Company Overview

Throughout its 128 year history, The Merchants Trust PLC has provided shareholders with an opportunity to benefit from investment in a diversified portfolio of leading companies with strong balance sheets and the potential to pay attractive dividends.

Merchants is governed by an independent board of directors and has no employees. Like other investment companies, it outsources management and administration to an investment management company – Allianz Global Investors – and other third party service providers to provide shareholders with an efficient, competitive and cost-effective way to gain wide investment exposure through a single investment vehicle.

The company's shares are recognised by the Association of Investment Companies (AIC) as suitable for retail investors.

Investment Policy

Objective

The Merchants Trust aims to provide an above average level of income and income growth together with long term capital growth through a policy of investing mainly in higher yielding large UK companies.

The company's investment performance is assessed by comparison with other investment trusts within the UK Equity Income sector. Performance is benchmarked against the FTSE All-Share Index*, reflecting the emphasis within the portfolio.

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 state that the company's borrowings may not exceed its called up share capital and reserves. The board's policy is to maintain gearing (borrowings as a percentage of net assets) in the range of 10-25% (at the time of drawdown). Gearing averaged 22.7% in the year to 31 January 2017 (2016 - 21.8%).

Risk Diversification

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

* The benchmark was the FTSE 100 Index until 1 February 2017.

← Cover photo: The Shard and Southwark Cathedral, London

Financial Highlights

Dividend	Yield	NAV per ordinary share*	Revenue earnings per ordinary share
24.2p	5.3%	478.9p	24.1p
2016 24.0p	2016 5.8%	2016 437.7p	2016 24.1p
+0.8%		**+9.4%**	**+0.0%**

Net Asset Value Total Return* 2017 +14.9%

Benchmark Total Return# 2017 +21.4%

Share Price 2017 452.5p 2016 414.0p **+9.3%**

* Debt at market value

\# For the year under review the benchmark is the FTSE 100 Index. From 1 February 2017 the benchmark is the FTSE All-Share Index.

Chairman's Statement

Dear Shareholder

I am delighted to announce that following our Annual General Meeting, The Merchants Trust will have an unbroken record of 35 years of dividend growth and that we continue to be promoted in the 'dividend heroes' list published by the Association of Investment Companies.

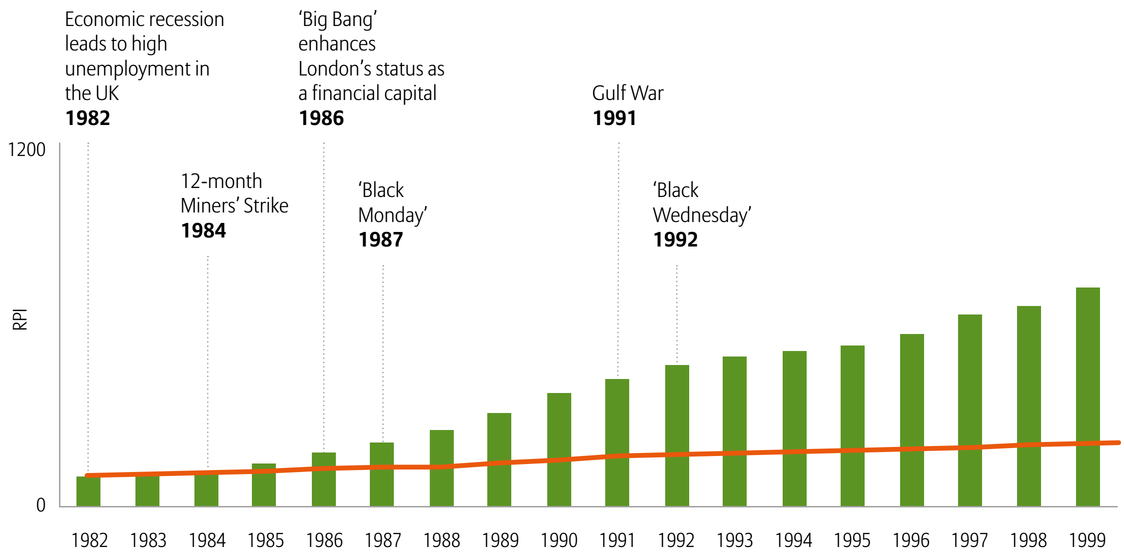
A high and rising dividend is a hallmark of The Merchants Trust and is widely appreciated by shareholders. We are committed to generous dividends and dividend growth and this was reaffirmed as a key objective at the recent annual strategy session by the board.

Net Earnings and Dividends

The board is recommending a final dividend of 6.1p (2016: 6.0p). This payment will make our total dividend for the year 24.2p (2016: 24.0p), an increase of 0.8%.

Our net earnings were unchanged this year but we have over the years retained substantial reserves to enable shareholders to be provided with high and growing income. The final dividend of 6.1p will be paid on 18 May 2017 to shareholders on the register on 21 April 2017. This dividend requires a modest contribution from revenue reserves. After providing for the final dividend payment, the company's revenue reserves amounted to £11.5m (10.6p per share).

The board monitors the company's yield relative to other investment trusts in the UK Equity Income sector. At 31 January 2017, the company's yield of 5.3% ranked Merchants as third in the sector.



Total dividend: from 2.1p to 24.2p over the period, representing growth of 12x over 35 years

UK RPI growth of 3x over 35 years

*Final dividend for approval at the 2017 AGM.

Source: AllianzGI.

Chairman's Statement *(continued)*

As at 27 March 2017, the company's ordinary shares yielded 5.1% compared with the 3.5% yield on the FTSE All-Share Index at that date.

Looking back over the last decade, because of the high starting yield, and due to the tough conditions for several companies paying dividends in the aftermath of the financial crisis, the rate of increase in the dividends paid by the company has not quite matched the rate of inflation.

Asset returns

In a strong year for the stock market, the company's NAV total return was +14.9%. This was behind the total return on our benchmark, the FTSE 100 Index, of +21.4% This return placed the company tenth out of twenty-two funds in its peer group. The investment manager's review describes the equity performance and attribution in more detail on page 21. Falling bond yields also held back returns as they led to an increase in the value of the company's debt. On the other hand, gearing had a positive effect in a rising market environment, even after the cost of finance.

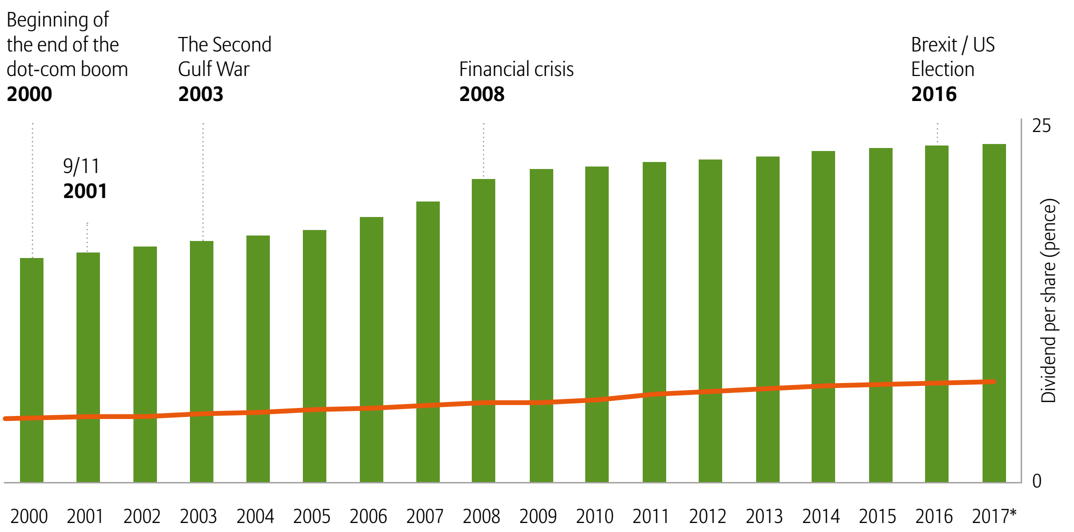
Despite underperforming the index last year performance has been ahead of the benchmark in three of the last five years. On a cumulative basis, over five years, the NAV total return was 71.3%, the equity portfolio total return was 61.1%, whilst the benchmark return was 50.5%.

The company's share price rose by 9.3% from 414.0p to 452.5p over the year. On a total return basis (which includes net dividends) the value of the shares increased by 15.1%.

Benchmark Change

The board monitors the company's NAV total return against several comparators, including the FTSE 100 Index which was the benchmark for the year to 31 January 2017, and the peer group, the UK equity income sector. As the manager has diversified the sources of income to build sustainable growth and resilience into the income stream, the proportion of the portfolio invested outside of the FTSE 100 Index has increased from 11% to 36% during the last ten years. As a result, in January, the board decided to

The board also monitors the company's yield relative to other investment trusts in the UK Equity Income sector. At 31 January 2017, the company's yield of 5.3% ranked Merchants as third in the sector.



Chairman's Statement *(continued)*

change the benchmark to the FTSE All-Share Index which more closely reflects the structure of the portfolio and the available investment universe. This change came into effect from the beginning of the current financial year, 1 February 2017.

The Board

During the year we welcomed Timon Drakesmith to the board. Timon joined on 1 November 2016 and took on the role of Audit Committee Chairman on appointment. His biography is on page 34 and he will be standing for election at the annual general meeting.

Mike McKeon retired from the board at the end of the financial year, on 31 January 2017. Over his nine years on the board Mike provided excellent counsel and guidance both as Chairman of the Audit Committee and as the Senior Independent Director, and made an invaluable contribution as a board colleague; we wish him well for the future.

Sybella Stanley has been appointed as the Senior Independent Director.

Strategy and the Strategic Report

The Strategic Report follows on page 12. At our annual strategy day last year we had an in-depth look at the matters we consider at each board meeting, including our position relative to our peer group and benchmark, together with a number of other topics including the gearing structure and the future of our debentures. We are looking this year at the company's debt structure and making plans for the future of the gearing as we are to repay the most expensive portion of our long term loans by the end of January 2018.

Issue of new shares and the buyback of shares

For much of the year to 31 January 2017 we saw the company's share price trade at a discount to the net asset value but the discount was not large enough to make buying back shares good value for shareholders. No shares were therefore bought back. At the end of the financial year the discount to NAV with debt at market value was 5.5%.

Our policy continues to be to issue shares at a premium to net asset value, cum income with debt at market value, at a price that is not dilutive to existing shareholders, to meet natural demand in the market and conversely, to buy back shares either for cancellation or for holding in treasury. Prior to such a decision, the board would need to consider the discount to be significant, taking gearing into account, and deem a buyback to be good relative value. Any shares issued or sold from treasury will be at a premium to the NAV to ensure that existing shareholders benefit from the transaction.

Marketing drives demand for Merchants Trust shares

As a board, we understand the merits of marketing activity. In particular we are keen to grow the number of individual shareholders that hold their shares directly. Our communication programme has been instrumental in creating sustained and ongoing demand for Merchants shares through execution only platforms in recent years.

The programme also includes communication with both national and industry journalists, since positive coverage can be highly influential on retail flows. We were pleased to see that the company was featured in the Mail on Sunday's popular 'Fund Focus' column on 22 January 2017 (reproduced on page 7 and in full on the website, www.merchantstrust.co.uk), generating significant interest.

Chairman's Statement *(continued)*

The Merchants Trust website continues to be the company's 'shop window' and contains considerable information, including the latest investment performance and commentaries, as well as video interviews, press coverage and a library of other useful materials. The site is constantly evolving and will be refreshed in 2017 to make it easier to access via mobile phones or tablets. Through the website, investors can also register to receive monthly performance updates via email.

The website also includes information on how to invest in shares, including links to a number of online trading platforms. Many platform providers offer Individual Savings Account and pension products as well as the facility to invest on a regular monthly basis. Competition amongst platform providers has grown increasingly over recent years so investing online can be a very cost-effective way to buy Merchants shares.

Gearing

The company continues to have long term debt amounting to £76 million (plus £34 million of short term debt which is to be repaid in the current financial year). This is all deployed in the market for investment purposes. Our gearing averaged 22.7% throughout the year, compared to 21.8% last year.

The maturity of the loan in 2018 gives us an opportunity to decide the best gearing structure going forward and identifying attractive borrowing opportunities is a key focus this year.

Derivatives

We have continued our policy of selectively writing call options on a limited number of the company's holdings. Writing options has provided a small amount of additional income. There are more details in the Investment Manager's Review on page 25.

Annual General Meeting

The annual general meeting of the company will be held on Tuesday 16 May 2017 at 12.00 noon at Grocers' Hall, Princes Street London EC2R 8AD, and we look forward to seeing as many shareholders then as are able to attend.

Outlook

In the next twelve months our earnings per share will continue to be supported by the translation of international dividend payments back into sterling and the maturity of our expensive loan in January 2018.

More broadly, we face many political and economic risks over the short to medium term, ranging from the impact of elections in Europe and the nature of Brexit, to the American domestic and foreign policy under President Trump. However, The Merchants Trust has navigated its way through many uncertain periods in its 128 year existence.

In these situations, it is best to focus on the competitive position and financial strength of individual companies, rather than the prospects for the stock market as a whole. Our fund managers are able to identify many opportunities to invest in businesses which offer a combination of an attractive dividend yield and the potential for capital growth. By keeping to our strategy of investing in a diversified portfolio of UK equities offering these characteristics, the board believes that the company is well positioned to meet its objectives of paying a high and growing dividend yield, and delivering attractive total returns for shareholders in the years to come.

Simon Fraser
Chairman
27 March 2017

Our fund managers are able to identify many opportunities to invest in businesses which offer a combination of an attractive dividend yield and the potential for capital growth.

Where does the WORLD GO FROM HERE?

As we move from winter to spring, the political turmoil of 2016 still casts its shadow: the future repercussions of last year's Brexit referendum result and Donald Trump's election as President of the United States will surely shape politics for many years to come, although no one really knows how. Such unpredictability adds a new dimension to an already uncertain world. Both in the UK and the US, personality rather than policy seems to be dominating politics lately; and distrust in governments and politicians forms a universal theme. Globalisation now looks to be under threat, replaced by a tide of rising protectionism.

This creates an interesting – and challenging – backdrop for the year ahead, a new way of thinking that began last year with Trump and Brexit and will surely continue throughout 2017. This is a year in which there will be four important elections in Europe, including France and Germany, not to mention the reality of what the Trump presidency and the roll-out of Brexit will truly mean.

We are witnessing massive shifts in political trends. So, where does the world go from here and what may the implications be for investors? With a lack of certainty combined with the buoyant stock markets we have witnessed in the early part of 2017, one can't help but sympathise with investors who may feel daunted by the investment decisions they often make at this time of year, as one tax year ends and a new one begins. After all, this is traditionally the time of year when retail investors are most likely to invest in the stock market, using up their ISA or pension personal allowance before the tax year ends.

Hard to speculate how the stock market may behave

With the FTSE 100 reaching record highs in January (boosted by the fall in sterling which, in turn, benefited companies and funds with overseas exposure) it is very hard to speculate how the stock market may behave in 2017. It is possible to imagine a stronger stock market, caused by hopes for higher economic and profits growth, as inflation creeps back into the system. However, it is equally possible to make the opposite case, since rising interest rates could choke off economic growth.

Although the outlook may be difficult to predict, it is still possible to build a portfolio for these circumstances, finding investments that should deliver reasonable returns to investors over the medium term. As manager of The Merchants Trust, the team and I pay particular attention to the fundamental qualities and valuations of companies we invest in. We are looking to own strong businesses that are priced at attractive valuations, from which our investors can expect to earn a decent return over the medium to long term. An attractive valuation is particularly important, as it can provide downside protection in a difficult stock market environment, such as the current one.

Our fundamental approach to investing is designed to manage risk whilst delivering the upside for our investors, whatever the political landscape. We spend a significant amount of time understanding the business, financial and valuation risks of the investments we make. We believe this focus allows us to identify situations where the risk-reward profile in absolute terms is highly attractive.

Consistent to its roots

Launched in 1889, Merchants has been consistent to its roots ever since: the founders of the trust set out to deliver 5% income to investors and that is very similar to what we are striving to do in the present day. At the time of writing, investors in Merchants have benefited from 34 years of consecutive growth in dividend payments. Although past performance is no indicator of what lies ahead for capital and dividend growth, we hope investors will be reassured by the Trust's longevity and track record; after all, it has survived every conflict and crisis over its 128 years – and generated notable investment returns.

Attention to detail, diligent research, caution and the prudent accumulation of reserves have all been at the heart of Merchants from its first day, and all of these factors have played their part in its fulfilment of its investment aims: **to provide a high and growing level of income and long-term capital growth.** It sets out to do this by investing in between 40 and 50 higher yielding, large UK companies at any one time. This is a relatively concentrated portfolio but one that is driven by conviction, allowing a sharper and more detailed focus on each investment considered.

When it comes to stock selection, we are seeking situations where our assessment of the investment case is markedly superior to that which is discounted by the stock market. We use a fundamentally driven, bottom up investment approach, which we are confident will work out over the long-term.

Close attention paid to the risks in each stock

When constructing the portfolio, we pay close attention to the risks in each stock, including: operational risk, concerned with the business dynamics; financial risk, regarding the level of debt and strength of cash flow; and valuation risk, reflecting whether the shares could be vulnerable to a de-rating. Ultimately, we aim to have smaller positions in riskier stocks and the largest investments in the less risky stocks.

Within the portfolio, some of our biggest investments are in certain of the very largest UK companies, such as the oil majors, BP and Shell, HSBC bank and the pharmaceutical, vaccines and consumer business GlaxoSmithKline. There is a tremendous advantage in having these leading companies, which have substantial overseas exposure and earnings, listed in the UK stock market. This means that investors can benefit from extremely high standards of corporate governance and yet gain global exposure. ■

Simon Gergel
Portfolio Manager, The Merchants Trust PLC
Allianz Global Investors

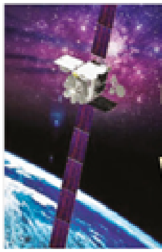
Simon Gergel is CIO of UK Equities at Allianz Global Investors and is portfolio manager of The Merchants Trust PLC. Merchants has for many years focused on a simple proposition to deliver a high and rising income together with capital growth for its shareholders. Although past performance is no guide to the future, Merchants has paid a rising dividend to shareholders for 34 consecutive years.

This is no recommendation or solicitation to buy or sell any particular security. Any security mentioned above will not necessarily be comprised in the portfolio by the time this document is disclosed or at any other subsequent date. ***Investing involves risk. The value of an investment and the income from it may fall as well as rise and investors may not get back the full amount invested.*** *The views and opinions expressed herein, which are subject to change without notice, are those of the issuer and/or its affiliated companies at the time of publication. The data used is derived from various sources, and assumed to be correct and reliable, but it has not been independently verified; its accuracy or completeness is not guaranteed and no liability is assumed for any direct or consequential losses arising from its use, unless caused by gross negligence or wilful misconduct. The conditions of any underlying offer or contract that may have been or will be made or concluded shall prevail.*

The Mail ON SUNDAY

PERSONAL FINANCE

The Mail on Sunday JANUARY 22 • 2017



34 years of dividend increases... we're the Merchants of boom

FUND FOCUS

INVESTMENT trust Merchants remains one of the industry's most popular vehicles among investors searching for high and growing income.

With a yield of more than five per cent, it offers a more attractive income than most other UK equity income oriented funds, which average 3.6 per cent. It has also managed to increase its payouts for 34 years running.

Last week, its board announced a small rise in next month's quarterly dividend. Provided there are no nasty surprises before April, when it will confirm the final dividend payment for the current financial year, it means that 34 will become 35.

Understandably, longstanding manager Simon Gergel is proud of the trust's impressive record.

'It is our focus,' he says. 'We are income seekers and we make no apology for buying shares that provide the high yield we require. It's why so many private investors hold the trust.'

Its biggest investors are those who have bought shares through fund platforms Alliance and Hargreaves Lansdown and via stockbroker Brewin Dolphin.

Gergel, who works for asset manager Allianz Global Investors, is unfazed by Prime Minister Theresa May's vow last week to take Britain out of the European single market. He says that if the economy is hit by the march towards Brexit, he believes the make-up of the trust's portfolio will shield it from the worst effects.

'The trust is more than 60 per cent exposed to FTSE 100 firms,' he says. 'Most of these are not dependent on the UK economy. They derive most of their earnings abroad. So they should be protected from any fallout.'

Merchants has stakes in 44 companies. Its biggest holdings are in businesses renowned for being dividend friendly, such as oil giants BP and Royal Dutch Shell and bank HSBC. But it also has positions in firms that are normally off the radar of income-seeking fund managers. Among its top ten holdings are exhibitions organiser UBM and satellite specialist Inmarsat.

'UBM is a super business,' says Gergel. 'It does not absorb vast amounts of capital, it gets paid in advance and its exhibitions have longevity, getting bigger every year. The high barriers to entry mean its cash flow is not threatened by competitors.'

Among the company's longest running exhibitions is the Hong Kong Jewellery and Gem Fair, one of Asia's top fine jewellery events.

Inmarsat, he says, is booming on the back of strong demand for satellites from the marine and aviation industries and governments worldwide.

Though Merchants' income record is beyond reproach, its relative overall performance is a little disappointing. Over the past one and three years, it has underperformed its benchmark, the FTSE 100 Index. In the past year, it returned 22 per cent against the Footsie's 28 per cent.

Gergel's retort is to point to the trust's outperformance over the past five years and, of course, the higher yield Merchants offers – 5.1 per cent compared with the Footsie's 3.6 per cent. From next month, the trust will use the FTSE All-Share Index as its benchmark, reflecting its increasing exposure to stocks outside the FTSE 100.

Two additional features should reassure investors contemplating Merchants as a home for their money. One is the trust's low ongoing charge of 0.58 per cent. The other is just under a year's worth of income in reserve, which can be drawn upon if the trust at any stage has to top up payments to shareholders in order to keep the growing dividend record heading towards 40 years.

Jeff Prestridge

FACTS AT A GLANCE

SIZE AND RETURNS: £646million. One year, +22%; three years, +5%; five years, +72%.

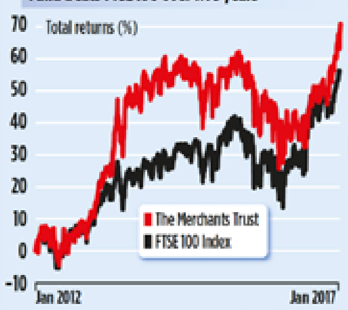
MANAGER AND TENURE: Simon Gergel since April 2006.

THE BIG RIVALS: They include UK equity income trusts Edinburgh, JP Morgan Claverhouse, Lowland, Murray Income and The City of London.

HOW TO INVEST: The trust is best bought through an online fund supermarket. The ongoing charge is 0.58%. A platform fee may also apply.

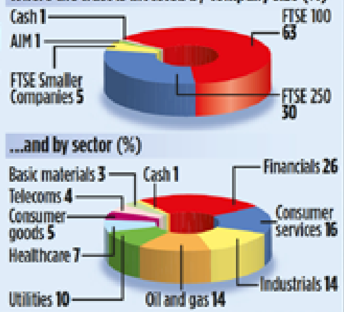
THE MERCHANTS TRUST

Fund beats FTSE 100 over five years



Where the trust is invested by company size (%)

...and by sector (%)



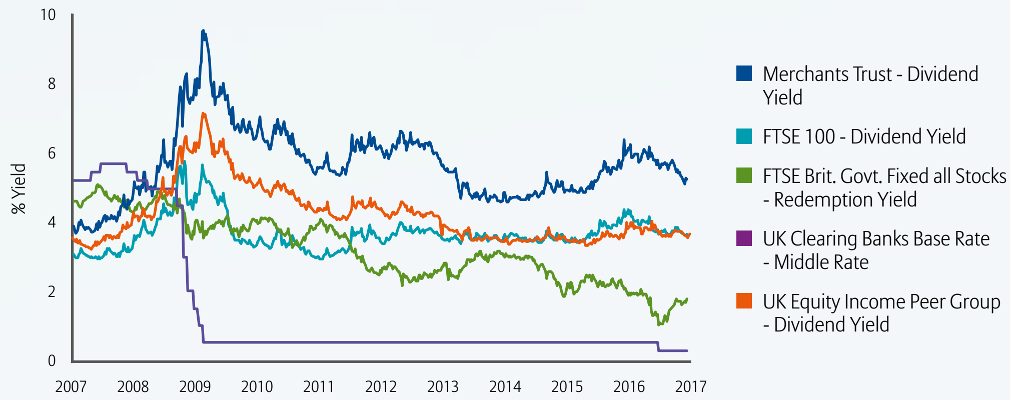
Source: FINANCIAL EXPRESS

RIGHT SIGNALS: Satellite specialist Inmarsat, top, is among fund manager Simon Gergel's leading holdings

Strategic Review

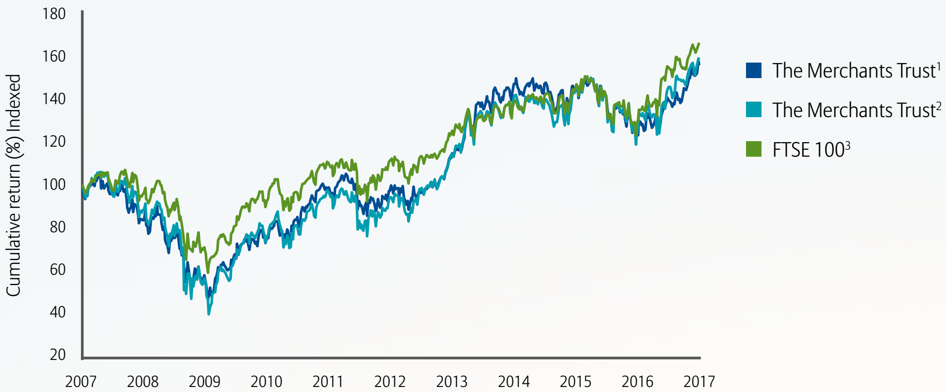
Performance Graphs

The Merchants Trust Dividend Yield compared to the FTSE 100 Index, UK Equity Income, UK Gilt Yield and Cash



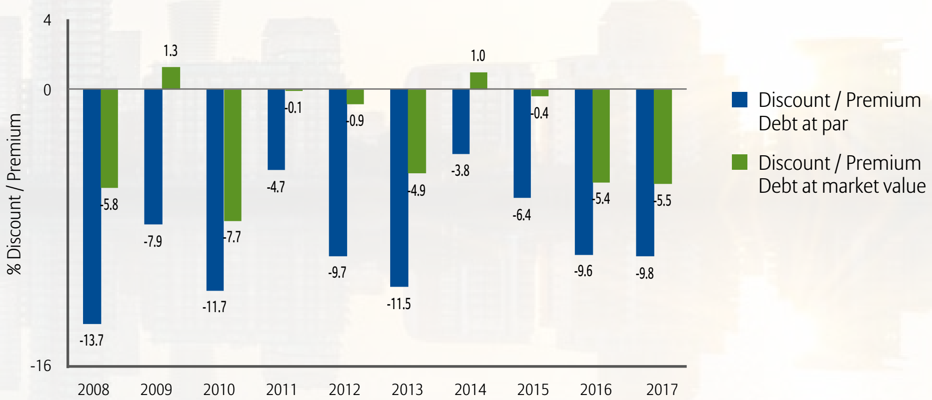
NB: With effect from 1 February 2017 the benchmark is FTSE All-Share Index.

The Merchants Trust 10 Year Cumulative Total Return compared to the FTSE 100 Index



[1] The Merchants Trust (Share Price Total Return). [2] The Merchants Trust (NAV Total Return) with debt at market value. [3] FTSE 100 (Total Return).
NB: With effect from 1 February 2017 the benchmark is the FTSE All-Share Index.

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



Source: AllianzGI / Datastream in GBP.

Performance – Review of the Year

Financial Summary

Revenue	For the year ended 31 January 2017	For the year ended 31 January 2016	% change
Income	£31,123,179	£30,984,794	+0.4
Revenue earnings attributable to ordinary shareholders	£26,160,643	£26,145,206	+0.1
Revenue earnings per ordinary share	24.1p	24.1p	+0.0
Dividends per ordinary share	24.2p	24.0p	+0.8

Assets	2017	2016	Capital Earnings % change	Total Return % change
Total assets less current liabilities	£621,339,256	£608,370,101	+2.1	-
Total net assets with debt at par	£545,317,550	£498,107,865	+9.5	-
Total net assets with debt at market value	£520,728,742	£475,880,871	+9.4	-
Net asset value per ordinary share with debt at par	501.5p	458.1p	+9.5	+14.7*
Net asset value per ordinary share with debt at market value	478.9p	437.7p	+9.4	+14.9*
Ordinary share price	452.5p	414.0p	+9.3	+15.1
FTSE 100 Index	7,099.2	6,083.8	+16.7	+21.4
Discount ordinary share price to net asset value	-9.8%	-9.6%	n/a	n/a
Discount (debt at market value)	-5.5%	-5.4%	n/a	n/a
Ongoing charges†	0.6%	0.6%	n/a	n/a

* NAV total return reflects both the change in net asset value per ordinary share and the net ordinary dividends paid.
† The ongoing charges percentage is calculated in accordance with the explanation given on page 15.

Performance Attribution Analysis against the FTSE 100 Index	Capital Return %	Income Return %	Total Return %
Return of Index	16.7%	4.7%	21.4%
Relative return on portfolio	-7.6%	0.7%	-6.9%
Return of portfolio	9.1%	5.4%	14.5%
Impact of gearing on portfolio	3.0%	1.6%	4.6%
Movement in market value of debt	-0.5%	0.0%	-0.5%
Finance costs	-1.3%	-0.7%	-2.0%
Management fee	-0.3%	-0.2%	-0.5%
Administration expenses	0.0%	-0.2%	-0.2%
Other	-0.6%	-0.4%	-1.0%
Change in net asset value per ordinary share (debt at market value)	9.4%	5.5%	14.9%

← Canary Wharf, London

Fund Manager Simon Gergel with Matthew Tillett of the UK Equity Team.

> "It was a year to expect the unexpected… but knowing what would happen politically would not necessarily have helped predict where markets would go. Financial market reactions confounded most expert predictions."

Simon Gergel
Fund Manager

Strategic Report

at 31 January 2017

Strategy Review

Every year we hold a Strategy Meeting outside the regular timetable of board meetings. At the most recent meeting the topics covered included:

- The company's market position compared with its peer group, including an analysis of objectives, yields, gearing and benchmarks;
- Gearing, and the future for our debentures and the appropriate debt structure;
- An in-depth examination of investment strategy, including the continued relevance of the FTSE 100 as the benchmark;
- Dividend strategy;
- Investment risk strategy;
- Other investment strategies, e.g., fixed income and investment overseas; and
- Marketing and communications strategy.

Following our strategic review, the actions we have taken are to:

- Make final arrangements for the first of the loan maturities in January 2018;
- Consider marketing strategy and confirm that expenditure provides value; and
- Consider Merchants' benchmark and decide to change from the FTSE 100 to the FTSE All-Share.

Strategic Aims

The company's aims continue to be to:

- Provide a high income
- Provide a progressively growing income
- Provide long term capital growth
- Appeal to a broad range of investors ensuring that the company remains relevant and attractive to new investors and investor groups
- Be a widely recommended investment across multiple platforms
- Ensure the costs of running the company remain reasonable and competitive
- Engage with shareholders and other relevant stakeholders to understand their needs and take their views into account in the development of future plans and strategy
- Understand the implications of changes to future income growth prospects

Objectives

Our objective is to provide shareholders with an above average level of income and income growth with long term capital growth through a policy of investing mainly in higher yielding large UK companies.

We measure our success in attaining this objective by comparing the performance of the portfolio against the performance of the FTSE All-Share Index*. We also note how the yield on the company's shares compares with the yields in our peer group, in the UK Equity Income sector, and the growth of the dividend itself against the retail price index in the UK.

A review of the company's business, activities and prospects is given in the Chairman's Statement starting on page 2, and in the Investment Manager's Review on pages 20 to 27.

Investment Strategy and Policy

We aim to achieve our objective through a strategy of investing in a portfolio of mainly higher yielding large UK companies and by using appropriate gearing to enhance returns. This strategy is designed for those investors who require a single investment in a diversified and professionally managed portfolio.

The fund manager manages the portfolio primarily on a bottom up basis - selecting the best stocks - rather than through sector allocation. The portfolio is managed on a high conviction basis and as at 31 January 2017 was concentrated into 44 listed equity stocks.

Idea generation: The fund manager, who is supported by the UK equity income team, identifies potential investments for the portfolio by using an extensive team of over 85 in-house research analysts, meeting with individual companies and using sell-side research. In addition, the fund manager uses Grassroots℠ Research, Allianz Global Investors' (AllianzGI) extensive global research resource in which sector analysts are backed by over 300 field force investigators. This network of independent researchers and journalists conducts investigative fieldwork and data collection to identify and confirm trends and test market assumptions. This provides the fund managers with timely and customised business insights and is unique to AllianzGI.

* The benchmark was the FTSE 100 Index until 1 February 2017.

Strategic Report *(continued)*

at 31 January 2017

Stock selection: The fund manager makes a validation of his investment case through further analysis, discussions with the UK equity team, a stringent buy and sell discipline and consideration of the yield requirement.

Portfolio construction: The fund manager then constructs the portfolio based upon his level of conviction generated from the idea generation and stock selection process. He ensures that the portfolio is diversified with a specific eye on risk analysis and control.

Implementation: Once a decision has been made to buy or sell a stock, the fund manager aims to get best execution through AllianzGI's central dealing desk.

Stewardship activities: As a signatory to the UK Stewardship Code and consistent with our investment objectives, the fund manager monitors portfolio holdings and proactively engages with investee companies as appropriate. The fund manager's engagement activities cover a broad range of matters, including strategy, performance, risk management, capital allocation, corporate governance, and environmental and social impacts.

Benchmark

At its recent annual strategy session, the board concluded that the aims of the company remain appropriate for the current environment. Merchants seeks to provide an above average level of income and income growth together with long term capital growth through a policy of investing mainly in higher yielding UK listed large companies.

The board monitors the company's NAV total return against several comparators, including the FTSE 100 Index which was the benchmark for the year to 31 January 2017, and the company's peer group, which is the UK equity income sector. As our manager has diversified the sources of income to build sustainable growth and resilience into the income stream, the proportion of the portfolio invested outside of the FTSE 100 Index has increased from 11% to 36% during the last ten years. Given this, at its meeting in January the board decided to change the benchmark to the FTSE All-Share Index which more closely reflects the structure of the portfolio and the available investment universe. This change came into effect from the beginning of the new financial year, 1 February 2017. We anticipate no significant changes to the management of the portfolio as a result of the change of benchmark.

Gearing

The gearing - employing the company's borrowings to invest – is in the form of long term debentures. The manager fully utilises the gearing within the guidelines set by the board.

Marketing

The company's marketing activity promotes The Merchants Trust to investors looking for exposure to capital growth in large UK equities and an above average level of dividend. The policy is to reach out to private investors managing their own investments as well as wealth managers and institutional fund managers. This is undertaken through regional roadshows, marketing and public relations campaigns.

Investors seeking to generate income have faced a tough task since 2008's financial crisis and it is pleasing that Merchants has been such a popular choice for those looking to investment trusts as a source of regular income. We attribute this to the following factors, all of which may resonate with investors in an ongoing low interest rate environment:

- One of the highest yielding investment trusts in the sector;
- A 35 year track record of growing dividends and the company's status as a 'dividend hero' as defined by the Association of Investment Companies;
- The company's investment policy which aims to provide growth in capital and income over the medium to long term; and
- Stable portfolio management over many years.

The company's retail audience includes those investors who delegate their investment decisions to financial advisers as well as the ever increasing numbers who are self-directed investors, researching and purchasing their own investments online. This is evidenced by the ever-increasing number of shares being held via investment platforms. The company undertakes joint marketing initiatives with a number of market-leading platforms and this has proved to be a highly successful strategy.

We were pleased to note that during the year our manager won the 'Best Investor Education Award' at the Shares Awards.

Strategic Report *(continued)*

at 31 January 2017

Dividend

Income is distributed to provide an above average yield on an annual basis. The board seeks to increase the company's total dividend each year whilst keeping back a modest amount for reserves in years of strong income growth. Investors receive a dividend each quarter.

Discount/premium

The discount/premium of the share price to net asset value is closely monitored. When shares are trading at a premium, the policy is to be prepared to issue shares to meet natural demand in the market. Issuance is at a premium to net asset value, cum income with debt at market value, at a price that is not dilutive to existing shareholders. Conversely, when shares are trading at a discount shares may be bought back and cancelled or held in treasury when the board considers the discount to be significant and a buyback will be good relative value, taking gearing into account.

Business Model

The Merchants Trust carries on business as an investment company and follows the investment policy described above.

Merchants is governed by an independent board of non-executive directors and has no employees or premises of its own. Like other investment companies, it outsources investment management, accounting, company secretarial and other administration services to an investment management company – Allianz Global Investors GmbH (AllianzGI) – and other third parties to provide shareholders with an efficient, competitive, cost-effective way to gain wide investment exposure through a single investment vehicle.

The company has a premium listing on the London Stock Exchange. In addition to annual and half-yearly financial reports, the company announces net asset values per share daily and provides more detailed information monthly to the Association of Investment Companies (AIC), of which the company is a member, in order for brokers and investors to compare its performance with its peer group.

Key Performance Indicators

The board uses certain financial Key Performance Indicators (KPIs) to monitor and assess the performance of the company.

Performance against the Benchmark Index

This is the most important KPI by which performance is judged and this is shown in graph form on page 9. 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 large UK companies, and for this reason the FTSE All-Share is the benchmark index against which we measure our performance.

We set out performance figures in the tables on page 10 of this Annual Report, but the main indicator of performance is the Net Asset Value Total Return, and the figures for this year and the previous year were as follows:

Year to 31 January 2017 Merchants Total Return

NAV Debt at market value +14.9%
NAV Debt at par +14.7%
Benchmark* +21.4%

Year to 31 January 2016 Merchants Total Return

NAV Debt at market value -5.0%
NAV Debt at par -6.7%
Benchmark* -6.5%

* Benchmark for the year under review is the FTSE 100 Index. From 1 February 2017 benchmark is the FTSE All-Share Index.

Strategic Report *(continued)*

at 31 January 2017

Expenses of running the Company

The board has a policy of ensuring that the costs of running the company are reasonable and competitive. Ongoing charges are operating expenses incurred in the running of the company, whether charged to revenue or capital, but excluding financing costs. The ongoing charges figure (OCF) is calculated by dividing operating expenses, that is, the company's management fee and all other ongoing charges, by the average net asset value (with debt at market value) over the period. Ongoing charges are published by the AIC.

Merchants	Peer Group
2017 0.63%	2017 1.0%
2016 0.58%	2016 1.0%

Performance against the Company's Peers

The board also monitors the performance relative to a broad range of competitor investment trusts over a range of time periods, taking into account comparative investment policies and objectives.

We look at the UK Equity Income investment trust sector and also compare the performance against a smaller number of competitors with the closest policies and objectives to our own.

As at 31 January 2017, the company was ranked in the UK Equity Income sector as follows:

1 year - 10 out of 22
3 years - 20 out of 22
5 years - 15 out of 22

(Net asset total return, with debt at market value, Source J.P. Morgan Cazenove)

The company's yield, at 5.3% was third highest in the sector at 31 January 2017 (2016 - 5.8% third highest). Source: J.P. Morgan Cazenove).

Dividends

The board has a policy of paying a progressive dividend each year, taking into account inflation and subject to general earnings growth and dividends received in the portfolio. Dividends paid in the past ten years are set out in the Historical Record table on page 32. Ordinary dividends have risen in every year since 1982.

2017 24.2p +0.8%
2016 24.0p +0.8%

The board also takes account of the company's dividend yields in relation to its peers. There is a chart showing the history on page 9.

Gearing

The company has the facility to gear - borrow money - with the objective of enhancing future returns. The market price of the debt is calculated and reflected in the published net asset values and gearing can be used to help to support dividend payments. Historically, gearing has been in the form of long term fixed rate debentures. The board monitors gearing throughout the year.

2017 Highest 27.4% Lowest 19.1% Average 22.7%
2016 Highest 25.8% Lowest 18.7% Average 21.8%

Strategic Report *(continued)*

at 31 January 2017

Risk Policy

The board operates a risk management policy to ensure that the level of risk taken in pursuit of the board's objectives and in implementing its strategy are understood. The principal risks identified by the board are set out in the table on page 17, together with the actions taken to mitigate these risks. The process by which the directors monitor risk is described in the Audit Committee Report on page 45.

Risk Appetite

The directors' approach to risk is to identify where there are risks and to note mitigation actions taken and then to look at the probability of the event and consider the extent to which the resulting residual risk is acceptable, which is defined as the board's risk appetite. As a result of this exercise the risks are rated as 'red' or 'high' when the risk is of concern and sufficient mitigation measures are not possible or not yet in place; 'amber' or 'moderate' when the risk is of concern but sufficient measures are defined and have been or are being implemented; and 'green' or 'acceptable' when the risk is acceptable and no further measures are needed. The nature of the company's business means that a certain amount of risk must be taken for the objectives to be met and it is not surprising that portfolio risk types earn amber ratings.

Risk Appetite:

- Risk is acceptable, no additional measures needed
- Risk is of concern, but sufficient measures are defined and being implemented
- Risk is of concern, sufficient mitigation measures not possible or not yet in place

In the risk appetite column in the table opposite, the board identifies risks, considers controls and mitigation, and then evaluates whether its risk appetite is satisfied. This column shows whether the residual risks, measured against the board's risk appetite, are satisfactory. The ticks enable the board to conclude that its assessment of risk is in line with its risk appetite.

The current board, from left to right, Mary Ann Sieghart, Timon Drakesmith, Simon Fraser, Sybella Stanley, Paul Yates.

Strategic Report *(continued)*

at 31 January 2017

Principal Risks

A more detailed version of the table below, in the form of a risk map, is reviewed and updated by the audit committee at least twice yearly. The principal risks are broadly unchanged from the previous year.

Risk Type	Principal Risks identified	Controls and mitigation	Risk Appetite
Portfolio Risk	■ Macro-economic shocks to the portfolio if economists fail to predict changes to the investment environment ■ Significant market movements may adversely impact the investments held by the company increasing the risk of loss or challenges to the investment strategy. ■ Reduction of dividends across the market affecting the portfolio yield and the ability to pay in line with dividend policy.	■ The manager reports regularly on macro-economic intelligence received from its internal and external sources. The investment process is bottom-up which manages risk of impact if predictions are inaccurate. ■ The board meets with the portfolio managers and considers asset allocation, stock selection and levels of gearing on a regular basis and has set investment restrictions and guidelines that are monitored and reported on by AllianzGI. ■ The board monitors yields and can modify investment parameters and consider a change to dividend policy. ■ The board receives reports from the manager on the stress testing of the portfolio at least twice each year and contact is made with the chairman and board if necessary between board meetings.	✓
Business Risk	■ An inappropriate investment strategy e.g. asset allocation or the level of gearing may lead to underperformance against the company's benchmark index and peer group companies, resulting in the company's shares trading on a wider discount. ■ Risk that there are insufficient liquid funds to pay back debentures on maturity.	■ 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 at every meeting. The board monitors the implementation and results of the investment process with the investment managers, who attend all board meetings, and reviews data which shows risk factors and how they affect the portfolio. The manager employs the company's gearing within a strategic range set by the board. The board also meets annually specifically to discuss strategy, including investment strategy. ■ The board has a plan to identify sufficient funds for the repayment of debenture holders.	✓
Operational Risk	■ Risk of inadequate procedures for the identification, evaluation and management of risks at outsourced providers including Allianz Global Investors (AllianzGI), and AllianzGI's outsourced providers, Bank of New York (BNYM) and Northern Trust (NT).	■ AllianzGI carries out regular monitoring of outsourced administration functions, this includes compliance visits and risk reviews where necessary. Results of these reviews are received by the board. ■ Agreed Service Level Agreements (SLAs) and Key Performance Indicators (KPIs) are in place and the board receives reports against these.	✓
Other Risk	■ Regulatory, external and catastrophic risk	■ In addition to the principal risks above, the board has identified more general risks, for example relating to compliance with accounting, tax, legal and regulatory requirements and to the provision of services from third parties. As in all companies, the board is alert to the risks of financial crime and threat of cyber attacks and reviews how third party service providers handle these threats. After ensuring that there are appropriate measures in place, the board considers these risks are effectively mitigated.	✓
	■ Macro-economic and political risk	■ The board also considers the impact from emerging risks that are not yet known or fully identifiable, such as economic, regulatory and political risks arising from the implementation of the UK's exit from the European Union or the US election. The board maintains close relations with its advisers (lawyers and manager) as well as its auditors and will make preparations for mitigation of these risks as and when they are known or can be anticipated.	✓

Strategic Report *(continued)*

at 31 January 2017

Viability Statement

The Merchants Trust is an investment company and has operated as an investment vehicle since 1889 with the aim of offering a return to investors over the long term. The board has confidence in the future of the company. Over its 128 year history, the company has survived numerous external crises and economic events; it has a solid portfolio of blue chip stocks and has built up substantial revenue reserves. The directors have formally assessed the company's prospects for a period longer than the one year required by the Going Concern principle. The directors believe that five years is an appropriate outlook period for this review as this would give investors assurance that there is a realistic prospect that the company will continue to be viable and continue to seek to achieve its aim to provide an above average level of income and income growth together with long term capital growth, whilst acknowledging the difficulty of forecasting prospects for markets beyond a relatively short horizon.

The board has assessed the long-term viability of the company against the principal risks faced by the company, outlined in the reporting under Risk in the Strategic Report, immediately above. The chief risks that could pose a threat to the future prospects of the company are around Investment Activity and Strategy, as described in the Risk reporting above.

A number of factors supported the board in its review and enabled the directors to make the formal statement, including:

- The company's investment strategy which, in the board's view, will continue to provide long term returns to shareholders as well as an attractive income as it has done in the past;
- The financial position of the company, including the impact of foreseeable market movements on cash flows - the board monitors the financial position in detail at each board meeting and at least twice each year it stress-tests the portfolio against significant market falls;
- The company's ability to meet interest payments and debt redemptions as they fall due, in particular the repayment of £34 million for the first of the debentures falling due in early 2018. This sum represents less than 7% of the assets of the company currently and so there is no significant risk that this repayment will not be met. The board will decide nearer the time how best to fund this repayment; and
- The liquidity of the portfolio, and the company's ability to pay dividends and to meet the budgeted expenses of running the company which is examined at each board meeting.

Based on the results of this assessment and on the assumption that the risks above are managed or mitigated effectively, the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the five year period of their review.

Social, Community and Human Rights Issues

As an investment trust, the company has no direct social or community responsibilities. However, the board shares the manager's view that it is in shareholders' interests to be aware of and consider human rights issues, together with environmental, social and governance factors when selecting and retaining investments. Details of the company's policy on the environment and socially responsible investment are set below.

Environmental Policy and Corporate Social Responsibility

The board has instructed the manager to take into account the impact of environmental policies on the investment prospects of the company's underlying investments. The board has noted the manager's views on Social Responsibility that it adheres to in engaging with the underlying investee companies and in exercising its delegated responsibilities in voting. AllianzGI has said: "We believe that good corporate governance includes the management of the company's impacts on society and the environment, as these are increasingly becoming a factor in contributing towards maximising long term shareholder value." In its Sustainable Investment Policy Statement, AllianzGI says it "believes that the consideration of environmental, social and governance issues within the investment decision process provides a new and longer-term perspective on evaluating risk and opportunities." The manager's environmental and corporate social responsibility policies can be found at www.esgmatters.com.

Directors and employees and gender representation

Biographies of the directors of the company on 31 January 2017 are set out on page 34. As at the date of this report there are three male directors and two female directors. The company has no employees.

The Future

Some of the trends likely to affect the company in the future are common to many investment companies, such as the future attractiveness of investment companies as investment vehicles and regulatory changes in the pensions and savings market. The outlook for economic growth, interest rates, inflation and asset returns will also be important factors. In particular for Merchants, the availability of attractive income producing UK equities and their future returns are central to the investment proposition.

The Chairman gives his view on the outlook in his statement on page 5 and the investment manager discusses his view of the outlook for the company's portfolio in his review on pages 26 and 27.

The board continues to believe that the Retail Distribution Review offers opportunities to generate more interest in investment trusts and to demonstrate the advantages over open-ended investments.

On behalf of the board

Simon Fraser
Chairman
27 March 2017

Old Royal Naval College, Greenwich, London →

The Merchants Trust PLC

Investment Manager's Review

Investment Manager's Review

Simon Gergel is Chief Investment Officer, UK Equities, Allianz Global Investors, based in London.

Economic and Market Background

It was a year to expect the unexpected, and not just Leicester City winning the English Premier League. A year ago, it seemed almost unimaginable that President Donald Trump would welcome Prime Minister Theresa May, as the first foreign head of state to visit him in the White House. Political events wrong-footed pollsters, whilst economists and the Bank of England misjudged the short term impact of Brexit. But it was also a year when knowing what would happen politically would not necessarily have helped predict where markets would go. Financial market reactions confounded most expert predictions. The reactions to both the Brexit vote and Donald Trump's election were more positive than anticipated, at least for equities. Stock and bond market moves had two distinct phases during the year. To stretch a football analogy, it was a year of two halves.

There were two major political events during the year. On 23rd June, the UK voted to leave the European Union, which also led to a change of Prime Minister and much of the cabinet. On 8th November, the United States elected Donald Trump as president. Both of these events reflected growing popular concern about income inequality, stagnant living standards, and a desire for change.

Many had expected the Brexit vote to prompt an immediate shock to the economy, and the then Chancellor George Osborne, had warned of the need for an emergency budget. However, the economy barely skipped a beat over the rest of the year. The UK grew steadily, recording an estimated 2.2% annualised growth in the fourth quarter of 2016. Economic activity was helped by an interest rate cut and other measures taken by the Bank of England as well as a sharp drop in the value of the pound, which boosted the competitiveness of the UK's manufacturing base.

The external environment was also helpful, with China stimulating its economy early in the year, leading to increasing demand for oil, commodities and other goods. The oil price rose 60% over the year to $56 per barrel, and copper and iron ore also surged.

Markets had two distinct phases. In the first five months of the year, before the Brexit referendum, the UK stock market made little progress. Low interest rates and concerns about risks to economic growth kept bond yields depressed (helping bond prices to rise). The referendum led to an immediate rise in share prices, especially for multinational companies, which benefited from the translation of their overseas profits at a lower sterling value. Expectations for fiscal stimulus, such as increasing infrastructure spending, also started to move the market's focus away from deflationary risks, towards thinking about higher growth and inflationary pressures. These trends were exacerbated by the US election result and further talk about higher government spending, including on defence.

Equities reacted well to the anticipation of stronger growth, but bonds retreated on fears of rising inflation and interest rates. The US Federal Reserve also raised interest rates, late in the year, its second rate rise since 2008's financial crisis. Over the year, the FTSE 100 Index of leading companies produced a total return of 21.4%. The more domestically oriented FTSE 250 Index of medium sized companies lagged behind significantly, with a return of 13.2%. This reflected concerns about risks to the UK economy from Brexit, and less benefit from the weakness of the pound on overseas earnings.

Investment Manager's Review *(continued)*

UK government bond (gilt) yields moved in a wide range in response to the changing perceptions about inflation and growth. Gilt yields fell from 1.6% in January, to a low point below 0.6% in August, before bouncing back up to 1.4% at the year end.

The strong overall stock market return masked a sharp polarisation between different industries, with a near reversal of last year's themes. The cyclical commodity sectors were extremely strong, with the mining sector giving a return of over 150% and the oil sector up almost 50%. Construction, general industrials, banks and financial services also performed very well. However, domestic cyclical sectors were very weak with retailers giving a negative return of -22%. Many of the more defensive sectors and those that benefit from low bond yields, also performed poorly, especially later in the year. Fixed and mobile telecommunications and real estate were especially weak with double digit negative returns.

Investment Performance

A full analysis of the performance of the company is given on page 10. In this section we discuss the performance of the portfolio and compare it to the performance of the FTSE 100 Index benchmark. The portfolio posted a total return of 14.5%, a strong absolute number, reflecting exceptional gains in some of the largest holdings in the portfolio, including a 58% return from Royal Dutch Shell, 48% from HSBC and 36% from BP. It is encouraging to see these "mega-caps" performing so well, albeit from a depressed level. The portfolio also benefited from the mining shares Antofagasta and BHP Billiton more than doubling. However, the FTSE 100 Index was even stronger than the portfolio, with a total return of 21.4%, as the mining and oil sectors had an even bigger impact there. Overall, the portfolio lagged the market return by 6.9%. This underperformance took place in the first half of the year, as reported at the interim stage, with a modest outperformance in the second half of the year.

The underperformance reflects two significant themes and a number of stock-specific issues. As described above, the mining sector was exceptionally strong. The portfolio has only had a limited exposure to mining for some time. This "underweight" positioning had helped relative performance in recent years, as the sector fell heavily. Although we bought the copper miner Antofagasta in 2015/16, the underweight stance in the sector overall still accounted for almost a third of the portfolio's underperformance.

The second theme was the relatively poor performance of medium sized companies. The company has around a third of its portfolio invested in medium and smaller sized companies. As a group, these lagged behind the FTSE 100 Index, in contrast to outperformance in recent years.

The table below shows the stocks that contributed most, both positively and negatively, relative to the index return.

The strong overall stock market return masked a sharp polarisation between different industries, with a near reversal of last year's themes.

Contribution to Investment Performance relative to the FTSE 100 Index

Positive Contribution	%	Over/under weight	Negative Contribution	%	Over/under weight
Vodafone	1.1	-	Inmarsat	-2.4	+
BT	1.0	-	Glencore	-1.6	-
Antofagasta	0.9	+	Rio Tinto	-1.2	-
AstraZeneca	0.8	-	Greene King	-1.0	+
UBM	0.8	+	Anglo American	-0.9	-
Imperial Brands	0.5	-	IG Group	-0.8	+
Next	0.4	-	Marks & Spencer	-0.7	+
Capita	0.4	-	Pennon	-0.7	+
Associated British Foods	0.3	-	Brammer	-0.6	+
CRH	0.3	+	Mothercare	-0.6	+

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

Investment Manager's Review *(continued)*

A high dispersion of stock returns and considerable volatility produced many investment opportunities during the period.

Looking at individual shares, the telecommunications and mining sectors stand out. The telecommunications sector was very weak for various reasons, including regulatory risks, rising competition and increased capital investment needs. The two biggest individual positive stock contributors, BT and Vodafone, were both companies where we had a zero exposure or a significant underweight position, which benefited relative performance as they fell. On the other hand Inmarsat was a big position in the portfolio and fell significantly, for similar reasons, and represented the biggest single negative stock contributor. Within the mining sector, Antofagasta had a large positive impact on performance, but not owning Glencore, Rio Tinto or Anglo American was a bigger negative factor.

Other positive stock contributions included; United Business Media, which performed well as the company focused down onto their attractive events and exhibitions business, and CRH, the building materials company that saw recovering profitability in the US in particular, and an anticipation of higher infrastructure spending. The remaining top ten positive stocks were all companies that we did not own in the portfolio but which performed poorly and held back the index return. Retailers weakened on trading issues and concerns about the impact of Brexit, with Next and Associated British Foods (which owns Primark) on the list. The other three stocks were AstraZeneca, Imperial Brands and Capita.

In the list of top negative impacts, there were also some consumer stocks; the retailers Marks & Spencer and Mothercare and the pub company Greene King fell back due to a combination of trading difficulties and economic concerns. Elsewhere Brammer experienced severe trading difficulties, which put the balance sheet under pressure. IG Group traded well, but the shares were hit by a regulatory consultation, that could affect the retail spread betting industry. Finally, Pennon's underlying performance was reasonable but the share price lagged the strong equity market.

Portfolio Changes

A high dispersion of stock returns and considerable volatility produced many investment opportunities during the period. We added four new companies to the portfolio and sold out of four others entirely. At the end of the year, the portfolio comprised 44 companies. As explained in the interim report, we

Largest Net Purchases		Largest Net Sales	
Company	£m	Company	£m
Senior	8.8	British American Tobacco	12.2
Legal & General	6.8	CRH	11.1
Inmarsat	5.9	William Hill	9.8
St Ives	5.5	UBM	9.8
Prudential	5.2	BAE Systems	8.1
Lloyds Banking Group	4.9	HSBC	7.9
Tyman	4.7	Carnival	5.0
Sirius Real Estate	4.2	Segro	4.0
Centrica	3.8	National Grid	4.0
Standard Life	3.2	Antofagasta	3.9

Source: Allianz Global Investors

Investment Manager's Review *(continued)*

bought a new position in the engineering company Senior, and sold out of William Hill, adding to Ladbrokes instead. We also switched out of Barclays into a bigger holding in Lloyds after the Brexit referendum, and reduced the large HSBC position.

The other share sold in the first half was the industrial property company, Segro where we saw limited further valuation upside after significant gains. Later in the year, we added a new industrial property company, Sirius Real Estate. Sirius has all its assets in Germany, where yields on its types of property (business parks, offices and industrial complexes) remain very attractive, and considerably above funding costs. The company's intensive management style gives it the potential to increase rental income and, therefore, Sirius can pay a high and growing dividend yield, and it has the potential for capital gains too.

Another company purchased in the second half was St Ives. This is a media business that has been transitioning into digital marketing services, from a historic base as a provider of book printing and other print services. An opportunity emerged to buy the shares cheaply, after a number of trading issues. The company's valuation was modest, and did not reflect the substantial repositioning that has taken place. The legacy print-based businesses have continued to struggle in recent months, but they represent a small proportion of profits. We believe the shares do not reflect the growth opportunities within marketing services.

We also bought Tyman, a manufacturer of hardware, seals and other products for doors and windows and other applications. The company operates predominantly in the US, where the housing market is recovering, with smaller operations in the UK and continental Europe. After a period of poor performance in 2016, the shares offered good value.

We bought a position in BT in October. However, in an unusual development, we sold the shares again in January. BT shares had fallen heavily early in the year, and seemed to be offering good value by October, despite a regulatory overhang and other issues. However, a large accounting write-off in January, accompanied by a cut to profit guidance in their UK public sector business, led to a significant downgrade to BT's cash flow expectations. Whilst the company still appeared cheap, the cash cover of the dividend had become much tighter, leaving less

We added four new companies to the portfolio and sold out of four others entirely. At the end of the year, the portfolio comprised 44 companies.

Construction, general industrials, banks and financial services also performed very well.

Investment Manager's Review *(continued)*

Life insurers were a notable feature, as they offered an appealing combination of attractive dividend yields and good dividend growth.

room for higher pension costs, increased capital expenditure, or any further trading developments. We also sold Brammer, a distributor of bearings and other industrial products, which has been a disappointing investment. Trading difficulties led to a cancellation of the dividend.

Elsewhere, ICAP completed its transformational deal with Tullett Prebon. The company now owns shares in two companies. TP ICAP is a world leader in inter-dealer broking and related information services. It stands to benefit from synergy savings from combining the two businesses within an increasingly concentrated industry. NEX Group has been formed from the more profitable part of ICAP, and comprises its faster growing electronic trading, information and optimisation services and its financial technology businesses.

Other than new investments and complete disposals, much of the portfolio activity involved taking advantage of considerable stock volatility. We added to companies that had been over-sold and offered good value, and took profits in several strong performing shares, as their valuations increased towards our target levels. Significant additions to existing positions included Legal & General, Prudential, Centrica, M&S, Standard Life and Inmarsat. Life insurers were a notable feature, as they offered an appealing combination of attractive dividend yields and good dividend growth.

Profit taking included CRH and BAE Systems, where share prices had benefited from expectations of increased spending on infrastructure and defence. Also, positions in strong performers, such as Carnival, Antofagasta and UBM were reduced, as well as highly valued defensive companies, like British American Tobacco and National Grid.

Dividends

A high yield and consistently rising dividend payments are key objectives of the company. Approximately 30% of the portfolio's income is paid in US dollar dividends. The sharp fall in the pound after the Brexit referendum gave a boost to the sterling value of these dividend payments later in the year, and is likely to help this year's income more significantly.

The company's income from dividends was £30.2m, slightly ahead of 2016 income of £30.0m. Total income was of £31.1m (2016 - £31.0m). Earnings per share (revenue) was 24.06p in line with 2016 (24.05p). The directors have proposed total dividends for the year of 24.2p (2016 – 24.0p) up 0.8%.

A year ago there was considerable media focus on the risks to dividends at many large UK companies. However, the outlook is much improved for the four largest income contributors in the portfolio, which all maintained their ordinary dividends. The oil majors Royal Dutch Shell and BP have slashed

Investment Manager's Review *(continued)*

investment spending to support cash flows, and they benefited from a recovery in the oil price. GlaxoSmithKline made good progress in improving profitability and cash flow, after the company's 2015 asset swap with Novartis. HSBC had a solid year, bolstering its capital with some significant asset sales, and benefiting from rising US interest rates. These four companies, contributed £11.4m of dividends in aggregate last year, representing approximately 38% of the portfolio's income.

There are several other factors that the board take into account when setting dividend policy. Investment trusts have the ability to smooth dividends by tucking away reserves in good times to maintain pay-outs in tougher times. At the end of the year, the remaining revenue reserves were £24.8m, or 22.8p per share, enough to cover 94% of the full year's dividend. Finally, one of the company's debentures, which was taken out when interest rates were considerably higher, matures before the end of the current financial year, giving the board flexibility to lower the company's interest costs.

Derivatives

The company operates a covered call overwriting strategy on a limited proportion of the portfolio to generate additional income. In "writing" or selling an option the company 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 company receives an option premium which is taken to the revenue account.

The company 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" (but not cash) cost to the company as the option holder can exercise their option to buy the shares at the strike price.

Option activity continued at a moderate pace through the year, with only limited opportunities for writing options that met our specific criteria. The option strategy once again delivered its primary objective of income generation, with approximately £0.9m of option premiums accrued. Allowing for the opportunity costs of any option exercises, the strategy generated a small overall loss of under £0.1m.

Our selective approach to option writing is driven by the investment fundamentals on each stock we hold rather than by a separate derivatives rationale. We write calls on portions of shareholdings that we are 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 less than 4 months duration. The total exposure is closely monitored and is limited to 15% of the portfolio value with all option positions "covered" by shares owned. From a holistic view, it can be argued that the overall strategy slightly reduces the company's gearing to the equity market, neutralising some of the financial leverage. It tends to be more profitable in sideways or downwards markets but less profitable in rising markets.

The outlook is much improved for the four largest income contributors in the portfolio, which all maintained their ordinary dividends.

Approximately 30% of the portfolio's income is paid in US dollar dividends.

Investment Manager's Review *(continued)*

Higher inflation, a weak pound and the promise of increased infrastructure spending could be supportive for equities.

Economic and Market Outlook

The political environment seems more uncertain than for many years. The nature of the UK's future relationship with the EU is unclear. There are elections in France and Germany, and rising social unease within the Eurozone. Donald Trump's US presidency could lead to unpredictable changes in policy within the world's largest economy, not to mention potentially major changes to foreign policy towards the superpowers of Russia and China.

Economically, the US is adding fiscal stimulus to an already growing economy with relatively low unemployment. This could lead it on a path of rising inflationary pressures and higher interest rates. The Eurozone is also witnessing a more robust recovery than for some time, though monetary policy is likely to remain accommodative, with low or negative interest rates.

The UK is somewhere in between these two regions, both geographically and economically. The economy has been resilient to the Brexit referendum result, so far, and inflation is picking up, partly due to the weakness of the pound and the higher cost of imports. However, interest rates are unlikely to rise significantly, as the Bank of England considers the future economic risks of Brexit.

Whilst there are numerous political and economic risks, the UK economy is growing solidly. Higher inflation, a weak pound and the promise of increased infrastructure spending could be supportive for equities. The FTSE 100 Index of leading shares has recently traded at record levels, which might suggest an overvalued stock market, but it is only just above the level reached at the turn of the century. Furthermore, the recent rally in the market has been very narrow, led by only a few sectors, with many shares trading well below previous high levels.

It is therefore hard, as ever, to predict where the overall market will go in the short term. However, even if we had correctly anticipated last year's political developments, it would not have helped us particularly in predicting the overall stock market reaction. We prefer to focus on individual company prospects and valuations when assessing investments and constructing a portfolio. There are many businesses with strong competitive positions offering the combination of an attractive dividend yield and the potential for capital gains for investors. These businesses should deliver good returns over the medium to long term. Two major areas offer particular value; selected "mega-cap" companies and recovery situations.

Investment Manager's Review *(continued)*

Within the "mega-caps", the company continues to own large holdings in Royal Dutch Shell, BP, GlaxoSmithKline and HSBC. Whilst three of these performed very well last year, they all still offer good value. Dividend yields of 5% or more, which look increasingly secure, provide a solid underpinning to their value, with opportunities to grow profits significantly. The oil majors stand to benefit from further efficiency improvements and, in the case of Shell, synergies from the BG takeover, which was completed near the trough in the oil price. HSBC should benefit from cost reductions and higher US dollar interest rates in particular. GSK is starting to reap the benefits of its transformational deal with Novartis in 2015 which gave it global leadership positions in consumer health and vaccines, but profit margins should improve further.

Recovery situations have been a focus in the portfolio for some time. In an uncertain world, with low interest rates, investors have been prepared to pay high prices for companies with relatively predictable earnings streams. The flip side has been that many businesses with strong competitive positions, but which are undergoing specific short term issues, have been lowly valued.

When these businesses recover, shareholders can make very high returns. This has happened over the last year or two with Carnival, the world's largest cruise company, and CRH in the cement and building materials industry. But there are still many companies trading well below their long term intrinsic value. The portfolio has a diversified exposure to recovery situations, particularly within the cyclical consumer and industrial sectors and within financial services.

Outside of these areas, the company also has significant exposure to life insurance and utilities, two sectors offering high yields and, in most cases, real dividend growth. Conversely, there is only limited exposure to consumer staples sectors, like food producers and beverages, where valuations are high and future returns are likely to be modest at best.

Simon Gergel
Allianz Global Investors

There are still many companies trading well below their long term intrinsic value.

Many businesses with strong competitive positions, but which are undergoing specific short term issues, have been lowly valued. When these businesses recover, shareholders can make very high returns.

Portfolio Holdings

at 31 January 2017

Listed Equity Holdings

Name	Value (£)	% of listed holdings	Principal Activities
Royal Dutch Shell 'B'	53,190,679	8.3	Oil & Gas Producers
GlaxoSmithKline	48,455,936	7.5	Pharmaceuticals & Biotechnology
HSBC	40,121,789	6.2	Banks
BP	38,052,448	5.9	Oil & Gas Producers
Lloyds Banking Group	26,227,680	4.1	Banks
UBM	25,201,628	3.9	Media
Centrica	20,023,360	3.1	Gas, Water & Multiutilities
Tate & Lyle	17,734,725	2.8	Food Producers
SSE	17,409,600	2.7	Electricity
Prudential	16,928,600	2.6	Life Insurance
Top Ten Holdings	303,346,445	47.1	
Inmarsat	15,882,462	2.5	Mobile Telecommunications
Legal & General	15,738,300	2.4	Life Insurance
BAE Systems	15,655,439	2.4	Aerospace & Defence
Kier Group	15,284,521	2.4	Construction & Materials
Standard Life	15,280,522	2.4	Life Insurance
SThree	14,240,892	2.2	Support Services
Hansteen	14,199,754	2.2	Real Estate Investment Trusts
Greene King	13,892,400	2.2	Travel & Leisure
BHP Billiton	13,249,193	2.1	Mining
Pennon	13,084,500	2.0	Gas, Water & Multiutilities
Sainsbury (J)	12,735,320	2.0	Food & Drug Retailers
Marks & Spencer	12,691,105	2.0	General Retailers
National Grid	12,466,944	1.9	Gas, Water & Multiutilities
Balfour Beatty	11,581,855	1.8	Construction & Materials
Diageo	10,794,700	1.7	Beverages
Carnival	10,788,889	1.7	Travel & Leisure
Antofagasta	9,560,750	1.5	Mining
Aviva	9,530,808	1.5	Life Insurance
Ladbrokes	9,305,400	1.4	Travel & Leisure
IG Group	9,043,166	1.4	Financial Services
Senior	8,946,089	1.4	Aerospace & Defence
NEX	8,860,844	1.4	Financial Services
Ashmore Group	8,446,189	1.3	Financial Services
CRH	8,445,450	1.3	Construction & Materials
Man Group	7,772,922	1.2	Financial Services
Equiniti	7,630,834	1.2	Support Services
TP ICAP	5,859,621	0.9	Financial Services

Portfolio Holdings *(continued)*

at 31 January 2017

Listed Equity Holdings *(continued)*

Name	Value (£)	% of listed holdings	Principal Activities
FirstGroup	5,766,450	0.9	Travel & Leisure
Sirius Real Estate	4,810,377	0.7	Real Estate Investment & Services
Tyman	4,655,000	0.7	Construction & Materials
British American Tobacco	4,423,307	0.7	Tobacco
Hostelworld	3,602,429	0.6	Travel & Leisure
Mothercare	2,920,680	0.5	General Retailers
St Ives	2,910,875	0.4	Support Services
Total Listed Equities	**643,404,432**	**100.0**	

Unlisted Equity Holdings

Name	Value (£)	% of unlisted holdings	Principal Activities
First Debenture Finance*	23,483	84.0	Financial Services
Fintrust Debenture*	4,486	16.0	Financial Services
Total Unlisted Equities	**27,969**	**100.0**	

* These companies are the lenders of the company's Stepped Rate Loan and Fixed Rate Interest Loan; more details are available in Note 9 on page 70.

Written Call Options

As at 31 January 2017, the market value of the open option positions was £(85,100) (2016 - £(214,350)), resulting in an underlying exposure to 2.8% of the portfolio (valued at strike price).

Distribution of Total Assets

at 31 January 2017

	Percentage of Total Assets* at 31 January 2017	Percentage of Total Assets* at 31 January 2016
Oil & Gas		
Oil & Gas Producers	14.7	11.3
	14.7	**11.3**
Basic Materials		
Mining	3.7	2.1
	3.7	**2.1**
Industrials		
Aerospace & Defence	4.0	3.4
Construction & Materials	6.4	6.2
Support Services	4.0	4.0
	14.4	**13.6**
Consumer Goods		
Beverages	1.7	2.0
Food & Drug Retailers	2.0	2.0
Food Producers	2.9	2.7
Tobacco	0.7	2.4
	7.3	**9.1**
Health Care		
Pharmaceuticals & Biotechnology	7.8	7.5
	7.8	**7.5**
Consumer Services		
General Retailers	2.5	3.0
Media	4.1	4.8
Travel & Leisure	7.0	9.2
	13.6	**17.0**

Distribution of Total Assets *(continued)*

at 31 January 2017

	Percentage of Total Assets* at 31 January 2017	Percentage of Total Assets* at 31 January 2016
Telecommunications		
Mobile Telecommunications	2.6	3.4
	2.6	**3.4**
Utilities		
Electricity	2.8	2.6
Gas, Water & Multiutilities	7.3	7.8
	10.1	**10.4**
Financials		
Banks	10.7	10.3
Financial Services	6.4	5.3
Life Insurance	9.2	6.6
Real Estate Investment & Services	0.8	-
Real Estate Investment Trusts	2.3	2.6
	29.4	**24.8**
Total Investments	**103.6**	**99.2**
Net Current (Liabilities) Assets	**(3.6)**	**0.8**
Total Assets	**100.0**	**100.0**

*Total Assets (less creditors due within one year) £621,339,256 (2016 - £608,370,101).

Historical Record

year ended 31 January 2017

Revenue and Capital	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Income (£'000s)	28,495	31,730	23,687	25,741	27,305	28,313	29,827	29,958	30,985	31,123
Net revenue earnings per ordinary share	22.86p	27.25p	18.91p	21.22p	22.00p	22.90p	24.22p	23.56p	24.05p	24.06p
Dividend per share	21.60p	22.80p	22.50p	22.80p	23.00p	23.20p	23.60p	23.80p	24.00p	24.20p
Ordinary dividend per share	21.60p	22.30p	22.50p	22.80p	23.00p	23.20p	23.60p	23.80p	24.00p	24.20p
Special dividend per share	-	0.50p	-	-	-	-	-	-	-	-
Tax credit per share	2.40p	2.53p	2.50p	2.53p	2.56p	2.58p	2.62p	2.64p	2.67p	n/a
Gross dividend per share	24.00p	25.33p	25.00p	25.33p	25.56p	25.78p	26.22p	26.44p	26.67p	24.20p
Total net assets attributable to ordinary capital (£'000s)	506,187	314,804	384,747	440,846	415,025	481,464	529,478	562,009	498,108	545,318
Net asset value per ordinary share (debt at par)	492.3p	306.2p	372.8p	427.1p	402.1p	466.5p	510.8p	516.9p	458.1p	501.5p
Net asset value per ordinary share (debt at market value) ~	-	278.5p	356.4p	407.3p	366.2p	434.1p	486.8p	486.1p	437.7p	478.9p
NAV total return (debt at par) % *	-9.6	-33.4	29.2	20.7	-0.5	21.8	14.5	5.8	-6.7	14.7
NAV total return (debt at market value) % *~	-	-	36.2	20.7	-4.5	24.9	17.5	4.7	-5.0	14.9
Ordinary share price	425.0p	282.0p	329.1p	406.9p	363.0p	412.7p	491.5p	484.0p	414.0p	452.5p
Share price total return %	-13.48	-29.11	25.83	31.35	-5.38	20.81	25.17	3.38	-9.80	15.57
Discount/premium (debt at par) %	-13.7	-7.9	-11.7	-4.7	-9.7	-11.5	-3.8	-6.4	-9.6	-9.8
Discount/premium (debt at market value) % ~	-5.8	1.3	-7.7	-0.1	-0.9	-4.9	+1.0	-0.4	-5.4	-5.5

Notes
* NAV total return reflects both the change in net asset value per ordinary share and the net ordinary dividends paid.
~ NAV debt at market value has been reported since 2009.

The Merchants Trust PLC

Directors' Review

Directors, Investment Manager and Advisers

Directors

Details of the directors at the end of the year are set out below. All directors are non-executive and independent of the manager.

Simon Fraser (Chairman)
Joined the board in August 2009 and became Chairman in 2010. He is Chairman of Foreign & Colonial Investment Trust PLC and Chairman of The Investor Forum and is a non-executive director of Ashmore Group plc and Fidelity European Values PLC (the latter until 15 May 2017). 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.

Timon Drakesmith (Chairman of the Audit Committee)
Joined the board in November 2016. He is an executive director and Chief Financial Officer of Hammerson plc. Timon is also Managing Director of Hammerson's Premium Outlets business and in that capacity is a non-executive director of Value Retail PLC and is Chairman of Via Outlets advisory committee. He was formerly Finance Director of Great Portland Estates plc and Group Director of Financial Operations of Novar plc. He is a Chartered Accountant and has held previous financial roles at Credit Suisse, Barclays and Deloitte Haskins and Sells.

Mike McKeon (retired 31 January 2017)
Joined the board in May 2008. He is a non-executive director of National Express Group PLC. He was Group Finance Director of Severn Trent Plc until 31 March 2015, when he retired from the board. Prior to that, from 2000 until 2005, he was Group Finance Director of Novar plc. He held various senior positions at Rolls-Royce plc from 1997 to 2000. He has extensive experience from a number of overseas roles, having worked at CarnaudMetalbox, Elf Atochem and PricewaterhouseCoopers LLP. He is a Chartered Accountant. Mike McKeon retired from the board on 31 January 2017.

Mary Ann Sieghart
Joined the board in November 2014. She is Chair of the Social Market Foundation, a non-executive director and Senior Independent Director of The Henderson Smaller Companies Investment Trust plc and a director of DLN Digital Ltd. Mary Ann sits on the Council of Tate Modern and the Content Board of Ofcom and she is a trustee of the Kennedy Memorial Trust and holds other voluntary posts. Mary Ann is a political journalist and broadcaster and was formerly Assistant Editor of The Times, a Lex Columnist at the Financial Times and City Editor of Today.

Sybella Stanley (Senior Independent Director)
Joined the board in November 2014. She is Director of Corporate Finance at RELX Group plc, where she manages RELX Group's global mergers and acquisitions programmes, and is a non-executive director of Tate & Lyle PLC. Sybella is also a Member of the Department of Business, Energy and Industrial Strategy's Industrial Development Advisory Board. Before joining RELX Group in 1997, Sybella was a member of the M&A advisory teams at, successively, Citi and Barings. She is a member of the Somerville College Oxford Development Board. Sybella is a barrister.

Paul Yates
Joined the board in March 2011. He is Chairman of the Advisory Board of 33 St James's Limited and is a non-executive director of Aberdeen UK Tracker Trust plc and of Fidelity European Values 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) Limited between 2001 and 2005. After undertaking a number of global roles at UBS he retired in 2007.

Directors, Investment Manager and Advisers

(continued)

The Manager

Allianz Global Investors GmbH is an investment company with limited liability incorporated in Germany and registered in the UK as a branch with establishment number BR009058 and with an establishment address of 199 Bishopsgate, London EC2M 3TY. It is authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and is subject to limited regulation by the Financial Conduct Authority (FCA).

Allianz Global Investors are active asset managers operating across 19 markets with specialised in-house research teams around the globe, managing assets for individuals, families and institutions worldwide.

As at 31 December 2016, Allianz Global Investors had €480 billion of assets under management worldwide.

Through its predecessors, Allianz Global Investors has a heritage of investment trust management expertise in the UK reaching back to the nineteenth century and as at 31 December 2016 had £1.27 billion of assets under management in a range of investment trusts. Website: www.allianzgi.co.uk

Head of Investment Trusts

Melissa Gallagher Email: melissa.gallagher@allianzgi.com

Investment Manager

Simon Gergel, representing Allianz Global Investors GmbH, UK Branch, 199 Bishopsgate, London EC2M 3TY.

Company Secretary and Registered Office

Kirsten Salt BA (Hons) ACIS, 199 Bishopsgate, London EC2M 3TY
Telephone: 020 3246 7513 Email: kirsten.salt@allianzgi.com

Registered Number

28276

Independent Auditors

PricewaterhouseCoopers LLP

Bankers

HSBC Bank plc,
Barclays Bank plc

Registrars

Capita Asset Services
(full details on page 84)

Solicitors

Herbert Smith Freehills LLP

Stockbrokers

J.P. Morgan Securities Limited

Depositary and Custodian

HSBC Bank PLC

Statement of the Depositary's Responsibilities in Respect of the Company

"The Depositary must ensure that the company is managed in accordance with the Financial Conduct Authority's Investment Funds Sourcebook, ("the Sourcebook"), the Alternative Investment Fund Managers Directive ("AIFMD") (together "the Regulations") and the company's Articles of Association.

The Depositary must in the context of its role act honestly, fairly, professionally, independently and in the interests of the company and its investors.

The Depositary is responsible for the safekeeping of the assets of the company in accordance with the Regulations.

The Depositary must ensure that:

- the company's cash flows are properly monitored and that cash of the company is booked into the cash accounts in accordance with the Regulations;
- the sale, issue, repurchase, redemption and cancellation of shares are carried out in accordance with the Regulations;
- the assets under management and the net asset value per share of the company are calculated in accordance with the Regulations;
- any consideration relating to transactions in the company's assets is remitted to the company within the usual time limits;
- that the company's income is applied in accordance with the Regulations; and
- the instructions of the Alternative Investment Fund Manager ("the AIFM") are carried out (unless they conflict with the Regulations).

The Depositary also has a duty to take reasonable care to ensure that the company is managed in accordance with the Articles of Association in relation to the investment and borrowing powers applicable to the company.

Report of the Depositary to the Shareholders of The Merchants Trust PLC (the company) for the period ended 31 January 2017.

Having carried out such procedures as we consider necessary to discharge our responsibilities as Depositary of the company, it is our opinion, based on the information available to us and the explanations provided, that in all material respects the company, acting through the AIFM has been managed in accordance with the rules in the Sourcebook, the Articles of Association of the company and as required by the AIFMD."

HSBC Bank plc
21 February 2017

Further information about the relationship with the Depositary is on page 83.

Directors' Report

The directors present their report and the audited financial statements of the company for the year ended 31 January 2017.

Revenue

The revenue earnings attributable to ordinary shareholders for the year amounted to £26,160,643 or 24.1p per share (2016 - £26,145,206, 24.1p per share).

The first and second interim dividends of £6,523,708 each, or 6.0p per share, have been paid during the year. Since the year end the third interim dividend of £6,632,436, or 6.1p per share, was paid on 23 February. Subject to shareholder approval, a final dividend of 6.1p will be payable on 18 May 2017. In accordance with FRS 102 Section 32: 'Events after the end of the reporting period', the third interim dividend and final dividend are not recognised as liabilities within the financial statements on the basis that at the year end the third interim dividend had not been paid and the final dividend not approved by the shareholders.

Historical Record

The distribution of total assets is shown on pages 30 and 31, and the historical record of the company's revenue and capital over the past ten years is shown on page 32. Graphs appear on page 9 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 FTSE 100 Index, the growth in net ordinary distributions made by the company against the Retail Price Index, the company's discount/premium to net asset value and the dividend yield compared to the FTSE 100 Index, UK gilt yield and cash, over the same period.

Invested Funds

Sales of investments during the year resulted in net gains based on historical costs of £11,472,893 (2016 - costs of £25,305,862). Provisions contained in the Finance Act 2010 exempt approved investment trusts from corporation tax on their chargeable gains.

Share issuance and buy back

During the year and since the year end there have been no share issuances and no share buy backs.

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 Chairman's Statement on pages 2 to 5 sets out the outlook for the company and the investment manager also discusses his view of the outlook for the company's portfolio in his report beginning on page 20. The future is also discussed in the Strategic Report on page 18.

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 next twelve months. For this reason the directors continue to adopt the going concern basis in preparing the financial statements.

Section 992 of the Companies Act 2006

The following information is disclosed in accordance with Section 992 of the Companies Act 2006.

Capital Structure

The company's capital structure is summarised in Note 12 on page 72. The details of the 4% perpetual debenture stock and the 3.65% cumulative preference stock are provided in Notes 11(iv) and 11(v) respectively on page 72.

Directors' Report *(continued)*

Voting Rights in the Company's Shares

The voting rights at 27 March 2017 were:

Share class	Number of shares issued	Voting rights per share	Total voting rights
Ordinary shares of 25p	108,728,464	1	108,728,464
3.65% cumulative preference stock of £1	1,178,000	1	1,178,000
Total	109,906,464		109,906,464

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. The perpetual debenture stock and bonds carry no voting rights.

Interests in the Company's Share Capital

As at 27 March 2017 the company has received no declarations of notifiable interests in the company's issued share capital:

Directors

Biographical details of the current directors at the date of the signing of this report are shown on page 34.

All of the directors are retiring at the annual general meeting and each offers themself for election or re-election, as appropriate. The board considers each director to be independent of the manager and each has the full support of the board in standing for re-election. Following a formal performance evaluation conducted by the chairman it was noted that each director's individual performance continues to be effective and each director demonstrates commitment to his or her 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 company's Articles.

Directors' and officers' liability insurance cover is held by the company and deeds of indemnity are entered into with the directors. The indemnity is a qualifying third-party provision under the Companies Act 2006.

Related Party Transactions

During the financial year no transactions with related parties have taken place which would materially affect the financial position or the performance of the company.

Directors' Report *(continued)*

Management Contract and Management Fee

The management contract with Allianz Global Investors GmbH, UK Branch (AllianzGI) provides for a fee of 0.35% per annum (2016 - 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 AllianzGI. The management contract is terminable at one year's notice (2016 - one year). Under the contract, other than a year's fees which may be paid in lieu of notice, there are no compensation payments due on termination.

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 company'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.

Political Donations

The company made no political donations in the year (2016 - nil).

Corporate Governance Statement

The board has considered the principles and recommendations of the AIC Code of Corporate Governance 2015 (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 Guide enables investment company boards to meet their obligations under the UK Corporate Governance Code. The company has complied with the current 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; the remuneration committee; and the need for an internal audit function. 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 full text of the company's Corporate Governance Statement is on the website www.merchantstrust.co.uk in the literature/trust documents section.

Attendance by the directors at formal board and committee meetings during the year was as follows:

Director	Board	Audit Committee	Nomination Committee	Management Engagement Committee
Number of meetings	6	2	1	1
Simon Fraser	6	2†	1	1
Timon Drakesmith*	2	-	-	-
Mary Ann Sieghart	6	2	1	1
Sybella Stanley	6	2	1	1
Paul Yates	6	2	1	1
Mike McKeon**	6	2	1	1

† Invited to attend meetings, although not a committee member.
* Appointed to the board on 1 November 2016.
** Retired from the board on 31 January 2017.

Directors' Report *(continued)*

Alternative Performance Measures (APMs)

In addition to providing guidance on Corporate Governance, the AIC provides investment companies with leadership to support a fair and balanced approach to the reporting of APMs, such as NAVs, peer group comparisons, dividend yields and attribution analyses.

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 provides that 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 Composition and Succession Planning

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. The board considered its succession plans as part of the board evaluation exercise which took place during the year in March. On 1 November 2016, Timon Drakesmith was appointed to the board and Mike McKeon retired from the board on 31 January 2017. There are no current plans to recruit further new directors, but the board continues to keep this under review. The board's aim is to continue with a policy of shortlisting women in the search for new directors and achieved this in the recent recruitment exercise.

Gender Diversity

Three of the company's directors are male and two are female. As the company is an investment trust, all of its activities are outsourced and it does not have any employees. Therefore it has nothing further to report in respect of gender representation within the company.

Board Committees

Audit Committee

The Audit Committee Report is on pages 45 to 47.

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.

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 employed by the manager in the previous five years. It is chaired by Simon Fraser, the Chairman of the board.

Directors' Report *(continued)*

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 44. The Independent Auditors' Report can be found on pages 52 to 56.

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 or she ought to have taken as a director in order to make himself/ herself 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 of the Companies Act 2006.

Internal Control

The directors have overall responsibility for the company's system of internal control and are responsible for reviewing the effectiveness of the company's systems 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 risks faced by the company. The process has been fully in place throughout the year under review and up to the date of signing of this Annual 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 17). 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.
- AllianzGI, 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. The company receives full 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 AllianzGI's 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 systems of controls of third party service providers by reviewing internal control reports of those parties including the manager, the company's registrars, Capita Asset Services and the 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 on compliance with the manager'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.

Directors' Report *(continued)*

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, the Chairmen of the board's committees and the directors, 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, The Merchants Trust PLC, 199 Bishopsgate, London EC2M 3TY.

The notice of meeting sets out the business of the meeting and special resolutions are explained more fully later 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, AllianzGI. AllianzGI is a signatory to the UK Stewardship Code, which sets out good practice on engagement with investee companies. AllianzGI monitors our portfolio holdings and proactively engages with investee companies in line with the principles set out in the UK Stewardship Code and consistent with our investment objectives. AllianzGI's engagement activities cover a range of matters, including strategy, performance, risk management, capital allocation, corporate governance, and environmental and social impacts. Allianz Global Investors' policy statement on the Stewardship Code can be found on its website. The board has reviewed this policy statement and is satisfied that the company's delegated voting powers are being properly executed and that AllianzGI applies the principles of the Stewardship Code in practice. AllianzGI has recently been categorised as Tier 1 in the Financial Reporting Council's list of subscribers to the Stewardship Code.

AllianzGI is a member of the Investor Forum, established in the UK to facilitate collective, proactive engagement between companies and investors. It aims to position stewardship at the heart of investment decision making by facilitating dialogue, creating long term solutions and enhancing value. AllianzGI regularly reports to the board on stewardship and engagement matters.

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.

AllianzGI 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, AllianzGI is a member of the Pensions and Life Savings Association and the International Corporate Governance Network, 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 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.

AllianzGI subscribes to the ISS Proxy Voting Services. ISS manages the voting process and recommends actions based upon AllianzGI's Global Proxy Voting Policy Guidelines. Where recommendations are for a vote to be cast against a resolution or for an abstention, and for all extraordinary general meeting resolutions, the relevant portfolio managers or analysts are consulted and may decide on a different course of action. The reasons for such deviations are recorded as are all the reasons for abstaining on or voting against any resolution. An extract from the company's voting record in the previous year will be available for inspection at the annual general meeting each year.

Directors' Report *(continued)*

Modern Slavery Act 2015

The company does not provide goods or services in the normal course of business, and as a financial investment vehicle does not have customers. The directors therefore consider that the company is not required to make a statement under the Modern Slavery Act 2015 in relation to slavery or human trafficking.

Bribery Act 2010

The board has a zero tolerance policy in relation to bribery and corruption and has received assurance through internal controls reporting from the company's main third party service providers that adequate safeguards are in place to protect against any such potentially illegal behaviour by employees or agents.

Greenhouse Gas Emissions

The company has an external manager, AllianzGI, part of Allianz Group, and has no physical assets, operations, premises or employees of its own. Consequently it has no greenhouse gas emissions to report. Allianz Group reports on the greenhouse gas emissions for its own operations.

Annual General Meeting

1. Allotment of New Shares

Approval is sought in Resolution 12 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 36,242,821 ordinary shares, representing approximately one third of the existing ordinary share capital. This authority is renewable annually and will expire at the conclusion of the annual general meeting in 2018.

2. Disapplication of Pre-emption Rights

A resolution was passed at the annual general meeting held on 24 May 2016 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 2017. Special resolution 13 is therefore proposed under special business at the forthcoming annual general meeting to renew this authority until the conclusion of the annual general meeting in 2018 or 16 August 2018 if earlier. This power is limited to a maximum number of 10,872,846 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 16 May 2017.

Authority will also be sought in Resolution 13, which will be proposed as a Special Resolution, to disapply pre-emption rights in respect of the allotment of shares by the sale and reissue of shares held by the company as treasury shares.

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.

3. Purchase of Own Shares

The board is proposing that the company should be given renewed authority to purchase ordinary shares in the market to hold in treasury or 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.

Under the Companies Act 2006, the company is allowed to hold its own shares in treasury following a buy back, instead of having to cancel them. This gives the company the ability to reissue treasury shares quickly and cost-effectively (including pursuant to the authority under resolution 13, see above) and provides the company with additional flexibility in the management of its capital base. Such shares may be resold for cash but all rights attaching to them, including voting rights and any right to receive dividends are suspended whilst they are in the treasury. If the board exercises the authority conferred by resolution 14, which will be proposed as a Special Resolution, the company will have the option of either holding in treasury or of cancelling any of its shares purchased pursuant to this authority and will decide at the time of purchase which option to pursue.

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 £400 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

Directors' Report *(continued)*

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, could help to reduce the discount to net asset value when the company's shares trade at a discount.

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 its own 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 16,298,396 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 16 May 2017.

In addition to renewing its powers to buy back and cancel shares, the board will seek shareholder authority to reissue shares from treasury.

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 2018 or the expiry of 15 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.

4. Independent Auditors

The directors will place a resolution before the annual general meeting to reappoint 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.

The board and the Annual Report

The board reviewed the entire annual report and noted all the supporting information received. It then considered whether the annual report satisfactorily reflected a true picture of the company and its activities and performance in the year, with a clear link between the relevant sections of the report. The directors were then able to confirm that the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

By order of the board

Kirsten Salt
Company Secretary
27 March 2017

Statement of Directors' Responsibilities

The directors are responsible for preparing the Annual 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 prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (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 profit 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; and
- 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 directors each have a duty to make themselves aware of any "relevant audit information" and ensure that the auditors have been made aware of that information. A disclosure stating that each director has complied with that duty is given in the Directors' Report on page 40.

The directors are responsible for ensuring that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

The financial statements are published on www.merchantstrust.co.uk, which is a website maintained by the company's investment manager, AllianzGI. The directors are responsible for the maintenance and integrity of the company's website. The work undertaken by the auditors does not involve consideration of the maintenance and integrity of the website and, accordingly, the auditors accept 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 Disclosure and Transparency Rule 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, prepared in accordance with applicable accounting standards, give a true and fair view of the assets, liabilities, financial position and profit of the company;
- the Strategic Report includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that they face; and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the company's performance, business model and strategy.

For and on behalf of the board

Simon Fraser
Chairman
27 March 2017

Audit Committee Report

I am pleased to present the report of the audit committee for the year ended 31 January 2017. I would like to thank my predecessor, Mike McKeon, for his leadership of the Audit Committee for a large part of the year under review. I joined the board on 1 November 2016 and became Chairman of the Audit Committee at that date.

Composition

The audit committee consists of all of the independent non-executive directors, with the exception of the Chairman of the board. The committee considers that, collectively, its members have sufficient recent and relevant financial experience to discharge their responsibilities fully. I am a chartered accountant and have current experience as Chief Financial Officer of a large public company and previously in a similar capacity in other large companies.

Role

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 Report and the Half-yearly Report;
- consideration of the nature and scope of the external audit and the findings therefrom; and
- consideration of the terms of appointment of the auditors, including their remuneration and the provision of any non-audit services by them.

Activities

During the year the committee had two regular meetings during which the Annual Report and the Half-yearly Report respectively were reviewed in detail. The regular meetings were attended by representatives of the manager, including its compliance and risk departments. At each regular meeting the committee received reports 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 report, the planning and the process of the audit and the auditor's independence and objectivity. The audit committee believes the performance of the auditor is satisfactory and recommended the reappointment of PricewaterhouseCoopers LLP as auditors of the company to the board. The audit committee reviews the company's accounting policies with the manager and considers their appropriateness. The committee also reviews the terms of appointment of the auditors together with their remuneration.

Risk

Although the board has ultimate responsibility for the management of risk, the audit committee assists by monitoring the formal reports from the manager and third party service providers' reports on internal controls.

The committee reviewed its approach to the risk management process and concluded that existing processes were adequate to ensure that its assessment of risk is robust and of sufficient frequency.

A Risk Map is reviewed at each of the committee's meetings. We consider whether new risks should be added or removed, assess their likelihood of occurring and potential scale, review the mitigating actions and assess the residual risk against what we regard as acceptable – 'risk appetite'.

Assurance over mitigating actions in relation to these risks is provided in a series of reports from all the third party service providers.

Audit Committee Report *(continued)*

Resulting from the work of the audit committee, certain key risks are identified for disclosure and discussion in our annual report. We have also assessed residual risks after controls and mitigating actions have been applied and have evaluated if our risk appetite has been satisfactorily addressed. The principal risks are in relation to Portfolio, Business and Operational Matters. The risks identified together with mitigating actions are set out in the Strategic Report on page 17.

Viability Statement

Based on this review of risk, including the chief risks around Investment Activity and Strategy and the arrangements in place to manage and mitigate these risks, the committee reviewed a paper that supported the board's conclusion, set out on page 18 in the strategic report, of their reasonable expectation that the company is viable in the longer term.

Internal audit

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.

Assessment of Fair, Balanced and Understandable

The audit committee and then the whole board reviewed the entire annual report and noted all the supporting information received. It then considered whether the annual report satisfactorily reflected a true picture of the company and its activities and performance in the year, with a clear link between the relevant sections of the report and concluded that it did so. The directors were then able to confirm that the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy.

Review of Disclosure and Communication

At our meetings the audit committee reviews whether we are following best practice in our disclosure and whether we believe we are communicating clearly. In order to assist us in our review we receive reports on current and future changes to regulatory and accounting reporting from the manager and auditor.

Whistleblowing

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. The audit committee has, however, received and noted the manager's policy on this matter. Any matters concerning the company may be raised with the Chairman or the Senior Independent Director.

Financial Report and Significant Issues

The audit committee met with the auditors at the half-year point to discuss the audit plan for the year and identify the significant issues to be dealt with in the review of the year end results.

Significant issues considered by the audit committee in the year

Area of focus	Activity
Risks around the valuation of and the existence of investments.	The company's assets are principally invested in large UK listed equities traded on major exchanges. The committee notes that investments are valued using stock exchange prices provided by third party financial data vendors. During the year the committee reviewed internal controls reports from the manager concerning the systems and controls around the pricing and valuation of securities. The committee also reviews the valuation of unlisted investments. Unlisted investments are recognised on a fair value basis as set out in the Statement of Accounting Policies on page 63 and are reviewed by the manager's valuation committee before being approved by the company and being made available to the auditor.
The risk that income from the portfolio of investments was not correctly recognised and accounted for.	The committee noted that the board receives income forecasts throughout the year and is able to compare these against actual income received. The committee has also received assurances from the manager that the company's stated accounting policies, which are set out on pages 62 to 64, were noted and adhered to, for example, each special dividend received is considered by the board at its meetings and is treated as a capital or revenue item depending on the facts or circumstances of each dividend. The board also receives reports at the board meetings of the impact of currency movements, e.g., the devaluation of sterling, on the portfolio revenue.

Audit Committee Report *(continued)*

Area of focus	Activity
	These and other matters, identified as posing lesser risk, were considered and discussed with the manager and the auditors as part of the year end process. We also agreed the degree of materiality that the auditors would apply in their work, which is £5.5m million, or about 1% of Net Assets, although the auditors would bring to the audit committee's attention any significant misstatements below that level.

The audit, its effectiveness and the reappointment of the auditor

The committee reviewed the terms of appointment of the auditor, monitored the audit process, assessed the auditor's independence, objectivity and the effectiveness of the audit process, including the provision of non-audit services by the firm, and determined that they have had no impact on the auditor's independence and objectivity.

As part of the review of the auditor, the members of the committee and those representatives of the manager involved in the audit process reviewed and considered a number of areas including: the reputation and standing of the audit firm; the audit processes, evidence of partner oversight and external information about the firm; the skills, experience and specialist knowledge of the audit team, particularly relating to investment trusts; audit communication including details of planning, information on relevant accounting and regulatory developments, and recommendations on corporate reporting; the reasonableness of audit fees; and the Financial Reporting Council's Audit Quality Report on PricewaterhouseCoopers LLP for 2015/16.

The committee was satisfied that the audit process was effective for the year under review.

The committee considered the representations made by the auditor and sought comments from representatives of the manager on the provision of services by the auditors and the effectiveness of the external audit. The audit committee believes that the performance of the auditors is satisfactory and has recommended to the board that a resolution proposing the re-appointment of the auditors is put to shareholders at the annual general meeting.

Non-audit services

Non-audit services received in the year related to certificates supplied in connection with the covenants under the debenture trust deeds and the audit committee agreed that it was appropriate that the company's auditors should be asked to provide these services.

Fees for non-audit services were £4,600 in the year (2016 - £4,600). These fees are considered by the audit committee to be proportionate to the fees for audit services of £27,400 (2016 - £31,000). This non-audit work was found not to have a significant impact on the financial statements.

Auditor's tenure

PricewaterhouseCoopers LLP have acted as auditor to the company for over twenty years. EU audit legislation has been published in the past year which will require the rotation of PricewaterhouseCoopers LLP as the audit firm by 2020 . The current partner, Jeremy Jensen, will have completed five years on the company's audit in 2018 and it is the view of the audit committee that it will look to tender the audit at this time.

Timon Drakesmith
Audit Committee
Chairman
27 March 2017

Directors' Remuneration Report

The Remuneration Report

This is the Directors' Remuneration Report for the year. The report is submitted in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 for the year ended 31 January 2017. An ordinary resolution for the approval of the Directors' Remuneration Policy Report was put to a binding shareholder vote at the annual general meeting in 2014 and is next due to be placed before the shareholders for approval at this year's annual general meeting. The results of the vote at the 2014 AGM for this resolution were as follows: In favour 95.9%, Against 4.1% and 869,678 shares were withheld (in aggregate, 29,418,867 votes). The results of the advisory vote at the 2016 AGM for the resolution to approve the Implementation Report were as follows: In favour 94.1%, Against 5.6% and 724,155 shares were withheld (29,897,430 votes). The Directors' Remuneration Implementation Report will be put to an advisory shareholder vote at this year's AGM.

The information provided in this part of the Directors' Remuneration Report is not subject to audit unless specified below.

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.

Directors' Shareholdings and Share Interests (Audited)

The interest of the directors at the year end in the ordinary share capital of the company are set out below:

	2017	2016
Simon Fraser	20,000	20,000
Timon Drakesmith*	15,000	-
Mike McKeon**	5,450	5,450
Mary Ann Sieghart	1,000	1,000
Sybella Stanley	3,114	3,114
Paul Yates	10,000	10,000

* Appointed to the board on 1 November 2016
** Retired from the board on 31 January 2017

The company's Articles provide for directors to hold qualifying shares in the nominal amount of £100, i.e., currently 400 shares.

Directors' Remuneration Policy

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

The company's Articles limit the aggregate fees payable to the board of directors to a total of £200,000 per annum. Subject to this overall limit, it is the board's policy to determine the level of directors' fees having regard to the level of fees payable to non-executive directors in the investment trust industry generally, the role that individual directors fulfil, and the time committed to the company's affairs. The board believes that levels of remuneration should be sufficient to attract and retain non-executive directors to oversee the company.

Directors are entitled to be reimbursed for any reasonable expenses properly incurred by them in connection with the performance of their duties and attendance at meetings. There are no agreements between the company and its directors concerning compensation for loss of office.

The company's Articles also provide that additional discretionary payments can be made for services which in the opinion of the directors are outside the scope of the ordinary duties of a director.

This Directors' Remuneration Policy is the same in all material respects as that currently followed by the board and summarised in the last Directors' Remuneration Report and approved by the shareholders at the annual general meeting held on 21 May 2014.

The company has no employees and consequently has no policy on the remuneration of employees.

The board will consider, where raised, shareholders' views on directors' remuneration. No comments have been received on this subject in the past year.

Directors' Remuneration Report *(continued)*

Annual Statement and Directors' Remuneration Implementation Report

Directors' Emoluments (Audited)

The policy is to review directors' fee rates from time to time, but reviews will not necessarily result in a change to the rates.

In the year under review the directors were paid at a rate of £24,000 per annum with an additional £5,000 for the Chairman of the Audit Committee and the Chairman at a rate of £36,500 per annum. The current fees have applied since 1 February 2015.

The fees were reviewed in January 2017 and it was determined that there would be the following increase to directors' fees with effect from 1 February 2017: Chairman £37,500, Directors £25,000 with an additional £5,500 to the Chairman of the Audit Committee.

The directors' emoluments during the year and in the previous year, all of which were in the form of fees, were as follows:

	Directors' fees	
	2017 £	2016 £
Simon Fraser	36,500	36,500
Timon Drakesmith*	7,250	-
Mike McKeon**	27,750	29,000
Mary Ann Sieghart	24,000	24,000
Sybella Stanley	24,000	24,000
Paul Yates	24,000	24,000
Totals	**143,500**	**137,500**

* Appointed to the board on 1 November 2016.
** Retired from the board on 31 January 2017.

There are no other benefits requiring reporting.

Analysis of Pay against Distributions

A table showing actual expenditure by the company on remuneration and distributions to shareholders for the year and the prior year is below:

Expenditure by the company on remuneration and distributions to shareholders

	2017 £	2016 £
Remuneration paid to all directors	143,500	137,500
Distributions to shareholders	26,094,832	26,094,832

The disclosure is a statutory requirement, however the directors do not consider that the comparison of directors' remuneration with distributions to shareholders is a meaningful measure of the company's overall performance.

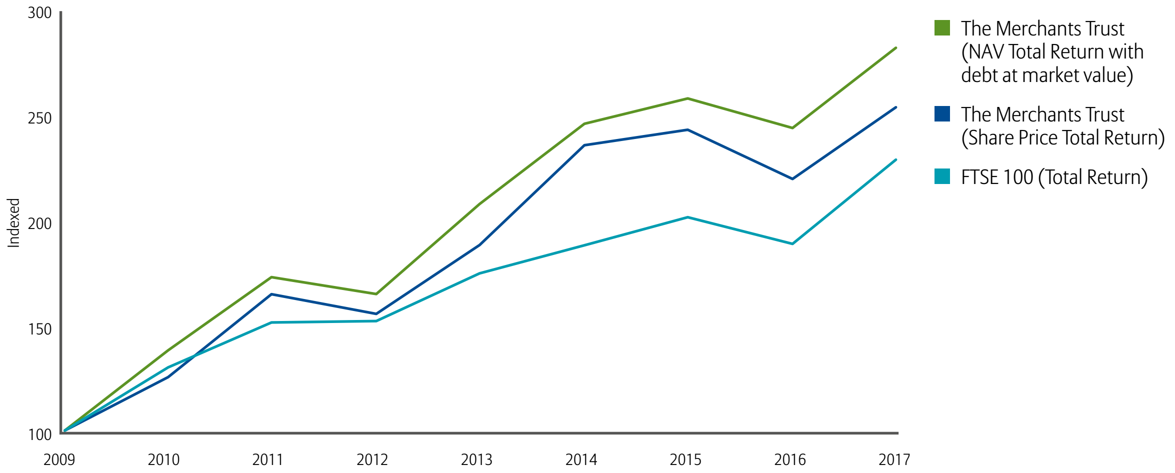
Directors' Remuneration Report *(continued)*

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.

Total shareholder return for the eight years to 31 January 2017



Source: AllianzGI / Datastream in GBP
Figures have been rebased to 100 as at January 2009

Signed on behalf of the board

Simon Fraser
Chairman
27 March 2017

The Merchants Trust PLC

Independent Auditors' Report

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

Report on the financial statements

Our opinion

In our opinion, The Merchants Trust PLC's financial statements (the "financial statements"):

- give a true and fair view of the state of the Company's affairs as at 31 January 2017 and of its profit 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.

What we have audited

The financial statements, included within the Annual Report comprise:

- the Balance Sheet as at 31 January 2017;
- the Income Statement for the year then ended;
- the Cash Flow Statement for the year then ended;
- the Statement of Changes in Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

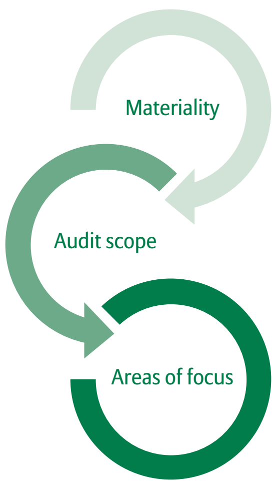
The financial reporting framework that has been applied in the preparation of the financial statements is United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law (United Kingdom Generally Accepted Accounting Practice).

Our audit approach

Context

The Merchants Trust PLC is an Investment Trust Company listed on the London Stock Exchange and invests primarily in UK equities. The operations of the Company are located in the UK. We focus our audit work primarily on the valuation and existence of investments and income.

Overview



- Overall materiality: £5.5m which represents 1% of Net Assets.

- The Company is a standalone Investment Trust Company and engages Allianz Global Investors GmbH (the "Manager") to manage its assets.
- We conducted our audit of the financial statements using information from Bank of New York Mellon (the "Administrator") to whom the Manager has, with the consent of the Directors, delegated the provision of certain administrative functions.
- We tailored the scope of our audit taking into account the types of investments within the Company, the involvement of the third parties referred to above, the accounting processes and controls, and the industry in which the Company operates.

- Valuation and existence of investments.
- Income.

Independent Auditors' Report to the members of The Merchants Trust PLC *(continued)*

The scope of our audit and our areas of focus
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)").

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as "areas of focus" in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

Area of focus	How our audit addressed the area of focus
Valuation and existence of investments Refer to page 46 (Audit Committee Report), page 63 (Accounting Policies) and page 69 (notes). The investment portfolio at the year-end principally comprised listed equity investments. We focused on the valuation and existence of investments because investments represent the principal element of the net asset value as disclosed on the Balance Sheet in the financial statements.	We tested the valuation of the listed equity investments by agreeing the prices used in the valuation to independent third party sources. No misstatements were identified by our testing which required reporting to those charged with governance. We tested the existence of the investments by agreeing the holdings for investments to an independent custodian confirmation. No differences were identified by our testing which required reporting to those charged with governance.
Income Refer to page 46 (Audit Committee Report), page 62 (Accounting Policies) and page 65 (notes). We focused on the accuracy and completeness of income recognition and its presentation in the Income Statement as set out in the requirements of The Association of Investment Companies Statement of Recommended Practice (the "AIC SORP"). This is because incomplete or inaccurate dividend income could have a material impact on the Company's net asset value and dividend cover.	We assessed the accounting policy for income recognition for compliance with accounting standards and the AIC SORP and performed testing to check that income had been accounted for in accordance with this stated accounting policy. We found that the accounting policies implemented were in accordance with accounting standards and the AIC SORP, and that income has been accounted for in accordance with the stated accounting policy. In addition, we tested dividend receipts by agreeing the dividend rates from investments to independent third party sources. No misstatements were identified which required reporting to those charged with governance. To test for completeness, we tested that the appropriate dividends had been received in the year by reference to independent data of dividends declared by investment holdings in the portfolio. Our testing did not identify any unrecorded dividends. We tested the allocation and presentation of dividend income between the revenue and capital return columns of the Income Statement in line with the requirements set out in the AIC SORP. We then tested the validity of revenue and capital special dividends to independent third party sources. We did not find any special dividends that were treated incorrectly in accordance with the AIC SORP.

Independent Auditors' Report to the members of The Merchants Trust PLC *(continued)*

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Company, the accounting processes and controls, and the industry in which the Company operates.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall materiality	£5.5m (2016: £4.9m).
How we determined it	1% of Net Assets.
Rationale for benchmark applied	We have applied this benchmark, which is a generally accepted auditing practice for investment trust audits.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £272k (2016: £249k) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

Under the Listing Rules we are required to review the Directors' statement, set out on page 36, in relation to going concern. We have nothing to report having performed our review. Under ISAs (UK & Ireland) we are also required to report to you if we have anything material to add or to draw attention to in relation to the Directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. We have nothing material to add or to draw attention to.

As noted in the Directors' statement, the Directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. The going concern basis presumes that the Company has adequate resources to remain in operation, and that the Directors intend it to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the Directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Company's ability to continue as a going concern.

Other required reporting

Consistency of other information and compliance with applicable requirements

Companies Act 2006 reporting

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

Independent Auditors' Report to the members of The Merchants Trust PLC *(continued)*

ISAs (UK & Ireland) reporting

As a result of the directors' voluntary reporting on how they have applied the Code, under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

Information in the Annual Report is: ▪ materially inconsistent with the information in the audited financial statements; or ▪ apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Company acquired in the course of performing our audit; or ▪ otherwise misleading.	We have no exceptions to report.
The statement given by the directors on page 43, in accordance with provision C.1.1 of the Code, that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Company acquired in the course of performing our audit.	We have no exceptions to report.
The section of the Annual Report on page 45, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report.

The directors' assessment of the prospects of the Company and of the principal risks that would threaten the solvency or liquidity of the Company

As a result of the directors' voluntary reporting on how they have applied the Code, under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to:

The directors' confirmation on page 17 of the Annual Report, in accordance with provision C.2.1 of the Code, that they have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity.	We have nothing material to add or to draw attention to.
The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.	We have nothing material to add or to draw attention to.
The directors' explanation on page 18 of the Annual Report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the Company, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or to draw attention to.

Adequacy of accounting records and information and explanations received

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

- we have not received all the information and explanations we require for our audit; or
- 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.

We have no exceptions to report arising from this responsibility.

Independent Auditors' Report to the members of The Merchants Trust PLC *(continued)*

Directors' remuneration

Directors' remuneration report - Companies Act 2006 opinion

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other Companies Act 2006 reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 44, 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 ISAs (UK & 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.

What an audit of financial statements involves

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.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

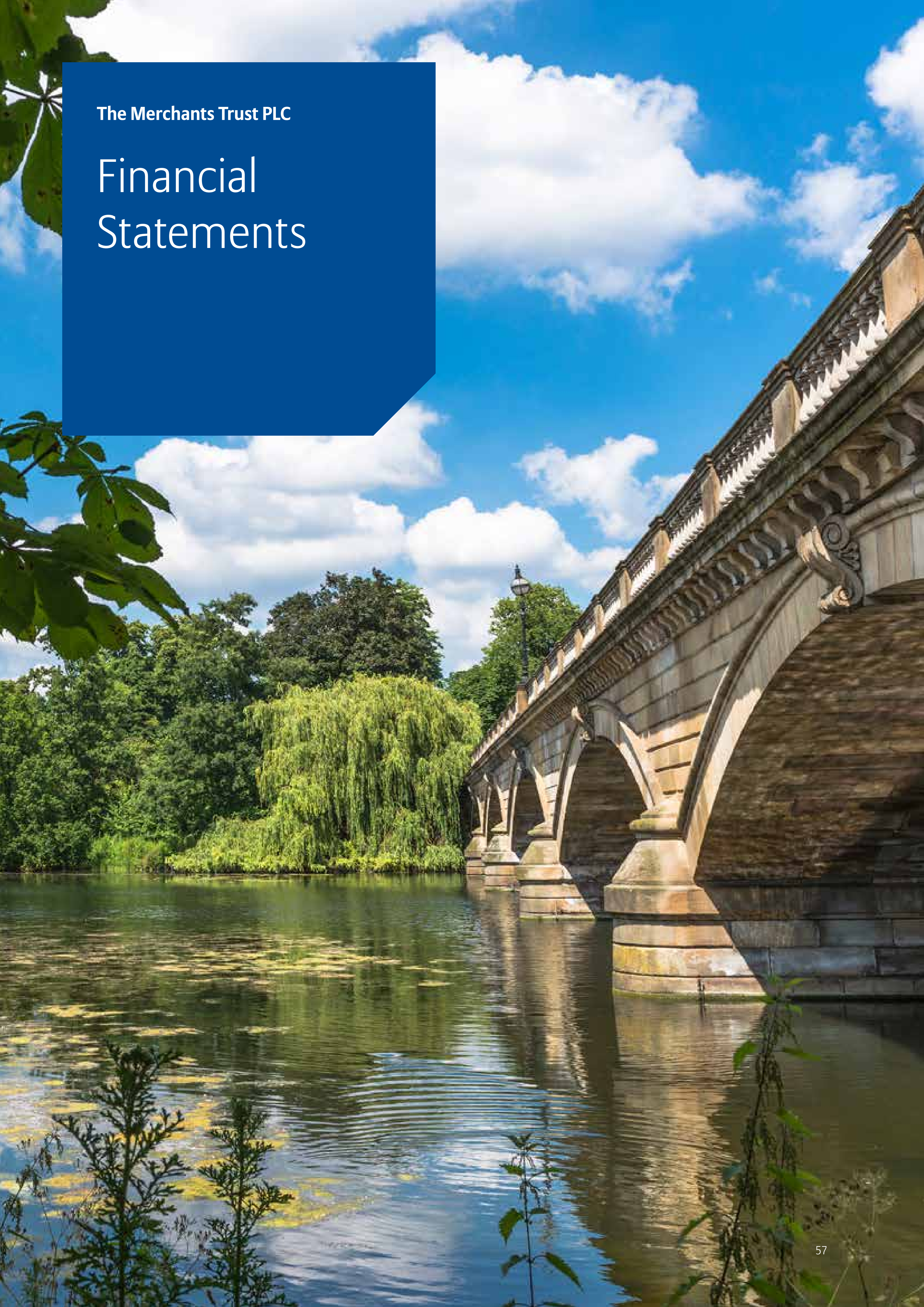
We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.

Jeremy Jensen (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors, London
27 March 2017

The Merchants Trust PLC

Financial Statements



Income Statement

for the year ended 31 January 2017

	Notes	2017 Revenue £	2017 Capital £	2017 Total Return £	2016 Revenue £	2016 Capital £	2016 Total Return £
Gains (losses) on investments held at fair value through profit or loss	8	-	54,569,087	54,569,087	-	(56,416,352)	(56,416,352)
Gains on foreign currencies		-	10,785	10,785	-	-	-
Income	1	31,123,179	-	31,123,179	30,984,794	-	30,984,794
Investment management fee	2	(773,904)	(1,437,251)	(2,211,155)	(795,370)	(1,477,115)	(2,272,485)
Administration expenses	3	(868,194)	(1,410)	(869,604)	(739,253)	(44)	(739,297)
Profit (loss) before finance costs and taxation		**29,481,081**	**53,141,211**	**82,622,292**	**29,450,171**	**(57,893,511)**	**(28,443,340)**
Finance costs: interest payable and similar charges	4	(3,320,438)	(6,085,717)	(9,406,155)	(3,304,965)	(6,057,941)	(9,362,906)
Profit (loss) on ordinary activities before taxation		**26,160,643**	**47,055,494**	**73,216,137**	**26,145,206**	**(63,951,452)**	**(37,806,246)**
Taxation	5	-	-	-	-	-	-
Profit (loss) after taxation attributable to ordinary shareholders		**26,160,643**	**47,055,494**	**73,216,137**	**26,145,206**	**(63,951,452)**	**(37,806,246)**
Earnings (loss) per ordinary share (basic and diluted)	7	**24.06p**	**43.28p**	**67.34p**	**24.05p**	**(58.82p)**	**(34.77p)**

Dividends in respect of the financial year ended 31 January 2017 total 24.20p (2016 - 24.00p), amounting to £26,312,288 (2016 - £26,094,832). Details are set out in Note 6 on page 68.

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.

The profit for the year disclosed above represents the company's total comprehensive income.

The Notes on pages 62 to 81 form an integral part of these financial statements.

Statement of Changes in Equity

for the year ended 31 January 2017

	Notes	Called up Share Capital £	Share Premium Account £	Capital Redemption Reserve £	Capital Reserve £	Revenue Reserve £	Total Shareholders Funds £
Net assets at 1 February 2016		27,182,116	33,717,572	292,853	412,304,076	24,611,248	498,107,865
Revenue profit		-	-	-	-	26,160,643	26,160,643
Dividends on ordinary shares	6	-	-	-	-	(26,094,832)	(26,094,832)
Unclaimed Dividends		-	-	-	-	88,380	88,380
Capital profit		-	-	-	47,055,494	-	47,055,494
Net assets at 31 January 2017		**27,182,116**	**33,717,572**	**292,853**	**459,359,570**	**24,765,439**	**545,317,550**
Net assets at 1 February 2015		27,182,116	33,717,572	292,853	476,255,528	24,560,874	562,008,943
Revenue profit		-	-	-	-	26,145,206	26,145,206
Dividends on ordinary shares	6	-	-	-	-	(26,094,832)	(26,094,832)
Capital loss		-	-	-	(63,951,452)	-	(63,951,452)
Net assets at 31 January 2016		**27,182,116**	**33,717,572**	**292,853**	**412,304,076**	**24,611,248**	**498,107,865**

The Notes on pages 62 to 81 form an integral part of these financial statements.

Balance Sheet

as at 31 January 2017

	Notes	2017 £	2017 £	2016 £
Fixed Assets				
Investments held at fair value through profit or loss	8		643,432,401	603,369,373
Current Assets				
Other receivables	10	504,132		946,814
Cash and cash equivalents		14,484,822		6,457,992
		14,988,954		**7,404,806**
Current Liabilities				
Other payables	10	(36,996,999)		(2,189,728)
Derivative financial instruments	8	(85,100)		(214,350)
		(37,082,099)		**(2,404,078)**
Net current (liabilities) assets			(22,093,145)	5,000,728
Total assets less current liabilities			**621,339,256**	**608,370,101**
Creditors: amounts falling due after more than one year	11		(76,021,706)	(110,262,236)
Total net assets			**545,317,550**	**498,107,865**
Capital and Reserves				
Called up share capital	12		27,182,116	27,182,116
Share premium account	13		33,717,572	33,717,572
Capital redemption reserve	13		292,853	292,853
Capital reserve	13		459,359,570	412,304,076
Revenue reserve	13		24,765,439	24,611,248
Equity shareholders' funds	**14**		**545,317,550**	**498,107,865**
Net asset value per ordinary share	**14**		**501.5p**	**458.1p**

The financial statements of The Merchants Trust PLC on pages 58 to 61 were approved and authorised for issue by the board of directors on 27 March 2017 and signed on its behalf by:

Simon Fraser
Chairman

The Notes on pages 62 to 81 form an integral part of these financial statements.

Cash Flow Statement

for the year ended 31 January 2017

	Notes	2017 £	2016 £
Operating activities			
Profit (loss) before finance costs and taxation		82,622,292	(28,443,340)
Less: (Gains) losses on investments at fair value		(54,569,087)	56,416,352
Less: Gains on foreign currency		(10,785)	-
Purchase of fixed asset investments held at fair value through profit or loss		(115,799,369)	(138,769,318)
Sales of fixed asset investments held at fair value through profit or loss		130,849,550	144,260,526
Decrease in other receivables		442,682	105,064
Increase (decrease) in other payables		87,656	(80,030)
Net cash inflow from operating activities		**43,622,939**	**33,489,254**
Financing activities			
Interest paid		(9,557,445)	(9,547,920)
Dividends paid on cumulative preference stock	4	(42,997)	(42,997)
Dividends paid on ordinary shares	6	(26,094,832)	(26,094,832)
Unclaimed dividends		88,380	-
Net cash outflow from financing activities		**(35,606,894)**	**(35,685,749)**
Increase (decrease) in cash and cash equivalents		**8,016,045**	**(2,196,495)**
Cash and cash equivalents at the start of the year		6,457,992	8,654,487
Effect of foreign exchange rates		10,785	-
Cash and cash equivalents at the end of the year		14,484,822	6,457,992
Comprised of:			
Cash at bank		14,484,822	6,457,992

* Cash inflow from dividends was on £30,624,230 (2016 - £30,074,093) and cash inflow from interest was £6,433 (2016 - £99).

The Notes on pages 62 to 81 form an integral part of these financial statements.

Statement of Accounting Policies

for the year ended 31 January 2017

The company is incorporated in the United Kingdom under the Companies Act.

The company is a public company limited by shares and is registered in England and Wales. The address of the company's registered office is shown on page 35.

The principal activity of the company and the nature of its operations are set out in the strategic report on pages 12 to 18. The company conducts its business so as to qualify as an investment trust company within the meaning of sub-section 1158 of the Corporation Tax Act 2010.

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and to the preceding year.

1 Basis of preparation – The financial statements have been prepared under the historical cost convention, except for the revaluation of financial instruments held at fair value through profit or loss and in accordance with applicable United Kingdom law and UK Accounting Standards (UK GAAP), including Financial Reporting Standard 102 – the Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland (FRS 102) and in line with the Statement of Recommended Practice "Financial Statements of Investment Trust Companies and Venture Capital Trusts" issued by the Association of Investment Companies (AIC SORP) in November 2014.

Investments and derivative financial instruments are designated as held at fair value through profit or loss in accordance with FRS 102 sections 11 and 12.

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 revenue and capital nature has been presented alongside the Income Statement. In accordance with the company's Articles of Association, net capital returns may be distributed by way of dividend.

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 Strategic Report on pages 12 to 18.

2 Income – Dividends received on equity shares are accounted for on an ex-dividend basis. UK dividends received up to 5 April 2016 are shown net of tax credits. Dividends received after 5 April 2016 will no longer be accompanied by a tax credit. Foreign dividends are grossed up at the appropriate rate of withholding tax.

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 reviews 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 is 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 shares underwritten is recognised as capital, with the balance recognised as revenue.

3 Investment management fees and administrative 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.

Statement of Accounting Policies *(continued)*

for the year ended 31 January 2017

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 102 Section 11: 'Basic Financial Instruments' and Section 12: 'Other Financial Instruments'. 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.

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 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 the financial assets are recognised on the trade date, being the date which the company commits to purchase or sell the assets.

Unlisted investments are valued by the Directors based upon the latest dealing prices, stockbrokers' valuations, net asset values, earnings and other known accounting information in accordance with the principles set out by the International Private Equity and Venture Capital Valuation Guidelines issued in December 2015.

After initial recognition unquoted stocks are valued by the board on an annual basis.

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. In accordance with FRS 102 Section 12: 'Other Financial Instruments', options are valued at fair value and are included in current assets or current liabilities in the balance sheet. 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. Premiums received on written options are amortised to revenue over the period to expiry. If an option is exercised early unamortised premiums are taken to capital.

6 **Finance costs** – In accordance with the FRS 102 Section 11: 'Basic Financial Instruments' and Section 12 'Other Financial Instruments', 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 102 Section 30: 'Foreign Currency Translation', the company is required to nominate a functional currency, being the currency in which the company predominately operates and in which its expenses are generally paid. The functional and reporting currency is pounds sterling. Transactions in foreign currencies are translated into pounds sterling at the rates of exchange ruling on the date of the transaction. Foreign currency monetary assets and liabilities are translated into sterling at

Statement of Accounting Policies *(continued)*

for the year ended 31 January 2017

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 102 Section 32: 'Events After the End of the Reporting Period', the final dividend proposed on ordinary shares is recognised as a liability when approved by shareholders. Interim dividends are recognised only when paid. Dividends are paid from the revenue reserve.

10 **Shares repurchased for cancellation and for holding in treasury** – 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.

For shares repurchased for holding in treasury, the full cost is charged to the capital reserve.

11 **Shares sold (reissued) from treasury** – Proceeds received from the sale of shares held in treasury are treated as realised profits in accordance with Section 731 of the Companies Act 2006. Proceeds equivalent to the original cost, calculated by applying a weighted average price, are credited to the capital reserve to replenish the profits available for distribution; proceeds in excess of the original cost are credited to the share premium account.

12 **Shares issued** – Share capital is increased by the nominal value of shares issued. The proceeds in excess of the nominal value of shares net of expenses are allocated to the share premium account.

13 **Significant judgements, estimates and assumptions** – In the application of the company's accounting policies, which are described above, the directors are required to make judgements, estimates, and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. These estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from the estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Notes to the Financial Statements

for the year ended 31 January 2017

1. Income

	2017 £	2016 £
Income from Investments*		
Equity dividends from UK investments #	29,040,234	29,086,457
Unfranked dividends from UK investments	525,920	492,498
Equity dividends from overseas investments	610,098	390,041
	30,176,252	**29,968,996**
Other Income		
Deposit interest	6,433	99
Premiums on derivative contracts	880,863	935,868
Underwriting commission	59,631	79,831
	946,927	**1,015,798**
Total income	**31,123,179**	**30,984,794**

* All equity income is derived from listed investments.
# Includes special revenue dividends of £1,038,910 (2016 - £315,597).

During the year, the company received premiums totalling £851,571 (2016 - £945,609) for writing covered call options for the purpose of revenue generation. Premium income of £880,863 was amortised to income (2016 - £935,868). All derivatives transactions were based on FTSE 100 stocks or the related index. At the year end there were five open positions with a net liability value of £85,100 (2016 - £214,350).

2. Investment Management Fee

	2017 Revenue £	2017 Capital £	2017 Total £	2016 Revenue £	2016 Capital £	2016 Total £
Investment management fee	773,904	1,437,251	2,211,155	795,370	1,477,115	2,272,485
Total	**773,904**	**1,437,251**	**2,211,155**	**795,370**	**1,477,115**	**2,272,485**

Under the terms of the Management and Administration Agreement the company's manager is Allianz Global Investors Europe GmbH, UK branch (AllianzGI). The agreement was restated in July 2014, with the appointment of AllianzGI as the Alternative Investment Fund Manager. The terms of the agreement were unchanged: it provides for a management fee based on 0.35% (2016 - 0.35%) per annum of the value of the assets after deduction of current liabilities, short term loans with an initial duration of less than one year and other funds managed by AllianzGI. Under the contract, AllianzGI provides the company with investment management, accounting, company secretarial and administration services.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

3. Administration Expenses

	2017 £	2016 £
Auditors' remuneration		
For audit services	27,400	31,000
Other services - for certification of loan covenants	4,600	4,600
VAT on auditors' remuneration	6,400	7,120
	38,400	**42,720**
Directors' fees	143,500	137,500
Marketing costs	303,064	217,559
Other administration expenses	383,230	341,474
	868,194	**739,253**

(i) The above expenses include value added tax where applicable.
(ii) Directors' fees are set out in the Directors' Remuneration Report on page 49.
(iii) Custody handling charges of £1,410 were charged to capital (2016 - £44).
(iv) 78% of marketing costs are payable to AllianzGI (2016 – 88%).

4. Finance Costs: Interest Payable and Similar Charges

	2017 Revenue £	2017 Capital £	2017 Total £	2016 Revenue £	2016 Capital £	2016 Total £
On Stepped Rate Interest Loan repayable:						
within one year	1,343,604	2,495,264	3,838,868	-	-	-
in one to five years	-	-	-	1,328,890	2,467,939	3,796,829
On Fixed Rate Interest Loan repayable after more than five years	1,284,845	2,386,141	3,670,986	1,286,046	2,388,371	3,674,417
On 4% Perpetual Debenture Stock repayable after more than five years	19,184	35,628	54,812	19,250	35,750	55,000
On 5.875% Secured Bonds repayable after more than five years	629,292	1,168,684	1,797,976	627,782	1,165,881	1,793,663
On 3.65% Preference Stock repayable after more than five years	42,997	-	42,997	42,997	-	42,997
On Sterling overdraft	516	-	516	-	-	-
	3,320,438	**6,085,717**	**9,406,155**	**3,304,965**	**6,057,941**	**9,362,906**

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

5. Taxation

	2017 Revenue £	2017 Capital £	2017 Total £	2016 Revenue £	2016 Capital £	2016 Total £
Overseas taxation	-	-	-	-	-	-
Total tax	-	-	-	-	-	-

Reconciliation of tax charge						
Profit (loss) before taxation	26,160,643	47,055,494	73,216,137	26,145,206	(63,951,452)	(37,806,246)
Tax on profit (loss) at 20.00% (2016 - 20.16%)	5,232,129	9,411,099	14,643,228	5,270,874	(12,892,613)	(7,621,739)
Effects of						
Non taxable income	(5,930,067)	-	(5,930,067)	(5,942,462)	-	(5,942,462)
Non taxable capital (gains) losses	-	(10,915,974)	(10,915,974)	-	11,373,537	11,373,537
Disallowable expenses	9,524	1,999	11,523	8,914	448	9,362
Excess of allowable expenses over taxable income	688,414	1,502,876	2,191,290	662,674	1,518,628	2,181,302
Total tax	-	-	-	-	-	-

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 2017, the company had accumulated surplus expenses of £205.3 million (2016 - £194.3 million).

The company has not recognised a deferred tax asset of £34.9 million (2016 - £35.0 million) in respect of these expenses, based on a prospective corporation tax rate of 17% (2016 – 18%) because there is no reasonable prospect of recovery. The reduction in the standard rate of corporation tax was substantively enacted on 15 September 2016 and is effective from 1 April 2020. 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.

In May 2013 the company received confirmation from HM Revenue & Customs of its status as an approved investment trust for accounting periods commencing on or after 1 February 2012, subject to the company continuing to meet the eligibility conditions of Section 1158 Corporation Tax Act 2010 and the ongoing requirements for approved companies in Chapter 3 of Part 2 Investment Trust (Approved Company) Tax Regulations 2011 (Statutory Instrument 2011/2999). The company intends to retain this approval and self-assesses compliance with the relevant conditions and requirements.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

6. Dividends on Ordinary Shares

	2017 £	2016 £
Dividends on Ordinary Shares of 25p		
Third interim dividend 6.0p paid 24 February 2016 (2016 - 6.0p)	6,523,708	6,523,708
Final dividend 6.0p paid 26 May 2016 (2016 - 6.0p)	6,523,708	6,523,708
First interim dividend 6.0p paid 12 August 2016 (2016 - 6.0p)	6,523,708	6,523,708
Second interim dividend 6.0p paid 10 November 2016 (2016 - 6.0p)	6,523,708	6,523,708
	26,094,832	26,094,832

Dividends payable at the year end are not recognised as a liability under FRS 102 Section 32 'Events After the End of the Reporting Period' (see page 64 - Statement of Accounting Policies). Details of these dividends are set out below.

	2017 £	2016 £
Third interim dividend 6.1p paid 23 February 2017 (2016 - 6.0p)	6,632,436	6,523,708
Final proposed dividend 6.1p payable 18 May 2017 (2016 - 6.0p)	6,632,436	6,523,708
	13,264,872	13,047,416

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 changes in the share capital between the year end and the record date.

All dividends disclosed in the tables above have been paid or are payable from the revenue reserves.

7. Earnings (loss) per Ordinary Share

	2017 Revenue £	2017 Capital £	2017 Total Return £	2016 Revenue £	2016 Capital £	2016 Total Return £
Profit (loss) after taxation attributable to ordinary shareholders	26,160,643	47,055,494	73,216,137	26,145,206	(63,951,452)	(37,806,246)
Earnings (loss) per ordinary share (basic and diluted)	**24.06p**	**43.28p**	**67.34p**	**24.05p**	**(58.82p)**	**(34.77p)**

The earnings (loss) per ordinary share is based on a weighted number of shares 108,728,464 (2016 - 108,728,464) ordinary shares in issue.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

8. Fixed Asset Investments

	2017 £	2016 £
Listed on the London Stock Exchange at market valuation	643,404,432	603,341,404
Unlisted at fair value (see Note 9)	27,969	27,969
Fixed asset investments	**643,432,401**	**603,369,373**
Derivative financial instruments - written call options	(85,100)	(214,350)
Total investments	**643,347,301**	**603,155,023**
Market value of investments brought forward	603,155,023	665,745,387
Investment holding losses (gains) brought forward	14,074,117	(68,284,965)
Derivative holding losses brought forward	70,268	175,355
Cost of investments held brought forward	**617,299,408**	**597,635,777**
Additions at cost	116,472,741	138,086,514
Disposals at cost	(116,648,589)	(118,422,883)
Cost of investments held at 31 January	**617,123,560**	**617,299,408**
Investment holding gains (losses) at 31 January	26,192,327	(14,074,117)
Derivative holding gains (losses) at 31 January	31,414	(70,268)
Market value of investments held at 31 January	**643,347,301**	**603,155,023**

Gains (losses) on investments

Gains on sales of investments based on historical costs	11,472,893	25,305,862
Adjustment for investment holding gains recognised in previous years	8,221,708	32,811,756
Gains on sales of fixed asset investments based on carrying value at previous balance sheet date	**19,694,601**	**58,117,618**
Losses on derivative financial instruments	(886)	(19,104)
Gains on sales of investments based on carrying value at previous balance sheet date	**19,693,715**	**58,098,514**
Investment holding gains (losses) arising in the year	32,044,736	(115,170,838)
Special dividends credited to capital	2,728,954	550,885
Derivative holding gains arising in the year	101,682	105,087
Gains (losses) on investments	**54,569,087**	**(56,416,352)**

The board considers that the company's unlisted investment is not material to the financial statements. No material disposals of unlisted investments took place during the year (2016 - none).

Transaction costs and stamp duty on purchases amounted to £651,785 (2016 - £779,462) and transaction costs on sales amounted to £93,688 (2016 - £119,929).

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

9. Investments in Other Companies

The company held more than 3% 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	Fair value £	% Equity
First Debenture Finance PLC (FDF)	'A' Shares	47	50.0
	'B' Shares	71	50.0
	'C' Shares	23,244	50.0
	'D' Shares	121	50.0
Fintrust Debenture PLC (Fintrust)	Ordinary Shares	4,486	50.0
Total		**27,969**	

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 FDFs 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 102 Section 14 and are therefore included in the Balance Sheet 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 11(i) and 11(ii), respectively. Apart from the finance costs, there were no other transactions between FDF, Fintrust and the company during the year.

10. Other Receivables and Other Payables

		2017 £	2016 £
Other receivables			
Prepayments		30,777	25,480
Accrued income		473,355	921,334
		504,132	**946,814**
Other payables: Amounts falling due within one year			
Purchases for future settlement		673,372	-
Stepped Rate Interest Loan	11(i)	34,034,109	-
Other payables		975,882	888,226
Interest on borrowings		1,313,636	1,301,502
		36,996,999	**2,189,728**
Interest on outstanding borrowing consists of:			
Stepped Rate Interest Loan		313,728	295,963
Fixed Rate Interest Loan		779,240	783,545
5.875% Secured Bonds 2029		207,105	208,243
4% Perpetual Debenture Stock		13,563	13,751
		1,313,636	**1,301,502**

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

11. Creditors: Amounts falling due after more than one year

		2017 £	2016 £
Creditors: Amounts falling due after more than one year			
Stepped Rate Interest Loan	11(i)	-	34,034,109
Fixed Rate Interest Loan	11(ii)	44,150,818	44,393,553
5.875% Secured Bonds 2029	11(iii)	29,317,888	29,281,574
4% Perpetual Debenture Stock	11(iv)	1,375,000	1,375,000
3.65% Cumulative Preference Stock	11(v)	1,178,000	1,178,000
		76,021,706	**110,262,236**

(i) The Stepped Rate Interest Loan of £34,034,109 (2016- £34,034,109) 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 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.

(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 11(i) above.

The loan of £30,000,000 taken out in 1993 is stated at £29,933,747 (2016 - £29,920,542), being the net proceeds of £29,858,947 plus accrued finance cost of £74,800 (2016 - £61,595). The effective interest rate of this portion of the loan is 9.51%.

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 2017, the loan is stated at £14,217,071 (2016 - £14,473,011), being the principal amount of £12,000,000 plus the unamortised premium of £2,217,071 (2016 - £2,473,011). The effective interest rate of this portion of the loan is 6.00%.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

(iii) The £30,000,000 of 5.875% Secured Bonds is stated at £29,317,888 (2016 - £29,281,574), being the net proceeds of £28,942,800 plus accrued finance costs of £375,088 (2016 - £338,774). 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 and 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 notes 11(i) and 11(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 FRS 102 Section 11: 'Basic Financial Instruments' and Section 12: 'Other Financial Instruments'. The right of the preference stock holders to receive payments is not calculated by reference to the company's profit 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 February and 1 August each year. The preference stock is non-redeemable.

12. Called up Share Capital

	2017 £	2016 £
Allotted and fully paid		
108,728,464 ordinary shares of 25p (2016 - 108,728,464)	27,182,116	27,182,116

The directors are authorised by an ordinary resolution passed on 24 May 2016 to allot relevant securities, in accordance with section 551 on the Companies Act 2006, up to a maximum of 36,242,821 ordinary shares of 25p each. This authority expires on 16 May 2017 and accordingly a renewed authority will be sought at the annual general meeting on 16 May 2017.

No ordinary shares were issued or repurchased during the year and no shares have been issued or repurchased since the year end.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

13. Reserves

	Share Premium Account £	Capital Redemption Reserve £	Capital Reserve: Gains (Losses) on sales of Investments £	Capital Reserve: Investment Holding Gains (Losses) £	Revenue Reserve £
Balance at 1 February 2016	33,717,572	292,853	426,448,461	(14,144,385)	24,611,248
Gains on sales of fixed asset investments	-	-	19,694,601	-	-
Losses on derivative financial instruments	-	-	(886)	-	-
Movement in fixed asset investment holding gains	-	-	-	32,044,736	-
Movement in derivative holding gains	-	-	-	101,682	-
Special dividends	-	-	2,728,954	-	-
Unclaimed dividends	-	-	-	-	88,380
Gains on foreign currencies	-	-	-	10,785	-
Transfer on sale of investments	-	-	(8,221,708)	8,221,708	-
Investment management fee	-	-	(1,437,251)	-	-
Finance costs of borrowings	-	-	(6,085,717)	-	-
Other capital expenses	-	-	(1,410)	-	-
Dividends appropriated in the year	-	-	-	-	(26,094,832)
Profit retained for the year	-	-	-	-	26,160,643
Balance at 31 January 2017	**33,717,572**	**292,853**	**433,125,044**	**26,234,526**	**24,765,439**

Distributions can be made from both the capital and revenue reserves. All paid or payable dividends for the year are payable from the revenue reserve (2016 - same).

14. Net Asset Value per Ordinary Share

	Net Asset Value per share attributable 2017	2016
Ordinary shares of 25p	**501.5p**	**458.1p**

	Net Asset Value attributable 2017	2016
Ordinary shares of 25p	**£545,317,550**	**£498,107,865**

The net asset value per ordinary share is based on 108,728,464 ordinary shares in issue at the year end (2016 - 108,728,464).

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

15. Contingent Liabilities and Commitments

At 31 January 2017 there were no contingent liabilities (2016 - £Nil).

Details of the guarantee provided by the company as part of the terms of the Loans are provided in Note 11(i), 11(ii) and 11(iii) Creditors: Amounts falling due after more than one year on pages 71 and 72.

16. Financial Risk Management Policies and Procedures

The company invests in equities and other investments in accordance with its investment objective as stated in the strategic report on page 12. 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 risk (comprising market price risk, market yield risk, foreign currency risk, interest rate risk), liquidity risk and credit risk. The directors' approach to the management of these risks is set out below. The directors determine the objectives and agree policies for managing each of these risks, as set out below. The 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 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 (price and yield), 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. An analysis of the company's portfolio is shown on pages 28 to 31.

Changes 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 17 on pages 80 and 81. 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 2017 was as follows:

	2017 £	2016 £
Listed investments held at fair value through profit or loss	643,404,432	603,341,404
Derivative financial instruments - written call options	(85,100)	(214,350)
Total listed investments	**643,319,332**	**603,127,054**

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

The following illustrates the sensitivity of the return and the net assets to an increase or decrease of 20% (2016: 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 profit 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 balance sheet date and the consequent impact on the investment management fees for the year, with all other variables held constant.

	2017 20% Increase in fair value £	2017 20% Decrease in fair value £	2016 20% Increase in fair value £	2016 20% Decrease in fair value £
Revenue earnings				
Investment management fees	(157,634)	157,634	(147,819)	147,819
Capital earnings				
Gains (losses) on investments at fair value	128,663,866	(128,663,866)	120,625,411	(120,625,411)
Investment management fees	(292,749)	292,749	(274,520)	274,520
Change in net earnings and net assets	**128,213,483**	**(128,213,483)**	**120,203,072**	**(120,203,072)**

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 fund 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.

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 28 and 29. 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. No put options were purchased in the year (see Note 1 on page 65 for detail of income received).

Further explanation of the derivatives strategy is included in the Manager's review on page 25.

Management of market yield risk

The directors regularly review the current and projected yield of the investment portfolio, and discuss with the 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 (2016 - no significant exposure).

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

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

(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.

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.

	2017 Fixed rate interest £	2017 Floating rate interest £	2017 Nil interest £	2017 Total £	2016 Fixed rate interest £	2016 Floating rate interest £	2016 Nil interest £	2016 Total £
Financial assets	-	14,484,822	643,432,401	657,917,223	-	6,457,992	603,369,373	609,827,365
Financial liabilities	(76,021,706)	-	(85,100)	(76,106,806)	(110,262,236)	-	(214,350)	(110,476,586)
Net financial (liabilities) assets	**(76,021,706)**	**14,484,822**	**643,347,301**	**581,810,417**	**(110,262,236)**	**6,457,992**	**603,155,023**	**499,350,779**
Short term receivables and payables				(36,492,867)				(1,242,914)
Net assets per balance sheet				**545,317,550**				**498,107,865**

As at 31 January 2017, the interest rates received on cash balances or paid on bank overdrafts, was nil and 1.10% per annum respectively (2016 - nil and 1.35% per annum).

The fixed rate interest bearing liabilities bear the following coupon and effective rates as at 31 January 2017 and 31 January 2016.

	Maturity date	Amount borrowed £	Coupon rate	Effective rate since inception*
First Debenture Finance PLC (FDF) - Bonds	02/01/2018	20,534,079	14.75%	11.28%
First Debenture Finance PLC (FDF) - Notes	02/01/2018	5,133,520	14.75%	11.28%
Fintrust Debenture PLC (Fintrust) - Original Loan	20/05/2023	30,000,000	9.25125%	9.51%
Fintrust Debenture PLC (Fintrust) - Additional Loan	20/05/2023	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 102 Section 12: 'Other Financial Instruments' as detailed in the Statement of Accounting Policies on page 63.

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% (2016 - 8.54%) and the weighted average period to maturity of these liabilities is 7.2 years (2016 - 8.2 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 profit and net assets, are not significantly affected by changes in interest rates.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

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 2017, 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 earnings and long term borrowings which are subject to fixed rates. Movement in interest rates will not have a material effect on the finance costs and financial liabilities of the company 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 11 on pages 71 and 72. The loans are each governed by a trust deed. 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.

2017	Three months or less £	Between three months and one year £	Between one and five years £	More than five years £	Total £
Other payables					
Amounts payable on maturity of borrowings	-	34,034,109	-	-	34,034,109
Finance costs of borrowing	-	9,510,471	-	-	9,510,471
Other payables	1,649,254	-	-	-	1,649,254
Derivative financial instruments	85,100	-	-	-	85,100
Creditors - amounts falling due after more than one year					
Amounts payable on maturity of borrowings	-	-	-	74,553,000	74,553,000
Finance cost of borrowings	-	-	22,985,288	21,435,891	44,421,179
	1,734,354	43,544,580	22,985,288	95,988,891	164,253,113

2016	Three months or less £	Between three months and one year £	Between one and five years £	More than five years £	Total £
Other payables					
Finance costs of borrowing	-	9,510,471	-	-	9,510,471
Other payables	888,226	-	-	-	888,226
Derivative financial instruments	214,350	-	-	-	214,350
Creditors - amounts falling due after more than one year					
Amounts payable on maturity of borrowings	-	-	34,034,109	74,553,000	108,587,109
Finance costs of borrowing	-	-	26,770,936	27,084,216	53,855,152
	1,102,576	9,510,471	60,805,045	101,637,216	173,055,308

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

Management of liquidity risk

Liquidity risk is not significant as the company's assets mainly comprise of 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 2017, the company had an undrawn committed borrowing facility of £10 million (2016 - £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. There were no impaired assets as of 31 January 2017 (31 January 2016 - nil). The counterparties the company engages with are regulated entities and are of high credit quality.

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 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:

	2017 £	2016 £
Other Receivables		
Prepayments	30,777	25,480
Accrued income	473,355	921,334
	504,132	**946,814**
Cash and cash equivalents	14,484,822	6,457,992
Total	**14,988,954**	**7,404,806**

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

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*:

	2017 Book value# £	2017 Fair value* £	2016 Book value# £	2016 Fair value* £
Stepped Rate Interest Loan	34,347,837	37,065,348	34,330,072	39,216,899
Fixed Rate Interest Loan	44,930,058	58,221,410	45,177,098	57,036,734
5.875% Secured Bonds 2029	29,524,993	37,913,338	29,489,817	35,368,040
4% Perpetual Debenture Stock	1,388,563	1,538,674	1,388,751	1,210,028
3.65% Cumulative Preference Stock	1,178,000	1,219,489	1,178,000	959,031
	111,369,451	**135,958,259**	**111,563,738**	**133,790,732**

The net asset value per ordinary share, with debt at fair value is calculated as follows:

	2017 £	2016 £
Net assets per balance sheet	545,317,550	498,107,865
Add: financial liabilities at book value#	111,369,451	111,563,738
Less: financial liabilities at fair value *	(135,958,259)	(133,790,732)
Net assets (debt at fair value)	**520,728,742**	**475,880,871**
Net asset value per ordinary share (debt at fair value)	**478.9p**	**437.7p**

* The fair value has been derived from the closing market value as at 31 January 2017 and 31 January 2016.
# Book value, par value and amortised cost are used interchangeably throughout this Annual Report.

The net asset value per ordinary share is based on 108,728,464 ordinary shares in issue at 31 January 2017 (2016 - 108,728,464)

The company's investments and derivatives financial instruments, as disclosed in the company's Balance Sheet, are valued at fair value.

The company has chosen to adopt sections 11 and 12 from FRS102 to account for its financial instruments.

The company has early adopted the 'Amendments to FRS 102 – Fair value hierarchy disclosure', where an entity is required to classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

Investments are designated as held at fair value through profit or loss in accordance with FRS 102 sections 11 and 12.

FRS 102 as amended for fair value hierarchy disclosures (March 2016) sets out three fair value levels.

Level 1: The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.

Level 2: Inputs other than quoted prices included within Level 1 that are observable (i.e., developed using market data) for the asset or liability, either directly or indirectly.

Level 3: Inputs are unobservable (i.e., for which market data is unavailable) for the asset or liability.

With the exception of those financial liabilities measured at amortised cost, all other 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.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

As at 31 January the financial assets at fair value through profit and loss are categorised as follows:

2017	Level 1 £	Level 2 £	Level 3 £	Total £
Financial assets at fair value through profit or loss				
Equity investments	643,404,432	-	-	643,404,432
Financial instruments	-	-	27,969	27,969
Derivatives financial instruments - written call options	(85,100)	-	-	(85,100)
	643,319,332	**-**	**27,969**	**643,347,301**

2016	Level 1 £	Level 2 £	Level 3 £	Total £
Financial assets at fair value through profit or loss				
Equity investments	603,341,404	-	-	603,341,404
Financial instruments	-	-	27,969	27,969
Derivatives financial instruments - written call options	(214,350)	-	-	(214,350)
	603,127,054	**-**	**27,969**	**603,155,023**

For exchange listed equity investments the quoted price is either the bid price or the last traded price depending on the convention of the relevant exchange. For written options the value of the option is marked to market based on traded prices. Financial instruments valued based on valuation techniques level 3 have, in the absence of relevant trading prices or market data, been valued based on the directors' best estimate. There are no investments held which are valued in accordance with level 2.

There were no transfers between levels for financial assets and financial liabilities during the year recorded at fair value as at 31 January 2017 and 31 January 2016.

17. 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. It invests in high yielding stocks and receives premium income from options.

The company's capital at 31 January comprises:

	2017 £	2016 £
Debt		
Stepped Rate Interest Loan due within one year	34,034,109	-
Creditors: amounts falling due after more than one year	76,021,706	110,262,236
	110,055,815	**110,262,236**
Equity		
Called up share capital	27,182,116	27,182,116
Share premium account and other reserves	518,135,434	470,925,749
	545,317,550	**498,107,865**
Total Capital	**655,373,365**	**608,370,101**
Debt as a percentage of total capital	16.8%	18.1%

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2017

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 whether to issue shares or repurchase shares for cancellation or for holding in treasury.

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 value of the capital and reserves. These are measured in accordance with the policies used in the annual report. The company has complied with these.

18. Transaction with the Investment Manager and related parties

The amounts paid to the investment manager include a proportion of marketing costs. Details of the fees paid under the investment management contract are disclosed in Note 2 on page 65. 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 FRS 102 Section 33: '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 49 and in the expenses note on page 66.

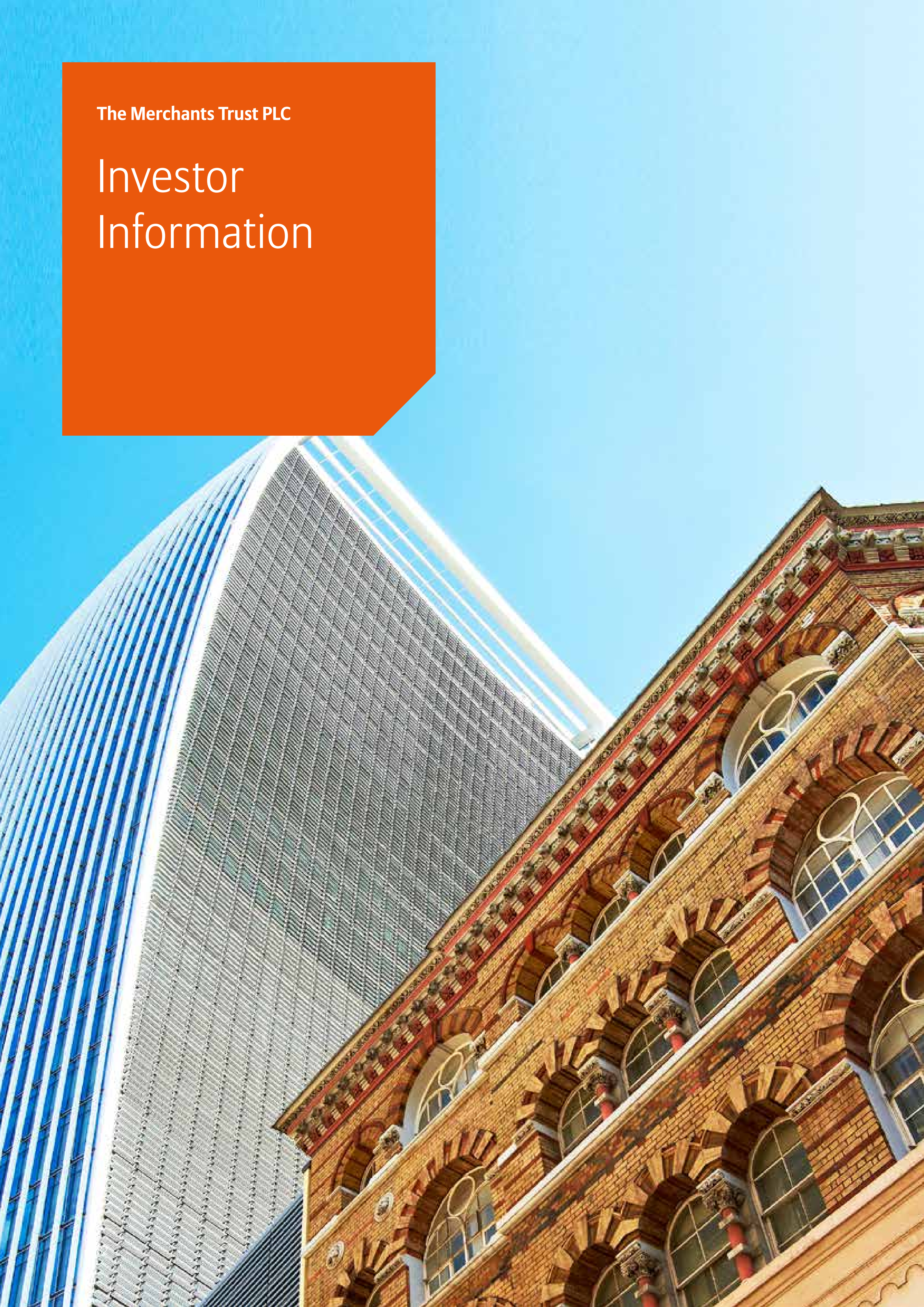
There are no other identifiable related parties at the year end, and as of 27 March 2017.

19. Post Balance Sheet events

There are no significant events after the end of the reporting period requiring disclosure.

The Merchants Trust PLC

Investor Information



Investor Information (unaudited)

Appointment of AIFM and Depositary

The Alternative Investment Fund Managers Directive (AIFMD) came into force in July 2014. The aim of the directive was to create a comprehensive and effective regulatory and supervisory framework for alternative investment fund managers within the EU.

Under AIFMD the company is an Alternative Investment Fund (AIF) which is required to appoint an Alternative Investment Fund Manager (AIFM) and a Depositary. In July 2014 the company announced that the current manager, Allianz Global Investors GmbH (AllianzGI), was designated the AIFM. Allianz is authorised to act as an AIFM and to conduct its activities from its UK Branch by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), in accordance with AIFMD and Financial Conduct Authority requirements. The management fee and the notice period are unchanged in the restated Management and Administration Agreement (details in Note 2 on page 65).

The company appointed HSBC Bank PLC as its depositary and custodian in accordance with AIFMD under an agreement between the company, AllianzGI and HSBC. Depositary fees are charged in addition to custody fees and are calculated on the basis of net assets.

Leverage and Risk Policies under AIFMD

Details of leverage and risk policies required under AIFMD are published on the website www.merchantstrust.co.uk under Literature/Trust Documents/Disclosures to Investors under AIFMD These policies represent no change to the board's policies in existence prior to AIFMD and are in place to ensure that these limits would not be breached under any foreseeable circumstances.

Remuneration Disclosure of the AIFM

Employee remuneration of Allianz Global Investors GmbH for the financial year ending 31 December 2016 (all values in Euro).

Number of employees: 1,618

	all employees	thereof Risk Taker	thereof Board Member	thereof Other Risk Taker	thereof Employees with Control Function	thereof Employees with Comparable Compensation
Fixed remuneration	145,421,511	8,368,445	2,865,587	896,592	1,073,330	3,532,936
Variable remuneration	117,553,590	29,025,053	12,000,472	2,475,944	1,907,394	12,641,243
Total remuneration	262,975,101	37,393,498	14,866,059	3,372,536	2,980,724	16,174,179

Remuneration Policy of the AIFM

The compensation structure at AllianzGI Europe is set up to avoid any kind of excessive risk-taking. Variable compensation awards are delivered via deferral programmes to ensure they are linked to sustainable performance. In addition, any compensation decisions have to be reviewed and approved by our Functional, Regional and Global Compensation Committees on both an aggregate and individual basis, to further ensure effective risk mitigation.

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 Equity Income.

Investor Information (unaudited) *(continued)*

Financial Calendar

Year end 31 January.
Full year results announced and Annual Report posted to shareholders in April.
Annual General Meeting held in May.
Half-yearly Report posted to shareholders in September.

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 the ATS Customer Services Department on 01382 573737 or by e-mail: contact@alliancetrust.co.uk, or from Allianz Global Investors either via Investor Services on 0800 389 4696 or on the company's website: www.merchantstrust.co.uk.

A list of other providers can be found at the company's website: www.merchantstrust.co.uk.

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 1 February and 1 August.

Benchmark

With effect from 1 February 2017 the company's benchmark is the FTSE All-Share Index. For the year ended 31 January 2017 the benchmark was the FTSE 100 Index. Please see the Chairman's Statement on page 3 for more information.

Market and Portfolio Information

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. The net asset value of the ordinary shares is calculated daily and published on the London Stock Exchange Regulatory News Service. The geographical spread of investments and ten largest holdings are published monthly on the London Stock Exchange Regulatory News Service. They are also available from the manager's Investors Helpline on 0800 389 4696 or via the company's website: www.merchantstrust.co.uk.

Website

Further information about The Merchants Trust PLC, including monthly fact sheets, daily share price and performance, is available on the company's website: www.merchantstrust.co.uk.

Dividend

The board is recommending a final distribution of 6.1p to be payable on 18 May 2017 to shareholders on the Register of Members at the close of business on 21 April 2017, making a total distribution of 24.2p per share for the year ended 31 January 2017, an increase of 0.8% over last year's distribution. The ex dividend date is 20 April 2017.

Cash dividends will be sent by cheque to first-named shareholders at their registered address. Dividends may be paid directly into shareholders' bank accounts. Details of how this may be arranged can be obtained from Capita Asset Services. Dividends mandated in this way are paid via Bankers' Automated Clearing Services (BACS).

Registrars

Capita Asset Services, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU. Telephone: 0371 664 0300. Lines are open 9.00 a.m. to 5.30 p.m. (London time) Monday to Friday. Email: ssd@capita.co.uk.
Website: www.capitaassetservices.com

Shareholder Enquiries

In the event of queries regarding their holdings of shares, lost certificates, dividend payments, registered details, etc., shareholders should contact the registrars on 0371 664 0300. Lines are open 9.00 a.m. to 5.30 p.m. (London time) Monday to Friday. 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.

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, 199 Bishopsgate, London EC2M 3TY. Telephone: 020 3246 7513.

Investor Information (unaudited) *(continued)*

Dividend Reinvestment Plan for Ordinary Shareholders (DRIP)

The registrars offer a DRIP which gives ordinary shareholders the opportunity to use their cash dividend to buy further shares in the company under a low-cost dealing arrangement. Terms and Conditions and an application form are enclosed with each dividend payment.

Share Dealing Services

Capita Asset Services operate an online and telephone dealing facility for UK resident shareholders with share certificates. Stamp duty and commission may be payable on transactions.

For further information on these services please contact: www.capitadeal.com for online dealing or 0371 664 0445 for telephone dealing. Lines are open 8.00 a.m. to 4.30 p.m. Monday to Friday (London time). 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.

Share Portal

Capita Asset Services offer shareholders a free online service called Share Portal, enabling shareholders to access a comprehensive range of shareholder related information. Through Share Portal, shareholders can: view their current and historical shareholding details; obtain an indicative share price and valuation; amend address details; view details of dividend payments; and apply for dividends to be paid directly to a bank or change existing bank details. Shareholders can access these services at www.capitaassetservices.com. Shareholders will need to register for a Share Portal Account by completing an on-screen registration form. An email address is required.

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.

International Payment Services

Capita Asset Services 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 Asset Services, working in partnership with Deutsche Bank, 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.capitaassetservices.com/international or by contacting Capita as detailed below.

For further information on these services please contact: 0371 664 0300. Lines are open between 9.00 a.m. and 5.30 p.m., Monday to Friday (London time) or email IPS@capita.co.uk.

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 persuasive. Shareholders are therefore advised to be very wary of any unsolicited advice or offers.

Please note that it is most unlikely that either the company or the company's Registrar, Capita Asset Services, 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.

Notice of Meeting (unaudited)

Notice is hereby given that the annual general meeting of The Merchants Trust PLC will be held at Grocers' Hall, Princes Street, London, EC2R 8AD, on Tuesday 16 May 2017 at 12 noon to transact the following business.

Ordinary Business

1 To receive and adopt the Directors' Report and the Financial Statements for the year ended 31 January 2017 together with the Auditors' Report thereon.

2 To declare a final dividend of 6.1p per ordinary share.

3 To re-elect Simon Fraser as a director.

4 To elect Timon Drakesmith as a director.

5 To re-elect Mary Ann Sieghart as a director.

6 To re-elect Sybella Stanley as a director.

7 To re-elect Paul Yates as a director.

8 To approve the Directors' Remuneration Policy.

9 To approve the Directors' Remuneration Implementation Report.

10 To reappoint 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.

11 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 12 will be proposed as an ordinary resolution and resolutions 13 and 14 as special resolutions:

12 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 36,242,821 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.

13 That the directors be empowered in accordance with section 570 of the Companies Act 2006 (the Act) to allot equity securities (within the meaning of section 560 of the Act) either for cash pursuant to the authority conferred by resolution 12 or by way of a sale of treasury shares 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 10,872,846 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 this resolution is passed, or 16 August 2018 if earlier; and

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

14 That the 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), either for retention as treasury shares or for cancellation provided that:

(i) the maximum number of ordinary shares hereby authorised to be purchased shall be 16,298,396;

(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;

Notice of Meeting (unaudited) *(continued)*

(iv) the authority hereby conferred shall expire at the conclusion of the annual general meeting of the company in 2018 or, if earlier, on the expiry of 15 months from the passing of this resolution, unless such authority is renewed prior to such time; and

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

By order of the board

Kirsten Salt
Company Secretary
199 Bishopsgate, London, EC2M 3TY
27 March 2017

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/she is appointed by multiple members who instruct him/her to vote in different ways, in which case he/she only has one vote for and one vote against the resolution.
3. A personalised form of proxy is provided with the Annual 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 6 p.m. on 12 May 2017 (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.

Notice of Meeting (unaudited) *(continued)*

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.
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 24 March 2017, 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 108,728,464 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 109,906,464.
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.merchantstrust.co.uk.
15. Contracts of service are not entered into with the directors, who hold office in accordance with the company's Articles.

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