The Merchants Trust PLC

Annual Report
31 January 2019

aic DIVIDEND HERO

THE MERCHANTS TRUST PLC
ALLIANZ GLOBAL INVESTORS
130
1889–2019

Allianz Global Investors

Why invest in The Merchants Trust PLC?

High income returns

Merchants aims to provide an above average level of income and income growth together with long-term growth of capital through a policy of investing mainly in higher yielding large UK companies. Portfolio Manager Simon Gergel draws on the considerable research resources of Allianz Global Investors as well as his 31 years of investment experience.

37 consecutive years of dividend growth

The trust has paid increasingly higher dividends to its shareholders year-on-year for the last 37 years – from 2.1 pence per share in 1982 to 26.0 pence per share as proposed to shareholders for approval at the Annual General Meeting in 2019. This is illustrated in the chart in the Chairman's Statement on pages 4 and 5. Furthermore, in periods of falling income such as during the financial crisis, the trust can draw on revenue reserves to support its dividend payouts to shareholders. These reserves help smooth dividend payments during short-term periods of difficult economic conditions, although income is not guaranteed and could go down as well as up.

Cost-effective solution

Buying shares in an investment trust can be less costly than purchasing the underlying stocks individually – with an annual management fee of 0.35% (ongoing charges 0.58%), see page 12), Merchants provides a cost-effective way to access an actively managed portfolio.

Liquidity and gearing

Merchants is the largest investment trust managed by Allianz Global Investors. With total assets of £644m, over 100 million shares in issue and a diversified share register, Merchants is one of the larger trusts in the market place. As an investment trust, Merchants is also able to employ gearing to seek enhanced returns for its shareholders. This can boost performance when markets go up. However, investors should be aware that losses are magnified when markets fall, which could lead to a substantial loss on their initial investment. Gearing is explained in more detail on page 44,

Independent, experienced board

As an investment trust, Merchants is an independent company listed on the London Stock Exchange. The investment manager is accountable to the trust's autonomous board of directors, who are charged with safeguarding shareholder interests. The directors' biographies are on pages 52 and 53.

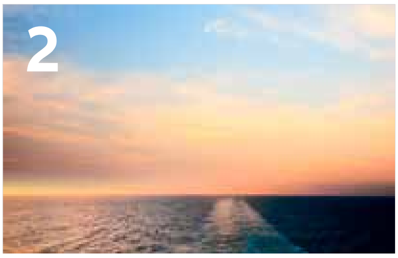
Long-term conviction

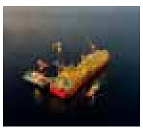
The Merchants Trust has been providing an actively managed portfolio of investments since its launch in 1889. The portfolio manager operates a measured, long-term investment strategy and makes portfolio decisions purely in terms of achieving the investment objectives set by the board. The investment manager's review, beginning on page 15, sets out the portfolio decisions in the year, and the investment philosophy and stock selection process is described on pages 28 and 29.

Spreading your risk

Investment trusts own shares in a variety of different companies, so buying shares in Merchants will effectively give you a diversified portfolio of UK stocks. This spreads your risk, as you are not reliant on the success of just one or two companies. There is a full portfolio listing on pages 36 and 37.

Contents





COVER PHOTO Royal Dutch Shell's Prelude FLNG, moored 178 miles off the north west coast of Australia, is the world's largest floating liquefied natural gas platform as well as the largest offshore facility ever constructed. Shell introduced gas on board Prelude FLNG for the first time in June 2018. Prelude FLNG should produce approximately 3.6 million tonnes of liquefied natural gas per year. The vessel displaces the same amount of water as six of the largest aircraft carriers and draws 50 million litres of cold water from the ocean every hour to help cool the natural gas.

Financial Highlights

As at 31 January 2019

Yield*

5.5%

2018 5.2%

Dividend for the year

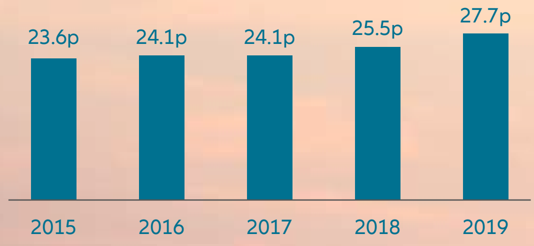
26.0p

+4.8%

Revenue earnings per ordinary share

27.7p

+8.6%



Net Asset Value Total Return*#

-5.2%

2018 +14.5%

Share Price Total Return*

+1.7%

2018 +13.3%

Benchmark Total Return*

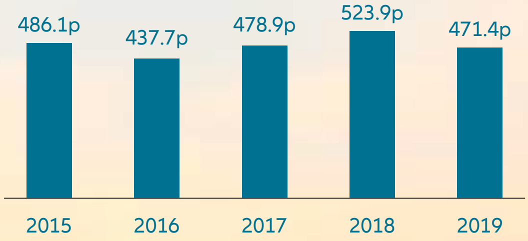
-3.8%

2018 +11.3%

Net Asset Value per ordinary share*#

471.4p

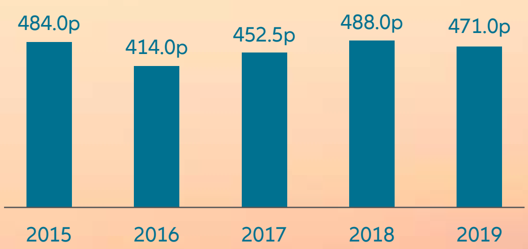
-10.0%



Share price

471.0p

-3.5%



* Alternative Performance Measure (APM).
\# Debt at market value.
See Glossary on page 42.

"UK shares are favourably priced when compared to other major world stock markets, largely due to investor nervousness over Brexit. This represents a particular opportunity as around two thirds of UK listed companies' sales and profits come from abroad."

Simon Gergel
Portfolio Manager

Chairman's Statement

Dear Shareholder

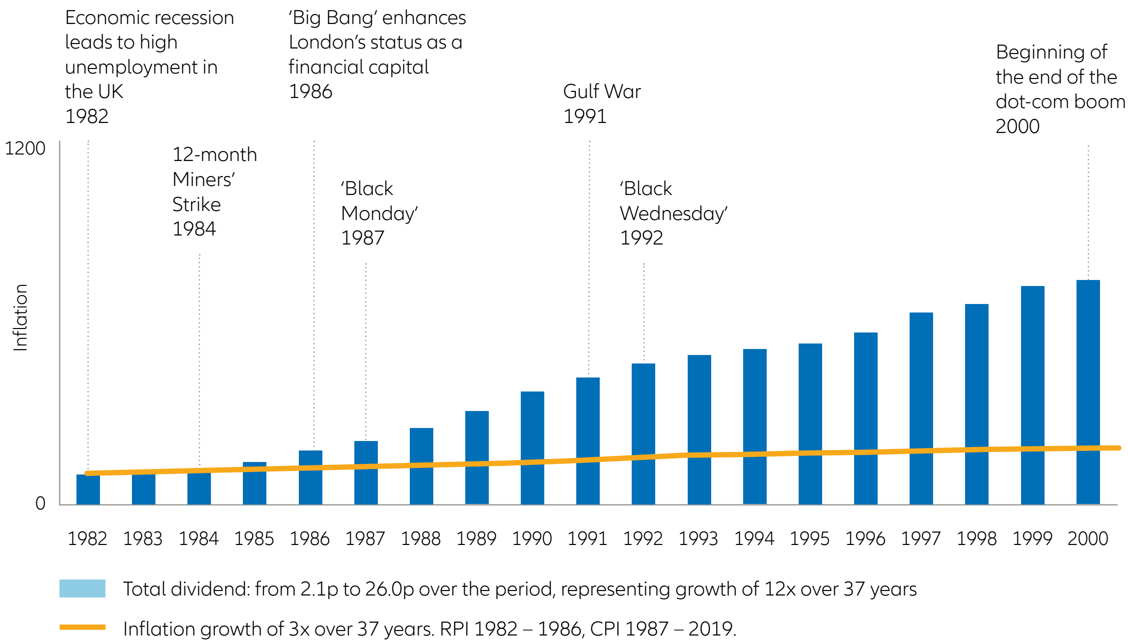
This year marks the 130 year anniversary of the formation of The Merchants Trust. The company was founded in 1889 by some of the leading financiers and lawyers of the day and was set up to provide investors with an opportunity to benefit from nascent international growth industries, such as those participating in the North American railway boom. Over time, the company's mandate has evolved to reflect both changing market conditions and investment opportunities.

It is a great privilege to be associated with the company as it celebrates 130 years. Much has changed over its timeline since 1889, with the company successfully navigating a variety of crises and challenging market conditions. Since the late 1980s, Merchants' investment universe has been primarily high-yielding, well-established UK companies (including some of the world's largest and best-known multinationals). However, one thing that has not changed is the company's overall objective: to deliver capital growth and healthy dividends to its shareholders. Income remains a theme for the company and its investors now, just as it was back in 1889.

Highlights of the year

- 1889 - 2019: celebrating 130 years
- Dividend hero: 37 consecutive years of dividend growth
- Dividend growth of nearly 5%, ahead of inflation, and yield remains well above the sector average
- Earnings growth +8.6%
- Overall, a challenging year for markets

Your board is proud of the company's record of paying a rising dividend to shareholders each year, so I am delighted to announce that, following our Annual General Meeting, Merchants will have achieved 37 consecutive years of dividend growth. The company continues to offer one of the highest dividend yields in its sector.



*Final dividend for approval at the 2019 AGM.

Source: AllianzGI.

Chairman's Statement *(continued)*

A challenging year with sharp moves in individual shares

This has been an unusual year in which investment markets have been particularly volatile, reflecting a succession of macro-economic concerns and geopolitical factors. Merchants' overall performance has been driven by sharp moves in individual shares, especially at the smaller market cap level. There have been a large number of positive and negative contributions to performance: you will find more information, including stock selections and portfolio changes, in the Investment Manager's Review on page 16.

In a challenging year overall for stock markets around the world, Merchants' UK equity portfolio outperformed its benchmark index, the FTSE All-Share by 0.3%, over the year to 31 January 2019, but ended in negative territory. The company's Net Asset Value (NAV) return was -5.2% compared with the benchmark total return of -3.8% due to the impact of gearing in a falling market. Please refer to the attribution analysis on page 13.

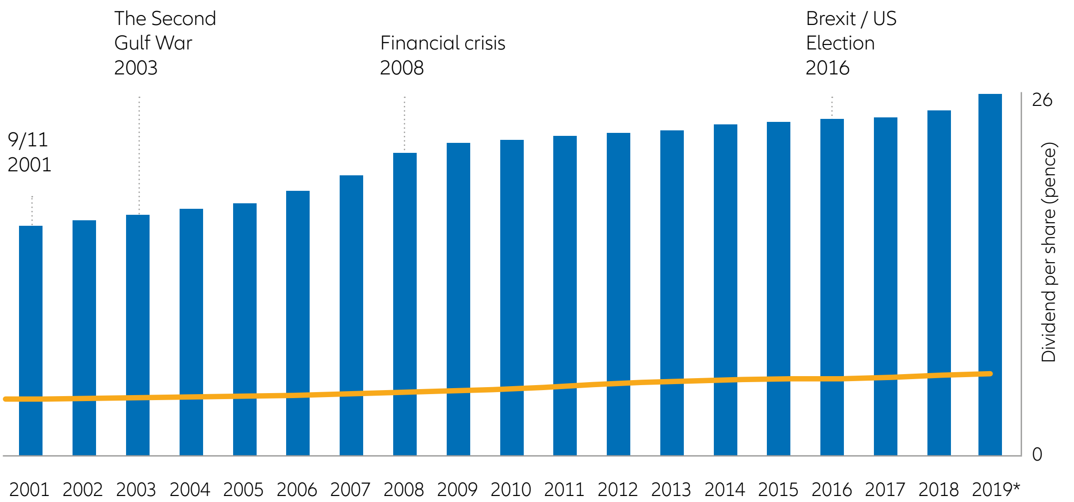
The company's share price fell by 3.5% over the year from 488p to 471p which is less than the fall in the NAV as the discount narrowed during the year. With dividends reinvested, on a total return basis, the value of the shares increased by 1.7%.

37 consecutive years of dividend growth

The board is recommending a final dividend of 6.6p (2018: 6.3p) which will increase the total dividend for the year to 26.0p (2018: 24.8p), a rise of 4.8%. Significantly, this will be the 37th consecutive year in which we have grown the dividend and we are extremely proud of our continued recognition as an AIC 'Dividend Hero'; this is an elite group of investment trust companies that have increased their dividends each year for 20 years or more. The board acknowledges that income is an important reason why investors choose to buy Merchants shares and it is the board's aim to continue increasing dividends in a sustainable and measured way.

The board monitors the company's yield relative to other investment trusts in the UK Equity Income sector. At 31 January 2019, the company's dividend yield of 5.5% ranked Merchants well above the sector average of 4.0%.

The final dividend of 6.6p will be paid on 22 May 2019 to shareholders on the register on 12 April 2019. The dividend is fully covered by the revenue generated by the company's portfolio and there are significant reserves. Following the debt refinancing undertaken at the end of the 2018 financial year, the company's average interest rate reduced



Chairman's Statement *(continued)*

from 8.5% to 6.1%. This reduction in costs, combined with improving income growth in the portfolio, presented the possibility of growing the dividend faster - and ahead of inflation. Pleasingly this aim has been achieved during the current financial year. These factors have also resulted in earnings per share (EPS) showing a steady improvement over the year, reaching a record level of 27.7p for the Company as it celebrates its 130th year.

Gearing

Investment Trusts like Merchants aim to enhance their investment returns by borrowing money to buy more assets (known as 'gearing'). The company has gearing in the form of long term debt amounting to £111 million, all deployed in the market for investment purposes. The gearing comprises a long-term debenture maturing in 2023, secured bonds maturing in 2029 and loan notes maturing in 2052. Overall, our gearing averaged 19.8% throughout the year, compared to 19.7% last year. At the end of the year, our gearing level was 20.5% compared to 17.9 % at 31 January 2018.

This year's annual report

The format of the company's annual report continues to evolve, as part of our ongoing quest to enhance it. The board remains conscious of the ever-increasing numbers of private individuals who have chosen to buy Merchants shares in recent years, so every effort is made to ensure that the content is interesting, relevant and jargon-free. This year's report features an expanded and improved Key Performance Indicators (KPI) section which we hope shareholders will find useful. Once again we have included case studies as well as profiles on the company's Top 20 holdings, as these have proven popular. Refining the look, feel and content of the report is an ongoing commitment and we welcome feedback from all shareholders, as well as suggestions that we can consider for future years.

Under ***Why invest with the Merchants Trust?*** on the inside front cover of this report, we have set out the reasons why holding shares in Merchants can suit a wide range of investors.

Board succession

As we announced last year, my intention is to retire from the Merchants Board during the course of this year, having been on the board for ten years and Chairman for nine. Sybella Stanley as Senior Independent Director has been leading the search for my replacement supported by search consultants Spencer Stuart and Nurole.

Following our search, I am very happy to say that Colin Clark will join our board in June and become Chairman at the beginning of September. Colin has extensive fund management and board experience. He worked for Mercury Asset Management for many years both running portfolios and distribution. More recently he has been on the main board of Standard Life where he was also head of distribution. He retired from Standard Life following the merger with Aberdeen Asset Management. Colin is currently on the board of AXA Investment Managers and Rathbone Brothers Plc.

It has been a great privilege to chair Merchants Trust over the course of its thirteenth decade. It is a very well managed trust with a real purpose in producing significant income from a portfolio of UK equities. I would like to thank all our shareholders for your support over this period and I wish the trust all the very best for the future.

Strategy and Strategic Report

At our annual strategy day last year, we took a more in-depth look at the matters we consider at each board meeting, including our objectives and key performance indicators, together with other topics including a further review of our gearing and how it is financed. The Strategic Report follows on page 43.

Chairman's Statement *(continued)*

Issue of new shares and buyback of shares

Over the year we saw the company's share price mainly trade at a discount to its 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. Later in the year the shares traded at a premium or close to par value but not for a sustained period and so there was no call to issue new shares to manage the market's demand. Our policy continues to be to issue shares at a premium to NAV, 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 a decision to buy back shares, 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.

Since the year end we have issued 200,000 new shares at an average premium of 1.0% .

Creating demand for Merchants shares

1. Marketing communications

As a board, we are keen to grow the number of individual shareholders that hold Merchants shares and our marketing activities are focused on achieving this. As always, we consider carefully the level of marketing expenditure that should be allocated to targeted and cost-effective marketing activity. The Merchants marketing programme includes electronic communications with existing and potential investors and substantial liaison with national and industry journalists, since positive press coverage can be highly influential.

Targeted online and print advertising is also undertaken on a very selective basis, where the potential benefits are judged to merit the cost. Recent campaign activity has focused on the company's 130-year history as well as its 'Dividend Hero' status, using 'As focused on dividends as you are' as its headline. We have also ventured into the podcast arena, with the introduction of 'A Value View', where the company's portfolio manager, Simon Gergel, shares his insights on the very latest developments affecting the UK stock market. These broadcasts have been very well received and are available through the Merchants website or by subscribing via a mobile device.

As previously noted, online trading platforms have largely replaced the traditional stockbroker as the destination for investors wishing to buy shares in recent years and our communication programme targets both platform providers and investors. Marketing activity has been instrumental in creating sustained and ongoing demand for Merchants shares through these platforms. Approximately 46.7% (2018: 41.7%) of the company's shares are now held by investors on these platforms, an increase of 4.9% in just one year.

We are keen to sustain this demand since this can reduce discount levels and ultimately lower running costs, which benefits all of the company's shareholders.

2. Meeting shareholders

As part of our strategy to keep the company 'front of mind' for existing and potential shareholders, the portfolio manager and other members of the Allianz Global Investors team dedicate considerable time to promoting the company around the country, in a comprehensive schedule that targets institutions, private investors and the wealth manager community. Roadshow activity is a proven way of maintaining relationships with key analysts and holders of the company's shares, as well as encouraging share purchases from new buyers.

Chairman's Statement *(continued)*

Online access for Merchants investors

The Merchants Trust website, www.merchantstrust.co.uk, continues to evolve and is at the heart of our marketing communications strategy. As well as the very latest performance statistics, visitors to the site can also access a wealth of information, including: 'Broadcast Hub' audio and video interviews with the portfolio manager; useful information on platform investing; educational content; and a complete literature library of current and historical documents. Since 2019 is such a significant anniversary year for the company, we are adding fresh content reflecting the company's history, including an interactive timeline that travels back in time to 1889.

Via the site, visitors can sign up to receive monthly Merchants Trust fact sheets by email, as well as other useful information. In May 2018, the General Data Protection Regulation (GDPR) became law. Under this regulation, shareholders must provide 'opt-in' consent to receive communications. If you have not already provided consent but would like to receive our targeted communications, such as the monthly Merchants fact sheet and commentary, you can opt in via the website – simply click on 'Sign up' on the home page.

Key Information Document

As detailed in last year's annual report, the Key Information Document (KID) is a standardised pan-European document that came into force in January 2018 for investment trusts and many other investment products operating under the Packaged Retail and Insurance-based Investment Products (PRIIP) Regulation. The KID contains product, risk, charges and other information. It is a regulatory requirement that you are provided with a KID before you invest, and you are required to declare that you have seen the latest KID when you make your investment.

Industry concerns that disclosures mandated for inclusion could be unhelpful for investors have gathered pace over the year. Specific concern surrounds the methodology for both the investment performance and risk sections. The Association of Investment Companies has been very vocal in its criticism of this regulatory document and has lobbied for KIDs to be suspended while the problems are addressed. The industry is encouraged that the Financial Conduct Authority (FCA) has taken on board the strong concerns raised and has agreed that the summary risk indicators and performance scenarios in KIDs can be misleading, and that the regulation could cause consumer harm if problems are not addressed. With this in mind, your board considers it worth reminding prospective investors in the company not to rely solely on the KID when making their investment decision.

Chairman's Statement *(continued)*

Annual General Meeting

We strongly encourage shareholders to attend the Annual General Meeting of the company. This will be held on Thursday, 16 May 2019 at 12 noon at Grocers' Hall, Princes Street, London EC4Y 0JP. As well as routine business, this year we will take the opportunity of toasting The Merchants Trust on the occasion of its 130th birthday.

Your board is responsible for safeguarding the interests of all shareholders. We are keen to remind you that being a shareholder gives you the right to vote on issues that affect the company, such as director elections and any amendments to policy. Irrespective of whether or not you are able to attend the AGM, Shareholders are encouraged to make their voices heard by voting on ordinary and special business matters, as detailed on the voting instruction card enclosed with this report.

For those shareholders unable to attend, filmed AGM video content will be added to the Merchants dedicated website as soon as it becomes available.

Outlook

When I wrote to shareholders in late September with the half year results, I noted both the increasing risk profile for the UK economy and the increasing volatility being experienced across global stock markets. This was before we experienced substantial market swings in the fourth quarter of 2018 which saw the FTSE All-Share Index tumble by approximately 10% (total return), before recovering somewhat in January. This was a period of quite extreme moves at both sector and stock level.

We remain in a period of heightened geopolitical and economic risk. However, whilst there has been volatility in share prices, the fundamentals of most companies in Merchants' portfolio remain robust, with a resilient outlook for profits and dividends, albeit that the economic outlook is more uncertain than a year ago.

Short-term, external setbacks have always challenged the company over its 130 years. In this landmark year, we are able to look back and acknowledge that, over time, the company has successfully delivered capital and income returns through good times and bad. The board continues to believe that the Portfolio Manager and his team's policy of investing in what they believe in, is a sound one. They are aiming to build a portfolio comprising solid businesses with good prospects for growth, attractive dividends and valuable assets that are priced at a level where they believe they can deliver good total returns for shareholders. This means that they are primarily investing on a 'bottom-up basis' rather than identifying opportunities through sector allocation.

Looking ahead we think it is vital to continue doing what we've always done at The Merchants Trust. In spite of the mixed economic and political signals all around us, there are good stock opportunities to be found. As Simon Gergel has stated in his update, UK shares are relatively cheap at the time of writing and this is potentially a good environment for active investors like AllianzGI. By focusing on individual stocks with strong fundamentals that may be temporarily out of favour, the team can continue investing successfully in a diverse portfolio of investments that enables investors to achieve both capital growth and healthy dividends over time.

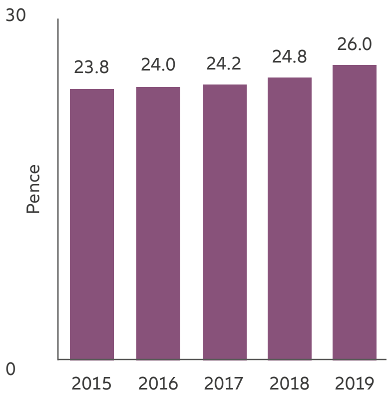
Simon Fraser
Chairman
28 March 2019

Key Performance Indicators (KPIs)

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

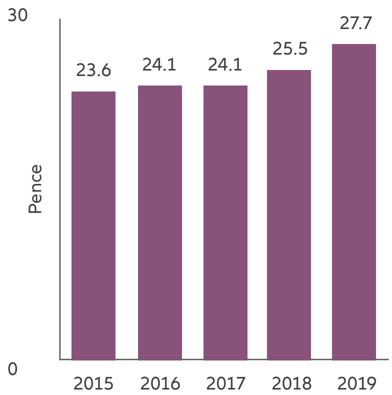
Increasing and sustainable dividends

Dividend record per share



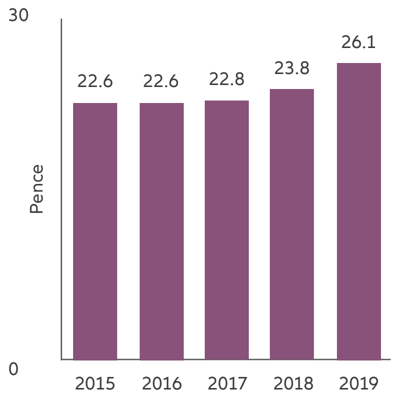
The board has a policy of paying a progressive dividend each year, taking into account inflation and subject to general earnings growth and dividends received in the portfolio. Ordinary dividends have risen in every year since 1982.

Earnings progression



Earnings per share (EPS) shows the income that the company generates each year which can be used to fund dividend payments to shareholders, over time.

Revenue reserves per share*



Revenue reserves can be used to ensure that dividend payments can be maintained through difficult market conditions.

Income is put aside in good years and can be used when needed to maintain a steady increase in dividend payments when income is less readily available.

Revenue reserves are shown in the chart above in pence per share.

* At the year end before payment of third quarter and final dividends.

Comment In recent years earnings have shown a steady improvement, benefiting from rising portfolio income and, in the last year, from the benefits of refinancing debt at a lower interest cost. Revenue reserves were last drawn upon in 2017 and at the year end 26.1p was available for future requirements.

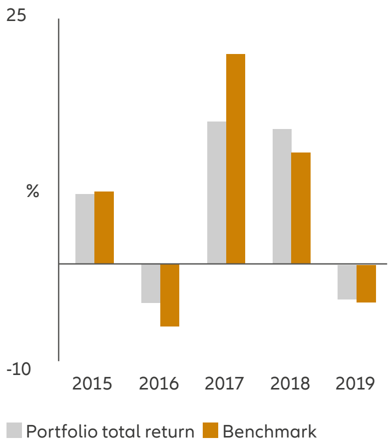
The dividend policy is discussed on page 43 and there is a chart showing Merchants' dividend payment history in my statement on page 4.

Simon Fraser, Chairman

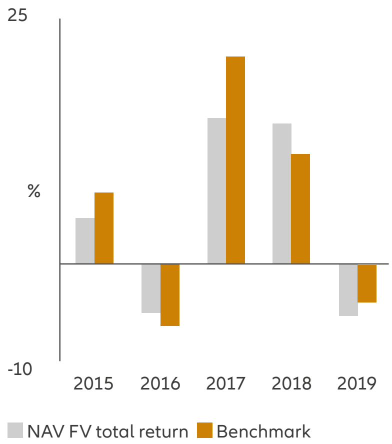
Key Performance Indicators (KPIs) *(continued)*

Shareholder return vs benchmark

Portfolio return vs benchmark



NAV return vs benchmark



I discuss performance in the Chairman's Statement on page 5.

The investment manager discusses how this works at the portfolio level on page 18.

Simon Fraser, Chairman

The board uses this KPI to monitor investment performance. 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 Index* has been chosen as the benchmark index against which we measure our performance. The board seeks a return that is better than the benchmark over various time periods.

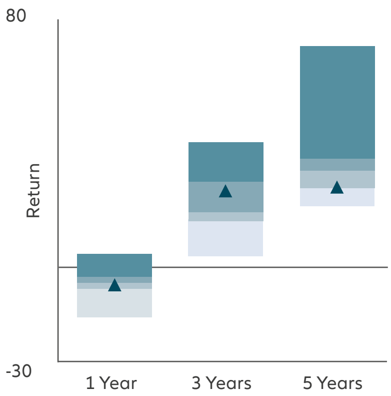
* The benchmark was the FTSE 100 Index until 31 January 2017.

Comment Last year the portfolio's return was ahead of the benchmark. However, the NAV return was behind the benchmark after the impact of gearing (borrowings). Gearing tends to amplify portfolio returns in both directions.

Key Performance Indicators (KPIs) *(continued)*

Performance vs peers

Peer rankings



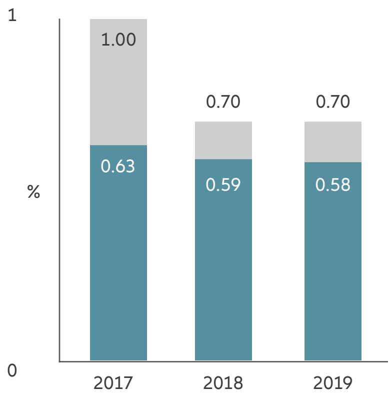
▲ Merchants Trust

Positions in peer group quartiles

Source: JP Morgan Cazenove.

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.

Ongoing charges



Merchants Trust Peer group

Source: Morningstar/AllianzGI.

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.

The board monitors the performance against the peer group of companies competing with Merchants for investors. This performance includes the dividend yield, discussed in my statement on page 4, as well as the growth in the value of the company's assets.

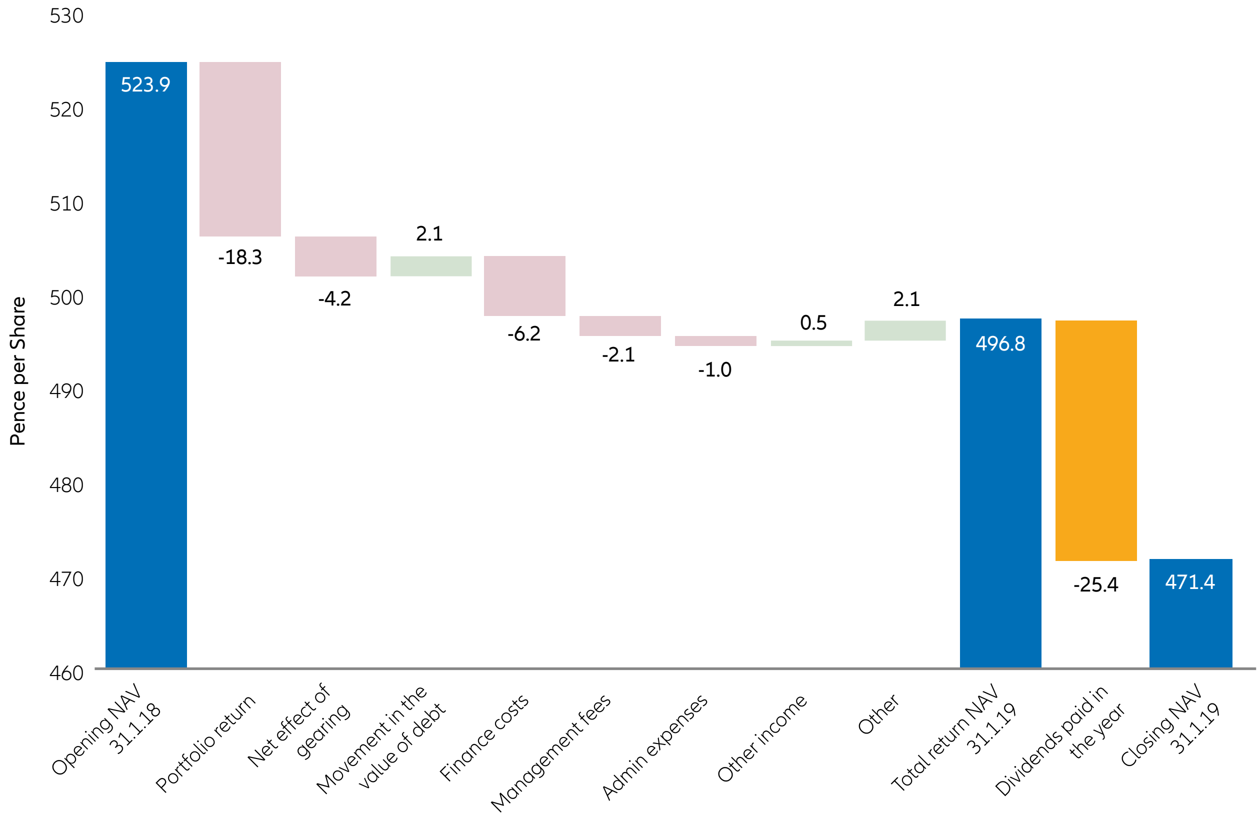
Ongoing charges are shown on page 41.

Simon Fraser, Chairman

Comment Performance was close to the peer group average over one year, ahead over three years and behind over five years. Last year and this year the ongoing charges were 0.59% and 0.58%, respectively. The chart shows Merchants' costs are below average in the peer group.

Attribution Analysis

Movement in Capital Return with Debt at Market Value for Year Ended 31 January 2019



The total return reflects both the change in net asset value, from 523.9p to 471.4p and the ordinary dividends paid in the year. The total return NAV of 496.8p as at 31 January 2019 is derived from the NAV with debt at market value of 471.4p plus dividends paid in the year of 25.4p.

Performance Attribution Analysis against the FTSE All-Share Index	Capital return %	Revenue return %	Total return %
Return of Index	-7.5%	3.7%	-3.8%
Relative return on portfolio	-0.4%	0.7%	0.3%
Return of portfolio	-7.9%	4.4%	-3.5%
Impact of gearing	-2.0%	1.2%	-0.8%
Movement in fair value of debt	0.4%	0.0%	0.4%
Finance costs	-0.7%	-0.5%	-1.2%
Management fee	-0.3%	-0.1%	-0.4%
Administration expenses	0.0%	-0.2%	-0.2%
Other income	0.0%	0.1%	0.1%
Retained revenue	0.4%	-0.4%	0.0%
Other	0.1%	0.3%	0.4%
Change in net asset value per ordinary share (debt at fair value)	-10.0%	4.8%	-5.2%

A Glossary of Alternative Performance Measures (APMs) is on page 42.

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

DIVIDEND HERO THAT'S ON TRACK FOR 37 YEARS OF RISES

Mail on Sunday
17 March 2019

POISED TO PAY OUT 5% OR MORE

Daily Mail
6 January 2019

Income trusts with high yields, large discounts and strong dividend growths

Daily Telegraph
13 December 2018

High-yielding Merchants' emphasis on value proves profitable

Money Observer
November 2018

Why it's all about yield for The Merchants Trust

Shares Magazine
19 July 2018

MERCHANTS TAKES THE LEAD IN TRUST DIVIDEND TURNAROUNDS

Citywire
5 July 2018

Positive press coverage can be highly influential in creating demand for Merchants Trust shares.

Simon Fraser
Chairman

Investment Manager's Review

Defensive sectors such as pharmaceuticals performed well over the period. At the end of the year, GlaxoSmithKline was the portfolio's largest holding.

Investment Manager's Review

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

Economic & Market Background

It was the best of times, it was the worst of times, it was the age of reason, it was the age of foolishness. As The Merchants Trust reaches its 130th anniversary, these famous words from Charles Dickens' "A Tale of Two Cities", written thirty years before Merchants was founded, seem just as appropriate to describe today's environment, as they were in the nineteenth century. The longer term perspective provided by Merchants' history, helps put current issues into perspective. The last 130 years has witnessed "the best of times"; with massive improvements in living standards and life expectancy, and pivotal inventions, such as aeroplanes, computers and the use of antibiotics, but also "the worst of times"; two world wars, the great depression, the three day week and periods of rampant inflation.

In contrast, the last year has not been so extreme, but there have still been notable high points as well as some lows. Thinking about "the best of times", the UK unemployment rate fell to only 4% by November, with a record 76% of the adult population in work. Wages were growing at 3.3%, ahead of the rate of inflation, and the economy has shown continuous growth for nine years, since the financial crisis. The world economy has also shown steady growth, with almost all regions making progress in 2018. Company profitability has generally been strong and dividend payments healthy. Stock markets were also reasonably healthy in the first half of the year.

However, one can also see "worst of times". Political risk was elevated in the UK, with considerable uncertainty over Brexit and a hard-left opposition party waiting in the wings. Similar political division could be seen in the USA, which endured a long government shutdown, due to a budget stalemate over the issue of President Trump's Mexican border wall. Also across much of Europe, we have seen the continuing rise of populist movements, as epitomised by the "yellow vests" protests in France. Rising trade tensions were an issue, most notably between the USA and China. Investor sentiment was shaken, especially in the second half of the year, due to concerns over these issues, but also over the pace of interest rate increases in the USA, with concern about the impact of higher borrowing costs

Rising trade tensions, most notably between the USA and China, shaped investor sentiment.

Investment Manager's Review *(continued)*

on economic growth. Economic surveys also painted a picture of slower UK growth towards the end of the year, even if the level of employment was robust.

Stock markets fell heavily in the last calendar quarter of 2018, although they made a strong recovery in January. Higher risk shares tended to lead the market decline globally in late 2018, with the highly rated US technology stocks like Amazon and Netflix falling sharply, whilst in the UK, medium sized companies were more volatile than the blue chips.

Overall, the FTSE All-Share index produced a total return of -3.8%, with medium sized companies in the FTSE 250 Index about 1% worse. Sector performance was diverse, reflecting different themes, with volatility picking up later in the year. In an uncertain environment, many defensive sectors performed well, including pharmaceuticals, beverages and gas & water utilities, with the latter rebounding from previous concerns about the risk of renationalisation. However, the worst two performing sectors were also normally defensive industries, namely;

FTSE All-Share 31.1.18 - 31.1.19. Source: AllianzGI/Datastream.

The pace of interest rate increases in the USA and the impact of higher borrowing costs on economic growth were also a concern for markets.

Investment Manager's Review *(continued)*

tobacco, which is seeing structural change in the industry and increased regulatory risk in the USA, and mobile telecommunications, where Vodafone suffered from competitive conditions and fears over dividend sustainability. Cyclical and financial sectors were generally weak, including software, construction, banks, retail and general industrials. Elsewhere, natural resources sectors, including mining and oil & gas producers gave positive returns, outperforming the downward market.

Investment Performance

A full attribution of performance is shown on page 13. In this section we concentrate on the performance of the investment portfolio and compare it to the benchmark, the FTSE All-Share Index. The portfolio return of -3.5% was 0.3% ahead of the benchmark return of -3.8%. The table below shows the ten biggest positive and negative contributors to performance relative to the benchmark.

Investment performance was primarily driven by individual stock selection, with a high level of individual share price volatility, exacerbated by limited liquidity, especially among smaller companies. However, there was one significant sector allocation impact, with a notable benefit from having a low exposure to the tobacco sector for most of the year. This can be seen in the list of the largest positive stock contributors, where not owning British American Tobacco (BAT), added considerably to the portfolio's relative return. BAT's 40% share price fall dragged down the benchmark return. In a similar vein, not owning Vodafone was very helpful to relative performance as that share fell heavily. The remaining top ten positive contributions all came from stocks owned in the portfolio.

GlaxoSmithKline shares rallied in a generally strong pharmaceutical sector. GSK specifically benefited from promising sales of its new shingles vaccine, as well as improved investor perception in a busy year for corporate

Contribution to Investment Performance relative to the FTSE All-Share Index

	Positive stocks	Performance impact %	Negative Stocks	Performance impact %
Overweight (holding larger than index weight)	GlaxoSmithKline	0.8	Standard Life Aberdeen	-1.2
	UBM	0.6	Keller	-0.7
	Greene King	0.6	Tyman	-0.6
	BHP	0.6	TP ICAP	-0.4
	Tate & Lyle	0.4	Lloyds	-0.3
	Sainsbury (J)	0.4		
	Nex	0.4		
	Meggitt	0.3		
Underweight (zero holding or weight lower than index weight)	British American Tobacco	1.8	Shire	-0.6
	Vodafone	0.8	AstraZeneca	-0.5
			Diageo	-0.4
			Sky	-0.3
			Rio Tinto	-0.3

Case study

GlaxoSmithKline

Pharmaceuticals & Biotechnology
34,722,522
5.7%

GlaxoSmithKline has been one of the largest holdings in the portfolio for some time, and it was a strong performer last year. Since Emma Walmsley took over as Chief Executive Officer in April 2017, she has spearheaded significant changes to develop the company's strategy and improve operational execution. We have long seen value in the combination of businesses that GSK owns, but important developments in each of the three divisions, Consumer Health, Vaccines and Pharmaceuticals, have helped to highlight their potential and create further value for shareholders.

The Consumer health business was originally formed by merging GSK's operations with those of Novartis, and includes brands such as Sensodyne Toothpaste and Voltarol, for pain relief. During the year, GSK bought out Novartis' stake in the division to give it full control. Later, GSK announced an intention to merge its consumer business with that of Pfizer, and to list the combined entity on the stock market within 3 years. This deal, not only forms the clear world leader in consumer health with £10bn annual sales, it also moves to crystallise that value in the stockmarket and remove a "conglomerate discount" that many investors have perceived in GSK.

In Vaccines, the company has made strong organic progress, in particular with the launch of Shingrix, its new vaccine aimed at preventing shingles. This product, which is more effective than the only other vaccine on the market, has immediately moved to secure almost the entire US market, and made sales of £784m in its first full year. There remains substantial room for Shingrix to grow further, both in the USA and elsewhere, and it highlights the attractions of this highly profitable division.

Pharmaceuticals is the largest and most complex division. GSK has been making steady progress developing new respiratory drugs, to take up the running as its blockbuster Advair faces generic competition for the first time. The company has also continued to develop its major franchise in HIV medicines. But the biggest change in the last year, has been a strategy to reinvigorate the drug development process under a new leadership team. Not only has the company streamlined the pipeline in order to concentrate resources on the most promising medicines, they have also concluded two transformational oncology deals. GSK brought Tesaro, a biopharmaceutical company with an important cancer drug, further medicines in development and an infrastructure to market the products. Also, they have announced an alliance with Merck KGaA, to jointly develop and commercialise another promising cancer drug.

This strategic activity has not held back the company's operating performance, with GSK generating enough profits and cash to comfortably cover its dividend in 2018, for the first time in several years. This combination of strategic development and strong operational performance has helped the shares to perform well.

Sector Value of holding Percentage of portfolio

Investment Manager's Review *(continued)*

restructuring, especially in its consumer health division. UBM shares added further to last year's gains before the takeover by Informa completed. The pub company Greene King outperformed, after a weak prior year, as the benefits of the Spirit acquisition and estate rationalisation started to come through, and trading improved following investments in pricing and service. BHP shares also performed well, helped by a special dividend, funded by the sale of US shale assets to BP.

Elsewhere, Tate & Lyle outperformed, especially later in the period, helped by its defensive qualities, resilient trading and a capital markets day in September. Corporate activity had an impact, with NEX shares returning over 60% in response to a bid by CME Group, and Sainsbury shares rallied in response to its proposed merger with Asda. Finally, among the top ten contributors, Meggitt shares performed well, as the aerospace and defence company reported encouraging trading.

The biggest individual negative stock contribution came from Standard Life Aberdeen. The company has seen poor investment performance and net client money outflows since the merger that formed the business, especially in two of its largest strategies. Whilst outflows were predicted, the quantum has been worse than expected, and falling markets exacerbated the trend, causing the shares to fall sharply. Another financial company that had been formed by a merger, TP ICAP, also saw its shares fall, after a profit warning that saw the Chief Executive Officer leave the company. TP ICAP warned that the company would not achieve all of the cost savings targeted in the merger, and would also see additional cost increases. The shares recovered some of their earlier underperformance in the second half, as a pick-up in market volatility helped the trading environment.

Keller shares fell by nearly 50% in response to a profit warning in its Asia Pacific region, even though the reduction in earnings forecasts was not that significant. This was a disappointing development, soon after our purchases of the shares, but Keller is a diversified business, most regions are performing well, and the valuation is exceptionally low. Tyman shares were also very weak, on cyclical concerns about the US and UK housing markets, although trading was actually quite resilient, and the business made

Bovis Homes is improving build quality and improving financial performance under new management.

Investment Manager's Review *(continued)*

further strategic progress in the year. Lloyds was another company where the share price fell back on concerns over the economic outlook, with relatively limited changes to short term consensus earnings forecasts.

The remaining shares on the list of top negative contributors were all stocks that were not owned, or where Merchants only had a small investment, which performed well and helped the index return. There were two large pharmaceutical stocks: Shire received a takeover approach from Takeda and AstraZeneca rallied on promising drug trial results. Diageo performed well due to its defensive qualities despite a high valuation. Sky was strong as it was taken over by Comcast, after a bidding war with Disney in a consolidating media industry. Finally, Rio Tinto outperformed in a resilient mining sector.

Portfolio Changes

Our investment philosophy is to seek to buy sound companies when they are under-priced in the stock market, in order to deliver a high income stream and above average total returns. Volatility within the stock market, such as we saw last year, can lead to mis-pricing of companies, and can create investment opportunities. With investors generally taking money out of the UK equity market causing thin liquidity, and with general concerns over Brexit and other macro-economic risks, we saw certain shares trading on extraordinarily depressed valuations, with few buyers, almost irrespective of prices. We responded to these opportunities to make a number of changes to the portfolio, with a higher level of turnover than in recent years. There were adjustments to existing positions as well as new investments or complete sales. Over the full year, there were six new companies introduced, and seven sold completely, leaving 44 holdings at the year end.

Investments were focused into a few sectors offering particular value: industrials, financial services and tobacco; whilst sales were most heavily biased towards oil and natural resources, pharmaceuticals, consumer staples and companies involved in mergers and acquisitions. These decisions were driven by specific individual considerations, which we discuss below, but they have also had an effect on the overall level of portfolio diversification and the potential for income growth. We have significantly reduced the concentration on the top four holdings, to 20.1% of the portfolio

Large Net Purchases	£m	Largest Net Sales	£m
Imperial Brands	30.7	Lloyds	-22.9
St James's Place	17.3	Royal Dutch Shell	-16.8
Keller	13.6	Informa	-16.8
British American Tobacco	13.1	Sainsbury (J)	-15.6
CRH	10.2	BP	-14.6
Hammerson	9.8	GlaxoSmithKline	-14.3
ITV	9.1	Diageo	-12.7
Standard Life Aberdeen	9.0	Kier	-11.8
Land Securities	7.1	Nex	-9.8
Barclays	6.6	Equiniti	-7.2

Investment Manager's Review *(continued)*

value, from 24.2% a year ago, and 27.9% two years ago. The four largest holdings in recent years, Shell, GSK, BP and HSBC, have made an important contribution to overall performance, and delivered a high level of income. However, they have not offered dividend growth, excluding currency movements. By reducing exposure to these companies, after their outperformance, and reinvesting elsewhere, we have reduced the risk from individual stock concentration and improved the overall income growth potential of the portfolio. Furthermore, this has been done without sacrificing income, due to the high dividend yields available from many other companies in the stock market.

Looking in more detail at the activity, there were two industrial sub-sectors where we were particularly active. In construction & building materials, we introduced the ground engineering company Keller, as discussed in the interim report, and also made significant additions to CRH and Tyman. All three companies were modestly valued and have a large exposure to attractive US construction markets, in particular, with only modest dependency on the UK market, despite UK stock market listings. Aerospace & defence is another attractive industrial market, as we see defence spending gradually recovering after years of cuts, especially in the key US market, and the civil aerospace market offers solid growth from long order books and a ramp up of new products. We added to BAE Systems, after the shares fell back, and we increased the Meggitt holding.

There were a number of significant investments into the financial services sector, where many share prices had fallen heavily and offered excellent value, due to concerns on the outlook for the UK economy or financial markets. As described in the interim report, we bought the high growth wealth management business, St. James's Place, and we also added to existing holdings in Standard Life Aberdeen, IG Group and Legal & General. Also within financial services, we put significant money into the listed real estate sector, introducing the retail real estate company Hammerson, as explained at the interim stage, and building up the position in Landsec. Real estate is one of the sectors most affected by poor investor sentiment on Brexit and fears over the structural outlook for shopping centres. Whilst we acknowledge these risks, discounts to asset values of well

432 Park Avenue, New York City, is the tallest residential tower in the world. HALFEN, a CRH group company, developed the 5.5km of stainless steel window washing track for the building.

Case study

St James's Place

Life Insurance

15,101,800

2.4%

St. James's Place, a leading UK wealth manager, is a high quality business with very attractive financial characteristics that are significantly underappreciated by the market today. The firm consists of a large network of tied financial advisors, 'partners', who offer full-service advice to help clients achieve their long term financial goals. Partners invest client assets, across a broad range of financial products that are generally outsourced from third parties, but negotiated by St. James's Place at scale for attractive terms. The firm has gathered funds under management totalling over £100bn, largely in the UK, with a partner network of around four thousand advisors. St. James's Place earns a proportion of the annual fees charged to clients.

St. James's Place scores highly on measures of investment quality. The brand is strong and well-recognized, with generally satisfied customers, a motivated partner network, and very high retention of client assets. Cash flows are highly predictable for a financials business given the recurring nature of fee-earned income, notwithstanding market fluctuations. The business has a good track record of growth in fund flows, translating into cash available for distribution to shareholders and reinvestment. The partner model and comprehensive advice service generates considerable growth from existing clients as well as referrals, and the business has been able to effectively grow both advisor numbers and advisor productivity over the longer term.

When we purchased the shares, they were trading at a highly attractive valuation, because the market seemed to be overlooking several pertinent aspects of the business model, and investors may struggle to categorise the business. Earnings appear distorted by accounting changes, whereas cash flow generation is strong and stable. The business is perceived and regulated as a life insurer, whereas the economic risk profile is actually a good deal simpler, as St James's Place does not guarantee performance or offer annuities. Most importantly, over a third of assets are not generating free cash or earnings for the businesses currently, but will do so over the next 5-6 years, greatly underpinning the growth profile.

Sector Value of holding Percentage of portfolio

Case study

Equiniti

Support Services
N/A
N/A

The investment in Equiniti, a financial services administration provider, demonstrates how the market can temporarily overlook a high quality business with a wide economic 'moat'. Merchants invested initially, shortly after the initial public offering in late 2015, and the shares gained over 55%, excluding dividends, before final sale in September 2018.

Equiniti helps major companies administer their financial obligations to employees and shareholders, with a leading position in share registration, and strong offerings in pensions administration, employee share plans and share dealing. These are highly regulated and complex areas of activity that lend themselves well to Equiniti's specialised and scalable solutions. The sensitive nature of the work provides for high returns and low competitive intensity. Customers are generally reluctant to switch provider once they have become used to handling their administration in a particular way, so high switching costs result in a loyal customer base and highly predictable cash flows for Equiniti.

The management team has followed a credible strategy of generating above-market revenue growth in the UK by cross selling services over a broad customer base. A major US acquisition in 2017, of Wells Fargo Share Services, provides geographic diversification, cost synergies, and a new avenue of growth in a less efficient and less consolidated market.

The core of the Equiniti investment case was an attractive valuation, and we began to divest as the shares steadily gained a more appropriate valuation relative to the high quality characteristics and growth potential of the business. The market was prepared to value Equiniti at a low multiple of forward earnings in late 2015, implying a slight decline in profits over time, but the shares re-rated significantly over the following three years. By identifying the intrinsic value of Equiniti's business early, we were able to generate significant excess returns over the holding period.

Sector Value of holding Percentage of portfolio

Investment Manager's Review *(continued)*

over 40% are highly unusual and do not reflect the diversity and quality of the estates of these businesses.

Whilst we thought that many financial shares were oversold last year, on macro-economic concerns, this was a matter of judgement, as there were genuine signs of the economy slowing down late in the year. In order to reflect a more challenging environment, we reduced the domestic banking exposure, as banks are more sensitive to the level of economic activity than many of the other financial services companies. We sold the Lloyds shareholding, although we reinvested part of the proceeds into Barclays, which has the potential to benefit from restructuring.

The third, and most significant, area of new investment was the tobacco sector. As described at the interim stage, the portfolio did not own Imperial Brands for nearly five years, or any tobacco company for almost a year, on concerns about high valuations and structural changes within the industry, such as competition from new products like e-cigarettes. However, after a period of extremely weak performance, the sector had de-rated significantly. Imperial Brands became lowly priced, so we added a new position in May and added more later in the year. We also made a new investment into British American Tobacco in January, with the shares having more than halved since we sold out 18 months earlier. Both companies offered growing dividends and yields of over 7%, as well as strong cash flow. Whilst there are challenges in the industry, both companies have a suite of next generation nicotine products and strong market positions, with BAT particularly well exposed in emerging markets.

The remaining new company in the portfolio is the broadcast and content production company, ITV, which we explained at the interim stage. In addition, the portfolio received shares in Informa following the takeover of UBM, although we took profits on a large proportion of the holding. There were also GVC shares received following the takeover of Ladbrokes Coral, and we added further to the holding later in the year at attractive valuations.

The largest sales from the portfolio included reductions to the mega-cap oil holdings, Royal Dutch Shell and BP, as referenced above. Both shares have been strong performers as the management teams have adjusted the business models to a lower oil price environment, and demonstrated that the companies can deliver strong cash flow and maintain their dividend payments. Although we still see solid value in both companies, the upside now looks more limited. We also reduced the mining company BHP, for similar valuation reasons. In the pharmaceuticals sector, we were encouraged by the corporate developments and operational execution at GlaxoSmithKline, which led to strong share price performance. This allowed us to reduce the Trust's large holding at a share price that more fairly reflected the quality of the pharmaceutical, vaccines and consumer health franchises, although we continue to see good value in the business. Among consumer staple stocks, we sold out of Diageo, at a full valuation.

The final theme was mergers & acquisitions. We sold out of NEX Group as it was being taken over at a high price by CME Group. We also sold Sainsbury, where the shares had performed well after announcing its proposed merger with Asda, moving the valuation close to our assessment of fair value, at least in the short term. The merger will take a long time to complete and is not without risk, so we decided to exit the position.

Elsewhere, there were a number of share sales for stock specific reasons. As described at the interim stage, we sold out of Kier, on concerns about the level of debt in the business. We also sold Equiniti, which had performed well since we bought it around the time of its flotation, and reached a fair valuation. Finally, we exited the modest remaining position in FirstGroup, following a change of view about the prospects for cash generation and dividend payments.

Derivatives

We only wrote a limited number of options this year, as there were relatively few situations that met our specific criteria. These were mostly in the oil & gas and aerospace & defence sectors. The option strategy once again delivered its primary objective of income generation, with approximately £0.6m of option premiums accrued. A sharp rally in oil stocks in the middle of the year led to several option exercises, and the underlying oil shares were sold. This crystallised opportunity costs for the strategy and meant that overall there was a notional loss of £0.7m.

Investment Manager's Review *(continued)*

Stewardship

As explained in the Directors' Report, on pages 59 and 60, we believe we have an important duty to actively engage with the boards and executive management teams of the companies in the portfolio, on behalf of shareholders. This is not simply about holding boards accountable for company performance, but it is also about helping to influence company strategy and ensuring that companies are governed effectively. Allianz Global Investors are founder members of The Investor Forum and we have worked with this organisation and in our own capacity to promote strong stewardship.

Last year we held 44 engagements with 24 different companies in the portfolio, approximately half of the total. These engagements ranged from fairly straightforward matters, like discussing board structure, remuneration policies and risk management processes, to more detailed discussions about corporate strategy, mergers and acquisitions or potential management change.

By way of examples; we engaged with a tobacco company about the supply chain in the tobacco industry. We wanted to understand policies that companies have in place to ensure fair treatment of tobacco farmers, and to ensure that there are effective processes to deal with issues such as Green Tobacco Sickness, and how companies monitor and prevent the potential use of child labour. In another case, we have had five engagements, including correspondence and meetings with executive and non-executive directors, and we have been actively challenging the composition of the board. We engaged with two oil majors on their preparedness for the transition to a low-carbon economy, in particular on better disclosure on climate-related targets and their linkage with executive compensation. Elsewhere, we engaged with a number of financial companies, to understand their cyber security policies in some detail, their response plans to potential cyber attacks, and levels of employee awareness of cyber issues.

Number of Company Engagement Activities by Topic and Global Industry Classification sector in the year

Topics and Engagements by Sector

Sector	Strategy / Business Model	Capital Management	Risk Management	Operational Performance	Corporate Governance	Environmental and social risks / impacts	Business conduct and culture
Materials		1	1	1		1	1
Real Estate					2		
Financials	2	1	7		8		4
Telecoms	5	4			9		1
Industrials	1			1	5		1
Consumer Staples	2	1			5	1	1
Consumer Discretionary	1		1		1		1
Energy					1	2	

Several issues may be covered in each meeting.

Investment Manager's Review *(continued)*

Economic and Market Outlook

Risk and opportunity are two sides of the same coin. There are risks for investors in the current geo-political environment, but these risks have also created investment opportunities. Risks include the potential impact of Brexit, the rise of anti-establishment movements across much of Europe, trade tensions between the USA and China, and a gradual tightening of monetary policy, especially in the USA.

The UK economic outlook is uncertain. After a decade of expansion since the financial crisis, with record levels of employment, and considering the risks listed above, the rate of economic growth could slow, perhaps sharply, and there have been some recent signs of weaker activity. However, it is also noteworthy, that the recovery since the last recession has been relatively muted, wages are only now starting to accelerate above the cost of living, and there is pent up demand, as Brexit uncertainty has put some investment and spending plans on hold. A lifting of the Brexit fog, and some resolution to the US/China trade spat, could lead to a re-acceleration of economic growth.

Stock markets are also sending mixed signals. UK Equity returns over the last decade have been extremely strong, yet the FTSE 100 Index of leading shares is broadly where it was a year ago and also 18 years ago, at the end of the 1990's. Valuations are considerably lower than at the end of the last century, albeit they are above the trough levels of 2009. UK shares are especially cheap compared to other major world stock markets, largely due to investor nervousness over Brexit. This represents a particular opportunity, especially as some two thirds of UK listed companies' sales and profits comes from abroad. Within the stock market, as we have discussed elsewhere, valuations are polarised, with domestically exposed stocks extremely depressed, whilst many higher growth or defensive, international earners seem fully or over-valued.

This is a good environment for active investors. We can identify many strong businesses, trading on unusually attractive valuations, which should, in the medium term, deliver a high and growing income and good total returns, in line with Merchants' objectives. Uncertainty over the outlook for economies and markets, makes it important to diversify the portfolio, and to pay close attention to balance sheet risks, economic sensitivity and structural concerns at the individual company level.

The Merchants' portfolio is positioned very differently to the overall stock market. There is limited exposure to highly priced consumer staples stocks, in sectors like beverages and food producers. On the other hand, there are large positions in industrial sectors like aerospace & defence and construction & building materials, or domestic sectors like travel & leisure. Less economically sensitive exposures include the new positions in lowly priced tobacco stocks, as well as utilities and the holding in GlaxoSmithKline. Among the financial sectors, we have a preference for life insurance, real estate and general financial stocks, with a more modest position in banks as the latter are most exposed to any weakness in the domestic economy. We have a lower weighting than a year ago in the natural resources sectors, particularly oil producers, where valuations are less compelling, although several mining and oil companies still offer solid value and attractive cash flows and dividends.

We have included on pages 36 and 37, a breakdown of the whole portfolio in four different investment categories; high yield, cyclical growth, defensive growth and special situations. We hope this provides shareholders with a greater insight into how we assess the balance of the portfolio, and the potential profile of future investment returns, between dividends, dividend growth and capital returns.

Investment Philosophy and Stock Selection Process

Inefficient markets

At the heart of our investment philosophy is a belief that stock markets are inefficient. By focusing on the fundamental qualities of businesses and identifying situations where those qualities are under-priced in the stock market, it is possible to deliver a high and rising income stream and superior long term returns for investors.

Income bias

There is compelling historical evidence that, on average, companies paying high dividend yields have delivered above average total returns, as well as a higher income stream. We therefore, principally, buy companies which have an above average yield, either today or within the near future. However, the dividend yield is never a sufficient reason for buying a share. We only buy companies where we believe shareholders can make an attractive total return. The buy and sell decisions are both driven by total return considerations. Furthermore, we do not have a rigid policy to sell shares at a particular yield.

Income Bias

- Target stocks yielding at least in line with the market within 18 months.
  (In exceptional cases we may buy a share with a yield below average if the share/sector represents both: a) a large part of the benchmark, and b) we believe the share/sector could perform well.)
- Yield alone is never a sufficient reason for buying a share
- Purchase/sale driven by total return considerations
- No automatic sale if yield drops below market level

Research intensive, focus on cash flow

Allianz Global Investors' research platform combines a large global team of equity and credit research analysts, environmental, social and governance specialists and our own Grassroots* market research organisation to provide our fund managers with in-depth analysis of businesses and industries as well as insights into structural and cyclical trends. Our research particularly focuses on the analysis of sustainable company cash flows, which typically provide the truest measure of corporate performance. (*Grassroots^{SM} is a division of Allianz Global Investors)

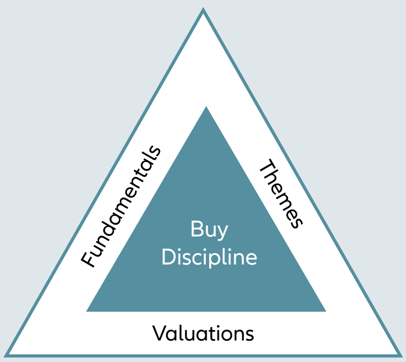
Stock Selection blends fundamentals, valuation and themes

Our stock selection process blends together a view on company fundamentals, valuation and external themes. Essentially we are trying to answer three critical questions; How good is this business? Are the shares undervalued? How supportive is the environment?

Buy Discipline

Fundamentals

Industry dynamics
Competitive position
Financials
Environmental, social & governance



Themes

Macroeconomic outlook
Business cycle
Industry/secular themes

Valuation

Absolute
Relative to history
Relative to market
Dividend yield

Investment Philosophy and Stock Selection Process *(continued)*

The fundamentals can be thought of as a full understanding of the strength of a company. We need to understand the prospects for the business area or industry that the company operates within. We analyse the company's competitive position, its products, brands, assets and technology to help understand the barriers to competition and the sustainability of returns.

Other important factors are the historic and expected growth rate and profitability of each major product, service and geographic region, a full financial profile including debt load and structure, cash-flow, assets and liabilities. Equally important is the corporate governance framework, management track record and incentive structure, as well as relevant environmental and social issues.

The focus in company valuation is to compare a wide range of valuation metrics in absolute terms and relative to the company's history and the wider sector and market, to understand what expectations are being priced into a stock and what return an investor is likely to achieve from this point forward.

Understanding valuation also helps towards understanding risk, not primarily in terms of tracking error or volatility of returns, but in terms of the risk of loss of capital value.

The third aspect of the buy discipline is themes, which are critical due to the dynamic nature of businesses and industries. Themes describe the environment in which a business operates. Themes can be broad, across the whole economy, or specific to a particular industry or sector, and they can be structural or cyclical. Themes can be positive or negative factors. They help us to understand the likelihood of various scenarios happening in the future and they can provide insight into the timing and pace of change. Perhaps most importantly for a value investment discipline, themes can help us to identify and avoid "value traps", or shares that appear cheap, but where a low valuation is deserved due to structural challenges or disruptive threats to an industry.

Bringing these three criteria together we are able to understand the fundamental strengths of a business, what return and risk is reflected or discounted in its valuation and how supportive the thematic environment is for the business and how this might be expected to change in the future.

Sell Discipline:

Stocks will be sold from the portfolio for one or more of the following reasons:

A stock reaches its target price. Target prices are regularly reviewed in the context of the company's fundamentals and the wider market. We adopt a gradualist approach in most circumstances, reducing positions as shares approach fair value.

A change to the investment thesis on a stock. We carefully reassess our investment thesis in response to relevant news flow.

We can identify better alternative investment opportunities, or similar opportunities with a more attractive risk profile.

Sell Discipline

1. Achieves target price
2. Change of investment case
3. Better opportunities elsewhere

Portfolio Construction

The portfolio consists of a concentrated selection of typically between 40 – 60 shares, chosen on individual merits, but taking account of the overall exposure to different industries and cyclical and structural themes. The size of each holding will reflect the level of conviction in the investment view, the potential valuation upside and the specific risk profile of the shares. At the portfolio level, the aim is to provide a diversified income stream and attractively priced exposure to a broad range of sectors and geographic regions.

Top 20 Holdings

1 GlaxoSmithKline

Pharmaceuticals & Biotechnology
34,722,522
5.7%

From humble origins as a London apothecary shop in 1715, GlaxoSmithKline has grown into a global science-led healthcare company today, with revenues in 2018 of over £30bn and a stable of world-leading treatments for a broad range of conditions, from hay fever to HIV.

The business is organised into three divisions: Pharmaceuticals, Vaccines, and Consumer Health. Leading Pharmaceuticals products include Advair for Asthma, and GSK's range of transformative treatments for HIV. Pharmaceuticals products often require a great deal of expensive research and development, but hit products attract very large revenues and patent-protected returns.

GSK's Vaccines division researches, manufactures and markets vaccines for 40% of the world's children. Vaccines are a high growth and high returns business, and thus very attractive to shareholders.

The Consumer Health division comprises well-known and well-loved brands helping retail customers to stay healthy and fit across a broad spectrum of categories from toothpaste ('Sensodyne'), cold & flu ('Beechams'), and pain relief ('Panadol'). Healthcare brands generally have very high equity and pricing power, benefiting from a loyal customer base for established treatments.

More details on GlaxoSmithKline are given in one of the case studies.

2 Royal Dutch Shell

Oil & Gas Producers
32,881,886
5.3%

Royal Dutch Shell is one of the leading global integrated oil and gas companies, with activities throughout the petroleum value chain, from exploration and production to refining and retailing. The company has natural resources that should enable it to maintain production of energy at today's levels for decades ahead. The business is roughly split three ways, between oil, gas and economic growth related activities such as power and chemicals.

Shell is well-positioned among major peers for an energy transition, with a high weighting towards gas in the asset portfolio, that is likely to benefit from higher demand in the future. Shell has learned from the painful experience of the oil price decline of late 2014 by aggressively tacking the cost base and investing more efficiently in new production. Shareholders are now able to reap the benefits of this prudence with a healthy dividend yield and share buyback set to deliver high returns to shareholders over the next few years.

Top 20 Holdings *(continued)*

3 Imperial Brands

Tobacco
£ 29,037,500
4.7%

Imperial Brands is a major global producer of cigarettes, tobacco, and nicotine products. We had not owned Imperial for nearly five years or any tobacco company for almost a year, on concerns about high valuations and structural changes to the industry from new products like e-cigarettes. However, the sector de-rated significantly as investors rapidly adopted an extremely negative view of the industry's prospects. Structural concerns are now much more than priced into shares of leading tobacco businesses, including Imperial, which offer compelling dividend yields, strong cash generation, and growing cash flows.

Imperial is far from inactive in the face of structural and regulatory challenge. Imperial's suite of new reduced risk products, including a competitive new e-cigarette class that is likely to gain significant traction with smokers globally, is significantly underappreciated by the market. Comparable products have recently attracted very high valuations, illustrating the value in Imperial's portfolio. Imperial has a strong enough product suite to navigate the shift to reduced-risk products whilst preserving profitability and gaining revenue market share.

4 HSBC Holdings

Banks
£ 27,351,282
4.4%

HSBC is one of the largest banking groups in the world, with more than 39 million customers across 66 countries, providing retail, commercial, private and investment banking services. HSBC is more geographically diversified than most UK-listed banks, with developing markets, most notably Hong Kong and China, accounting for a large proportion of revenues.

HSBC has undergone a significant restructuring programme, which strengthened the balance sheet and focussed the business on areas where it can generate satisfactory returns on equity. In addition, the whole banking industry is more tightly regulated today than before the financial crisis, with banks holding higher levels of capital and being subject to regular stress tests. This improved supervision should improve the resilience of banks' earnings, as well as favouring larger global players with the resources to compete effectively within tighter regulatory limits.

Although the stock is more highly rated than some UK peers it has a more attractive growth profile in emerging markets, and diversified risks, due to its broad geographical exposure.

Top 20 Holdings *(continued)*

5 BHP

Mining
23,691,246
3.8%

BHP is a world leading mineral exploration and production company, with a focus on iron ore, oil, copper and other natural resources. The investment case in BHP is based on a positive view of the copper and oil & gas fundamentals, in particular. BHP has a strong balance sheet, improving cash flow, and is reasonably priced, reflecting a generally nervous investor view of commodity shares.

6 BP

Oil & Gas Producers
22,871,226
3.7%

BP is another major global integrated oil and petrochemical company. Operating in 70 countries, BP finds and extracts oil and gas on land and offshore, refines products and distributes and sells fuel and energy around the world. With the end of extraordinary litigation costs finally in sight, the extensive operating improvements and restructuring the company has undertaken since 2011 can be more fully reflected in the valuation of the shares.

7 BAE Systems

Aerospace & Defence
22,382,183
3.6%

BAE Systems is the UK's biggest defence and aerospace company, involved in the development and manufacturing of military aircraft, surface ships, submarines, electronics, communications equipment and cyber security services. BAE's largest region is the USA, the world's biggest and most sophisticated market, benefiting from an increasing defence budget. It also has strong market positions in the UK and Saudi Arabia, as well as other export markets, providing diversity and spreading risk.

8 Legal & General

Life Insurance
22,178,700
3.6%

Legal & General is one of the UK's largest life insurance companies and a market-leading asset manager and provider of pension solutions. The company is also a major investor in UK infrastructure, and urban regeneration projects. L&G has achieved significant growth in areas such as individual and bulk annuities, and the expansion of its asset management division, which underpins a rising dividend and attractive yield.

Top 20 Holdings *(continued)*

9 SSE

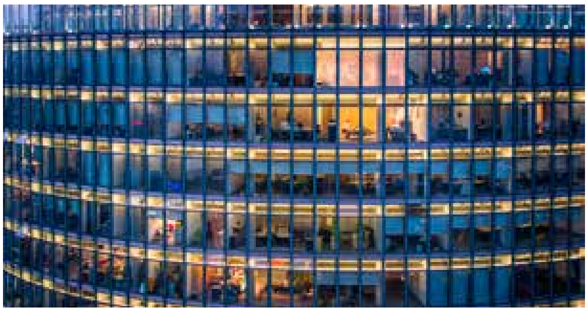
Electricity
18,068,775
2.9%

SSE is a high yielding integrated energy firm, with a balance of regulated distribution assets, electricity generation and energy supply businesses, including a large exposure to renewable generation. SSE's diversified structure offers some earnings protection through the cycle, with a high and increasing proportion of profits coming from regulated or semi-regulated activities, balancing the more challenged energy supply business.

10 Standard Life Aberdeen

Financial Services
17,981,531
2.9%

Standard Life Aberdeen is a large asset manager, formed by a merger of two complementary businesses in 2017. The company is well-positioned to grow assets from individual savings and personal pensions, and has valuable stakes in high growth asset management and insurance businesses in India. The shares are lowly priced after a difficult period of performance and fund flows, but significant cost saving synergies should support profitability.



11 Landsec

Real Estate Investment Trusts
16,485,663
2.7%

Landsec is a diversified UK real estate company, with a portfolio largely comprised of London offices, retail and leisure property. Long lease terms and high occupancy provide a good degree of visibility over cash flows, and the business runs a conservative balance sheet. The shares trades at an attractive discount to surveyed asset value owing to concerns surrounding Brexit and retail exposure, despite the defensive characteristics.

12 Prudential

Life Insurance
16,409,250
2.6%

Prudential is a global insurance and investment management company providing a wide range of products and services to customers across Europe, North America and Asia. Prudential is extremely well positioned in the fast growing Asian region and has a leading US annuity franchise, giving it one of the best growth track records in the sector. The planned demerger of these assets should unlock value in the years to come.

Top 20 Holdings *(continued)*

13 Barclays

Banks
15,976,180
2.6%

Barclays is a diversified financial services provider, spanning retail banking, wealth management, credit cards and investment banking. The company has been extensively restructured following the financial crisis. The sale of its African businesses has strengthened the balance sheet, and Barclays has a clear plan to improve returns, which should lead to a re-rating from a depressed valuation. Dividend payments were increased significantly last year.

14 Meggitt

Aerospace & Defence
15,551,370
2.5%

Meggitt is a global engineering group specialising in extreme environment components and systems for the defence and aerospace applications. The company has key products in aircraft braking systems, sensors, and heat controls. Meggitt is beginning to reap the rewards of a restructuring programme that should result in expanding margins and a higher return on capital. The shares are modestly rated, given Meggitt's growth prospects, defensive end-market exposures, and compelling market positions.

15 Greene King

Travel & Leisure
15,498,282
2.5%

Greene King is a leading pub company and brewery, running over 3,000 pubs, restaurants and hotels across the UK. It has a well invested, largely freehold pub estate, with several category leading brands. The shares trade well below the surveyed value of the assets, and Greene King generates strong cash flow, that has enabled continued investment in the business whilst maintaining a progressive dividend policy for over 40 years.

16 St. James's Place

Life Insurance
15,101,800
2.4%

St. James's Place is a major UK wealth manager with around £100bn in client assets. It has a very strong track record of asset gathering through a large network of partners, financial advisors, who invest client assets in the St. James's Place platform and product suite. The business model has proven resilient through varying market and macroeconomic conditions through a focus on full-service advice, and the shares offer an attractive and growing yield.

Top 20 Holdings *(continued)*

17 Tate & Lyle

Food Producers
15,062,820
2.4%

Tate & Lyle is a manufacturer of specialty food ingredients and primary products, which are sold to global food and beverage producers. A gradual shift of the business mix towards higher margin speciality ingredients, which are designed into food products and more differentiated than commodity products, should lead to higher growth and a revaluation of the business, driving attractive shareholder returns.

18 Pennon Group

Gas, Water & Multiutilities
14,924,144
2.4%

Pennon Group is a UK environmental infrastructure group, focusing on water, recycling and energy from waste services. Pennon's South West Water division generates best-in-sector returns on regulatory equity, whilst its Viridor business, which includes well-invested energy-from-waste assets, delivers differentiated earnings growth and diversification. The shares are suppressed by political and regulatory risk which appears overdone, given Pennon's quality assets and diversification.

19 IG Group Holdings

Financial Services
14,520,253
2.3%

IG Group is a leading global provider of financial derivatives contracts to the retail market, serving client demand for leveraged trading on a broad selection of assets. The leveraged trading industry is going through a period of regulatory change across key markets. IG's high quality customer base and conservative risk management should stand the company in good stead to outperform competitors and grow profits in the medium term.

20 CRH

Construction & Materials
14,454,000
2.3%

CRH is a diversified building materials group, producing, distributing and selling heavy building materials and construction-related products and services into US and European markets. CRH's global diversified exposures are overlooked, including good long term fundamentals driving infrastructure demand in the US. The shares trade at an attractive valuation, and the balance sheet is conservative and therefore resilient to cyclical risks.

Portfolio Holdings

at 31 January 2019

Listed Equity Holdings

Merchants Trust Portfolio Breakdown by Category

Name	Principal Activities	Value (£)	% of listed holdings	Investment Attributes: High Yield	Cyclical Growth	Defensive Growth	Special Situations
GlaxoSmithKline	Pharmaceuticals & Biotechnology	34,722,522	5.7			●	
Royal Dutch Shell B	Oil & Gas Producers	32,881,886	5.3	●			
Imperial Brands	Tobacco	29,037,500	4.7	●			
HSBC Holdings	Banks	27,351,282	4.4		●		
BHP*	Mining	23,691,246	3.8	●			
BP	Oil & Gas Producers	22,871,226	3.7	●			
BAE Systems	Aerospace & Defence	22,382,183	3.6			●	
Legal & General	Life Insurance	22,178,700	3.6		●		
SSE	Electricity	18,068,775	2.9			●	
Standard Life Aberdeen	Financial Services	17,981,531	2.9	●			
Landsec	Real Estate Investment Trusts	16,485,663	2.7	●			
Prudential	Life Insurance	16,409,250	2.6		●		
Barclays	Banks	15,976,180	2.6				●
Meggitt	Aerospace & Defence	15,551,370	2.5		●		
Greene King	Travel & Leisure	15,498,282	2.5	●			
St. James's Place	Life Insurance	15,101,800	2.4		●		
Tate & Lyle	Food Producers	15,062,820	2.4			●	
Pennon Group	Gas, Water & Multiutilities	14,924,144	2.4			●	
IG Group Holdings	Financial Services	14,520,253	2.3		●		
CRH	Construction & Materials	14,454,000	2.3		●		
British American Tobacco	Tobacco	13,964,600	2.2	●			
Antofagasta	Mining	12,826,600	2.1		●		
National Grid	Gas, Water & Multiutilities	12,745,214	2.0			●	
Tyman	Construction & Materials	12,380,049	2.0		●		
National Express Group	Travel & Leisure	12,059,000	1.9			●	
SThree	Support Services	10,350,325	1.7		●		
TP ICAP	Financial Services	9,798,082	1.6	●			
Morgan Advanced	Electronic & Electrical Equipment	9,675,718	1.6				●
Bovis Homes	Household Goods & Home Construction	9,517,500	1.5	●			
Marks & Spencer Group	General Retailers	9,342,680	1.5	●			
Informa	Media	9,272,849	1.5		●		
Senior	Aerospace & Defence	8,854,018	1.4		●		

Portfolio Holdings *(continued)*

at 31 January 2019

Listed Equity Holdings *(continued)*

				Investment Attributes			
Name	Principal Activities	Value (£)	% of listed holdings	High Yield	Cyclical Growth	Defensive Growth	Special Situations
GVC Holdings	Travel & Leisure	8,709,120	1.4		●		
Inmarsat	Mobile Telecommunications	8,522,970	1.4				●
Hammerson	Real Estate Investment Trusts	8,367,750	1.3	●			
Balfour Beatty	Construction & Materials	8,299,849	1.3				●
WPP	Media	8,263,100	1.3	●			
Keller	Construction & Materials	7,770,000	1.2		●		
Ashmore Group	Financial Services	7,741,061	1.2		●		
Man Group	Financial Services	6,771,646	1.1		●		
ITV	Media	6,697,740	1.1		●		
Kin and Carta	Support Services	5,432,625	0.9				●
Sirius Real Estate	Real Estate Investment & Services	5,008,000	0.8		●		
Hansteen Holdings	Real Estate Investment Trusts	4,547,825	0.7				●
		622,068,934	**100.0**	**35.0**	**35.6**	**20.9**	**8.5**

The portfolio has been broken down into four categories to provide shareholders with a greater insight into the investment rationale for different shareholdings. These are:

High Yield: Companies which we believe to be undervalued, with a high dividend yield. The return is expected to come from dividends and a revaluation.

Cyclical Growth: Companies that should grow over the economic cycle but which may have economic or market sensitivity. The return is expected to come from a revaluation of the shares and a compounding of growth, in addition to the dividend yield.

Defensive Growth: Companies that should grow over time, with limited economic sensitivity. The return is expected to come from dividends, compounding growth and potentially, a revaluation of the shares.

Special Situations: Companies where the investment case is typically based around a turnaround or restructuring of the business. These may have a low initial yield, if significant dividend growth is expected. The return will principally come from capital appreciation as shares are revalued.

Unlisted Equity Holdings

Name	Value (£)	% of listed holdings	Principal activities
Fintrust Debenture**	4,486	100.0	Financial Services
	4,486	**100.0**	

Written Call Options

As at 31 January 2019, the market value of the open option positions was £(10,490) (2018: £(51,450)), resulting in an underlying exposure to 0.6% of the portfolio (valued at strike price).

* BHP formerly BHP Billiton.
**Fintrust Debenture PLC is the lender of the company's Fixed Rate Interest Loan; more details are available in Note 9 on page 87.
All holdings are UK listed.

Distribution of Total Assets

at 31 January 2019

	Percentage of total assets* at 31 January 2019	Percentage of total assets* at 31 January 2018
Financials		
Banks	6.7	10.5
Financial Services	8.9	9.3
Life Insurance	8.2	5.9
Real Estate Investment & Services	0.8	0.8
Real Estate Investment Trusts	4.6	2.6
	29.2	**29.1**
Industrials		
Aerospace & Defence	7.3	6.2
Construction & Materials	6.6	5.4
Electronic & Electrical Equipment	1.5	1.4
Support Services	2.4	3.5
	17.8	**16.5**
Consumer Services		
General Retailers	1.5	1.4
Media	3.7	5.5
Travel & Leisure	5.7	6.0
	10.9	**12.9**
Consumer Goods		
Beverages	-	1.8
Food & Drug Retailers	-	1.8
Food Producers	2.3	2.2
Household Goods & Home Construction	1.5	1.4
Tobacco	6.7	-
	10.5	**7.2**

Distribution of Total Assets *(continued)*

at 31 January 2019

	Percentage of total assets* at 31 January 2019	Percentage of total assets* at 31 January 2018
Oil & Gas		
Oil & Gas Producers	8.7	12.6
	8.7	**12.6**
Utilities		
Electricity	2.8	2.9
Gas, Water & Multiutilities	4.3	3.3
	7.1	**6.2**
Basic Materials		
Mining	5.7	5.2
	5.7	**5.2**
Health Care		
Pharmaceuticals & Biotechnology	5.4	6.1
	5.4	**6.1**
Telecommunications		
Mobile Telecommunications	1.3	1.6
	1.3	**1.6**
Total Investments	**96.6**	**97.4**
Net Current Assets (Liabilities)	**3.4**	**2.6**
Total Assets	**100.0**	**100.0**

*Total assets (less creditors due within one year) £644,132,030 (2018: £703,921,177).

Senior plc designs, manufactures and markets high-technology components and systems for the aerospace, defence, land vehicle and energy industries. Fluid conveyance; gas turbine engine; and structural products and systems for aerospace customers accounted for 70% of group revenue in 2018.

"The current environment is a good one for active investors. We can identify many strong businesses, trading on unusually attractive valuations, which should, in the medium term, deliver a high and growing income and good total returns, in line with Merchants' objectives."

Simon Gergel
Portfolio Manager

Performance – Review of the Year

Revenue	2019	2018	% change
Income	£34,104,274	£32,633,321	+4.5
Revenue earnings attributable to ordinary shareholders	£30,095,750	£27,732,007	+8.5
Revenue earnings per ordinary share	27.7p	25.5p	+8.6
Dividends per ordinary share in respect of the year	26.0p	24.8p	+4.8

Assets	2019	2018	Capital return % change	Total return % change[1]
Net asset value per ordinary share with debt at par	491.1p	545.8p	-10.0	-5.4
Net asset value per ordinary share with debt at market value (capital)	471.4p	523.9p	-10.0	-5.2
Ordinary share price	471.0p	488.0p	-3.5	+1.7
FTSE All-Share	3,825.6	4,137.7	-7.5	-3.8
Discount of ordinary share price to net asset value (debt at par)	-4.1%	-10.6%	n/a	n/a
Discount of ordinary share price to net asset value (debt at market value)	-0.1%	-6.9%	n/a	n/a
Ongoing charges[2]	0.58%	0.59%	n/a	n/a

1 NAV total return reflects both the change in net asset value per ordinary share and the net ordinary dividends paid.
2 The ongoing charges percentage is calculated in accordance with the explanation given on page 42.

A Glossary of Alternative Performance Measures (APMs) is on page 42.

Glossary

UK GAAP performance measures

Net Asset Value is the value of total assets less all liabilities. The Net Asset Value, or NAV, per ordinary share is calculated by dividing this amount by the total number of ordinary shares in issue. The debt in the company used in the calculation is measured at par value, that is, the net proceeds on issue plus accrued finance costs to date and, if issued at a premium, the amortised premium to date.

Earnings per ordinary share is the profit after taxation, divided by the weighted average number of shares in issue for the period.

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, Merchants 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 Merchants receives an option premium, which is taken to the revenue account. Merchants 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, as the option holder can exercise their option to buy the shares at the strike price.

Merchants' 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 four 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 Trust's gearing to the equity market, neutralising a small part of the financial leverage. It tends to be more profitable in sideways or downwards markets but less profitable in rising markets.

Alternative Performance Measures (APMs)

Net Asset Value, debt at market value, is the value of total assets less all liabilities, with the company's debt measured at the market value at the time of calculation. The Net Asset Value, or NAV, per ordinary share with debt at market value is calculated by dividing this amount by the total number of ordinary shares in issue (see pages 96 and 97).

Net Asset Value per ordinary share, total return represents the theoretical return on NAV per ordinary share, assuming that dividends paid to shareholders were reinvested at the NAV per ordinary share at the close of business on the day the shares were quoted ex dividend (see page 3).

Share Price Total Return represents the theoretical return to a shareholder, on a closing market price basis, assuming that all dividends received were reinvested, without transaction costs, into the ordinary shares of the company at the close of business on the day the shares were quoted ex dividend (see page 3).

Benchmark Total Return is the return on the benchmark, on a closing market price basis, assuming that all dividends received were reinvested into the shares of the underlying companies at the time their shares were quoted ex dividend (see page 3).

Discount is the amount by which the stock market price per ordinary share is lower than the Net Asset Value, or NAV, with either debt at par or debt at market value, per ordinary share. The discount is normally expressed as a percentage of the NAV per ordinary share. The opposite of a discount is a premium (see pages 41 and 43).

Ongoing Charges are operating expenses incurred in the running of the company, whether charged to revenue or capital, but excluding financing costs. These are expressed as a percentage of the average net asset value during the year and this is calculated in accordance with guidance issued by the Association of Investment Companies (see pages 12 and 41).

Yield represents dividends declared in the past year as a percentage of share price. This is shown as 5.5% at 31 January 2019 in the highlights on page 2.

Strategic Report

Shares in mining, metals and petroleum multinational BHP performed well, helped by a special dividend funded by the sale of US shale assets to BP.

Strategic Report

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%, (measured at the time that any increase in total borrowing facilities is agreed). Gearing averaged 19.8% in the year to 31 January 2019 (2018: 19.7%).

Depending on equity market conditions, gearing may be outside this range from time to time but it is not the board's intention to increase total borrowing facilities if gearing is outside the range.

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.

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:

- A review of Merchants' stated objectives: are they still relevant; what is the correct order of priority
- The right KPIs: which should we monitor and how should they be reported by AllianzGI and the board
- Potential for long term dividend growth
- Digitalisation and how advertising makes a difference to Merchants
- Gearing strategy and refinancing considerations

Following our strategic review it was agreed that the company's objectives and KPIs were correctly identified. We also agreed that KPIs could be summarised in three distinct groupings and the new graphic presentation of the KPIs appears on pages 10 to 12.

We approved a continuation of our cost-effective marketing and advertising programme, as explained by the Chairman on page 7.

Strategic Aims
The company's aims continue to be to:

Dividends
- Provide a high income
- Provide a progressively growing income

Shareholder return
- 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

Performance
- 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

Strategic Report *(continued)*

Objectives

Our objective is to provide shareholders with 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.

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 consumer 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 4, and in the Investment Manager's Review on pages 16 to 27.

Investment Strategy

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.

More detail on the investment philosophy and stock selection process is set out in the investment manager's review on pages 28 to 29 which will help shareholders understand how and why the manager invests the way he does, and sets the background for individual investment decisions.

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.

The company undertakes joint marketing initiatives with a number of market-leading investment platforms and this has proved to be a highly successful strategy.

Dividend

Income is distributed to provide an above market 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. Conversely, when shares are trading at a discount shares may be bought back and cancelled or held in treasury. The board may buy back shares when it considers the discount to be significant and a buyback will be good relative value, taking gearing into account.

Since the year end, 200,000 new shares were issued.

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.

Strategic Report *(continued)*

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 listed below, together with the actions taken to mitigate them, and set out in the table opposite. The board has 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. The process by which the directors monitor risk is described in the Audit Committee Report on page 63.

Risk mapping

The risk map opposite shows the board's assessment of the principal risks facing the company. These have been grouped into three types: Investment and Portfolio Risks; Business and Strategy Risks; and Operational Risks. 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 its objectives to be met therefore it is not surprising that portfolio risk types earn amber ratings.

Principal risks

A more detailed version of the chart is reviewed and updated by the audit committee at least twice yearly. This takes the form of a matrix which sets out risk types, key risks identified and their status, the controls and mitigation in place to address these risks, together with the evidence of controls and gives an assessment of the risk using a traffic-light system, as shown at the bottom of the chart, to confirm the outcome of the assessment of the risk.

The principal risks are broadly unchanged from the previous year. Those identified as having the highest impact are **Market decline** (1.1 below), **Investment strategy** (2.2 below) and **Investment performance** (2.3 below). However, Market decline and Investment performance risks are shown to have increased in likelihood as shown by the arrows on the risk chart.

Risk appetite

The board identifies risks, considers controls and mitigation, the probability of the event, and assesses residual risk. It then evaluates whether its risk appetite is satisfied. The board confirms for the year ended 31 January 2019 that its assessment of risk is in line with its risk appetite for all key risks.

We set out below how we monitor and mitigate the risks.

Investment and Portfolio Risks

1.1 Market decline

The board receives regular reporting from the manager on macro-economic intelligence received from its internal and external sources. Macro-economic and political risks are taken into account during portfolio construction, although stock selection is predominantly "bottom up" driven. The portfolio is diversified across industries and stocks to mitigate the impact of individual share price volatility. Whilst the portfolio is only invested in UK listed companies, the end market exposures of these businesses are spread around the world. The portfolio is stress tested at least monthly.

1.2 Market liquidity and pricing

Board policies restrict the size of investments in individual companies and sectors. Liquidity reports including stock disposal times are evaluated by the manager at least monthly.

1.3 Counterparty

The manager operates on a delivery versus payment system, therefore reducing the risk of counterparty default.

1.4 Currency

The board monitors currency movement and determines hedging policy as appropriate. The portfolio is only invested in UK listed companies, with shares predominantly priced in sterling. Currency exposure is therefore primarily indirect, reflecting the market positions and trading exposures of these companies, but exposures are well diversified. Several companies pay dividends in non-sterling currencies, and the board monitors the income split by currency to assess risks to the revenue account.

Business and Strategy Risks

2.1 Shareholder relations

A review of shareholder lists takes place at each board meeting. Reports on shareholder sentiment are received from the manager and brokers and reviewed by the board. Significant movements in shareholder accounts are reported to the board. The AGM is the core interface between the company and shareholders in demonstrating accountable and transparent management of the company.

Strategic Report *(continued)*

Risk map

Impact

Likelihood

- Risk is acceptable, no more 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

→ Risk has increased from previous year
← Risk has decreased from previous year

Strategic Report *(continued)*

2.2 Investment strategy

Board policies restrict the size of investments in individual companies and sectors. The board reviews the suitability of the investment strategy and the stock selection process regularly, in particular at the annual strategy review. The board closely monitors the income projections for the portfolio, and the level of risk and diversification of this income, to ensure the company can meet its income objectives.

2.3 Investment performance

The investment manager attends all board meetings to discuss performance with the directors. The board manages these risks by giving investment guidelines which are monitored at each meeting. The board reviews the investment performance of the company against the benchmark and peer group. The board regularly discusses composition and succession planning to ensure that sufficient board members have the appropriate background and knowledge to evaluate performance.

2.4 Financial

The rolling income forecast (including special dividends), balance sheet and expenses are reviewed at every board meeting. Reporting from the custodian covering internal controls in place over custody of investments and over appointment and monitoring of sub-custodians is produced and reviewed at least annually. The board's investment restrictions are input in trading systems to impose a pre-trade check. The manager discusses derivative activity during a monthly risk call. Any overdue dividend debtors are monitored by the manager and variance analyses of income from meeting to meeting are provided to the board. The board annually reviews and approves the accounting policy for the income/capital split.

2.5 Liquidity and gearing

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. Regular compliance information is prepared by the manager and submitted to lenders in accordance with the covenant requirements.

2.6 Market demand

The board regularly reviews the level of discount and shares can be bought back by the company at discounts greater than an agreed level when there is demand to do so.

Operational Risks

3.1 Organisation set up and process

Business continuity plans are in place and are reviewed and tested on an annual basis by the manager. The manager engages an external party to audit its control environment, submitting the annual results to the board.

3.2 Outsourcing and third party

The board receives formal assurance reports from all of its direct service providers and the manager carries out regular monitoring of outsourced administration functions, this includes compliance visits and risk reviews where necessary. Results of these reviews are supplied to the board.

Service Level Agreements (SLAs) and Key Performance Indicators (KPIs) are in place with each service provider and the board receives reports outlining performance against these.

The company secretary reports to the board that the contracts with service providers are reasonable and competitive.

3.3 Regulatory

The board maintains close relations with its advisers and makes preparations for mitigation of these risks as and when they are known or can be anticipated.

3.4 Corporate governance

The board takes regular advice on best practice. The board is highly experienced and knowledgeable about corporate governance best practice, and the board includes directors who are board members of other large UK Plcs and other investment companies.

3.5 Human resources

Manager and board succession plans are in place. Cover is available for core members of the relevant teams of the manager, and work can be carried out by other team members should the need arise.

3.6 Financial crime, fraud and cyber security

AllianzGI has anti-fraud, anti-bribery policies and robust procedures in place. 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. These reports confirm that all systems are secure and are updated in response to any new threats as they arise.

Strategic Report *(continued)*

3.7 Reputational

The Investment Manager works closely with AllianzGI's Environmental, Social and Governance (ESG) and Stewardship function and actively engages with investee companies on ESG issues and makes investments incorporating ESG factors in the decision process.

The Investment Manager provides a statement on Stewardship on page 26.

3.8 Emerging

The Board carries out horizon scanning by keeping informed through its auditors, lawyers and manager on the political, economic and legal landscape, and reviews updates received on regulatory changes that affect the company. Examples include:

- Keeping informed on the Brexit preparations (soft or hard exit) by the manager and providers.
- Reviewing industry and manager thematic outlook and insights research publications
- Attending periodic thematic presentations by the manager's Global Strategist or CEO and by receiving and reviewing a summary update outlining the cyber exposures and control framework of the manager and other key providers.

Movements in the year

Movements in the positioning of the risks in the risk map during the year are shown using arrows. The board has assessed the risks and determined that there have been increases to the following risks: 1.1 Market decline; 2.3 Investment performance; 3.6 Financial crime, fraud and cyber security; and 3.8 Emerging.

In addition to the principal risks described 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 monitors reports provided by third party service providers on how these threats are being handled. After ensuring that there are appropriate measures in place, the board considers that these risks are effectively mitigated.

Cyber Security Risks – review

The risk of cyber attacks is identified in the company's risk matrix as being a moderate to high impact risk, likely to occur with moderate frequency (every two to five years). In the year under review the board has received the results of a review of the cyber security frameworks in place, including firewall security, and site visits, at each of the company's key suppliers, and it has concluded that there are sufficient safeguards in place for the risk profile in the matrix to remain unchanged.

Brexit – Risks and Implications

The board has considered the likely impact of the changes to the UK's relationship with The European Union and identified the areas where it believes there will be adjustments in how the company operates.

Portfolio management: There could be an impact on the day to day ability of the company to trade as the UK will be seen as a third country party under MiFID II. While the UK is expected to put in place a temporary permissions regime, there has been no clarity from the EU on how it will treat UK institutions. For example, the EU would need to formally recognise UK clearing banks as being properly regulated and supervised. Merchants Trust will be in the same position as other investment companies and will monitor the developments in this area closely with its advisers. The board has also reviewed the impact on the portfolio of investments in detail with the portfolio manager.

Regulations: The company will need to consider the impact of Brexit on the key financial services regulations which apply to it. Data Protection laws in the UK will remain in force, although there will need to be some safeguards on any transfers of personal data between the EEA and the UK. The UK government has indicated that it will enshrine all existing EU law into UK law at the date of withdrawal. The company's AIFM, Allianz Global Investors GmbH (AllianzGI GmbH) is incorporated in Germany and it currently provides cross-border management services to the company using the AIFMD management passport. The German regulator, BaFin, and the FCA in the UK have reached a formal understanding that AllianzGI GmbH can continue to operate as the AIFM after Brexit and apply to be regulated in the UK by the FCA in a three year transition period.

Banking and finance: The temporary permissions register being introduced by the UK government will also allow EEA firms which currently passport into the UK (such as its lending bank, ING Bank NV) to continue to operate in the UK for up to three years while they apply for full authorisation.

The board has concluded that although there may be some changes to the way the company operates after Brexit comes into force, that it is well prepared for what is foreseeable, and that there is likely to be no fundamental change to its business model.

Strategic Report *(continued)*

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 130 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 is broadly equivalent to the portfolio's investment cycle and because the board will have arranged for the refinancing or repayment of the 2023 debentures within that time period. Whilst acknowledging the difficulty of forecasting prospects for markets beyond a relatively short horizon, the board believes that this should 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.

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. The chief risks that could pose a threat to the future prospects of the company are Investment Performance and Market Decline, as described in the Risk reporting on pages 46 to 49.

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 future earnings and 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. The next such planned payment is in 2023; 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 socially responsible investment are set out above.

Directors and employees and gender representation

Biographies of the directors of the company on 31 January 2019 are set out on pages 52 and 53. 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 9 and the investment manager discusses his view of the outlook for the company's portfolio in his review on page 27.

The board continues to believe that the pension freedoms and the continuing evolution of the investment platforms market offer many opportunities for the self-directed investor.

On behalf of the board

Simon Fraser
Chairman
28 March 2019

Governance

Among the top ten contributors, Meggitt shares performed well, as the aerospace and defence company reported encouraging trading.

Directors

Simon Fraser

Chairman

Joined the board in August 2009 and became Chairman in 2010. He is Chairman of Foreign & Colonial Investment Trust PLC, The Investor Forum and McInroy and Wood. He is on the Advisory Board of the Independent Review into the Quality and Effectiveness of the UK Audit Market. Simon 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.

Simon will retire from the board on 1 September 2019.

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 and investment committees. Timon 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.

Mary Ann Sieghart

Joined the board in November 2014. She is Chair of the Social Market Foundation and she was, until recently, Senior Independent Director of The Henderson Smaller Companies Investment Trust plc. Mary Ann 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. She is a Visiting Fellow of All Souls College, Oxford for the academic year 2018-19.

Directors *(continued)*

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 and Co-chair of the Development Board of Somerville College, Oxford. Before joining RELX Group in 1997, Sybella was a member of the M&A advisory teams at, successively, Citi and Barings. 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 Fidelity European Values PLC and Witan PLC. Paul 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.

Committee memberships
All directors are non-executive and independent of the manager. All directors are members of the Management Engagement Committee. All directors, with the exception of the Chairman, Simon Fraser, are members of the Audit Committee. Further details are on page 58.

Investment Manager and Advisers

The Manager or Alternative Investment Fund Manager (AIFM)

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 2018, Allianz Global Investors had €505 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 2018 had £1.41 billion of assets under management in a range of investment trusts. Website: www.allianzgi.co.uk

Head of Investment Trusts

Stephanie Carbonneil
Email: stephanie.carbonneil@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

BDO LLP

Bankers

HSBC Bank plc,
Barclays Bank plc

Registrars

Link Asset Services
(full details on page 101)

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 year ended 31 January 2019.

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
27 March 2019

Further information about the relationship with the Depositary is on page 100.

Directors' Report

The directors present their report and the audited financial statements of the company for the year ended 31 January 2019.

Revenue

The revenue earnings attributable to ordinary shareholders for the year amounted to £30,095,750 or 27.7p per share (2018: £27,732,007, 25.5p per share).

The first quarterly dividend of £6,958,622, or 6.4p per share, and the second quarterly dividend of £7,067,350, or 6.5p per share, have been paid during the year. Since the year end the third quarterly dividend of £7,067,350, or 6.5p per share, was paid on 6 March. Subject to shareholder approval, a final dividend of 6.6p will be payable on 22 May 2019. 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.

Invested Funds

Sales of investments during the year resulted in net gains based on historical costs of £19,824,923 (2018: £23,575,112). 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 there were no share issuances and no share buybacks. Since the year end 200,000 new shares were issued.

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 page 9 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 on page 27. The future is also discussed in the Strategic Report on page 50.

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 11 on page 88. The details of the 4% perpetual debenture stock and the 3.65% cumulative preference stock are provided in Notes 11(iii) and 11(iv) respectively on page 89.

Voting Rights in the Company's Shares

The voting rights at 27 March 2019 were:

Share class	Number of shares issued	Voting rights per share	Total voting rights
Ordinary shares of 25p	108,928,464	1	108,928,464
3.65% cumulative preference stock of £1	1,178,000	1	1,178,000
Total	**110,106,464**		**110,106,464**

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..

Directors' Report *(continued)*

Interests in the Company's Share Capital

As at 27 March 2019 the company has received no declarations of notifiable interests in the company's issued share capital.

Common Reporting Standards (CRS)

CRS is a global standard for the automatic exchange of information commissioned by the Organisation for Economic Cooperation and Development and incorporated into UK law by the International Tax Compliance Regulations 2015. CRS requires the company to provide certain additional details to HMRC in relation to UK resident foreign investment holders. The reporting obligation began in 2016 and will be an annual requirement going forward. The Registrars, Link Asset Services, have been engaged to collate such information and file the reports with HMRC on behalf of the company.

Directors

Biographical details of the current directors at the date of the signing of this report are shown on pages 52 and 53.

All of the directors are retiring at the annual general meeting and each offers themself for re-election. 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. As of the date of this report, the board is announcing the retirement of the current Chairman, Simon Fraser, on 1 September this year, and as reported in the Chairman's Statement on page 6, the board is pleased to announce that Colin Clark, who will join the board on 30 June 2019, will become Chairman at that time.

Board evaluation

The board conducted a formal board evaluation after the year end. This was carried out by the Chairman, and an evaluation of the Chairman was performed by the Senior Independent Director. Both evaluations were conducted by means of individual interviews. The board, its committees and the individual directors were all found to be performing well and, upon receiving the reports, the board's Nomination Committee recommended to the board that each of the directors be nominated for re-election at the forthcoming Annual General Meeting. It was noted that the exercise to appoint a new Chairman had proceeded well and that a succession plan was in place. The board benefited from the breadth and depth of expertise on the board, with each director making sound contributions to the strong culture of the board. Other outcomes of the evaluation exercise were that the board would continue its engagements on strategic matters both with the manager and with external experts to continue to improve the wider understanding of how the company differentiated itself in its offering to investors and a continued focus on performance. .

Details of the directors' attendance at board and committee meetings is set out in the table on page 57.

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.

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 (2018: 0.35%) of the value of the assets, calculated quarterly, after deduction of current liabilities, short term loans with an initial duration of less than one year and any funds within the portfolio managed by AllianzGI. The management contract is terminable at one year's notice (2018: 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.

Corporate Governance Statement

The board has considered the principles and recommendations of the AIC Code of Corporate Governance 2016 (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

Directors' Report *(continued)*

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 revised UK Corporate Governance Code published in 2018, together with the AIC Code of Corporate Governance published in February 2019, which is effective for financial years beginning after 1 January 2019 will apply in the financial year ending 31 January 2020 and the board will report against this in the next year's annual report.

The full text of the company's Corporate Governance Statement is on the website www.merchantstrust.co.uk in the Literature & Resources section under Literature/Terms of Reference and Corporate Documents.

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
No. of meetings	6	2	1	1
Simon Fraser	6	2[1]	1	1
Timon Drakesmith	6	2	1	1
Mary Ann Sieghart	6	2	1	1
Sybella Stanley	6	2	1	1
Paul Yates	6	2	1	1

[1] Invited to attend meetings, although not a committee member.

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 or she 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 to shareholders on the company's procedures for ensuring that its powers of authorisation of conflicts are operated effectively and that the procedures have been followed.

Statements by the directors

Each of the directors provides a statement of all conflicts of interest and potential conflicts of interest relating to the company on appointment and subsequently in the event of any change or potential change to this statement. The statements made by each director are 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.

Good practice

The Merchants board follows good practice by having directors' interests as an agenda item at every scheduled board meeting, and a report of all directors' interests is tabled for consideration by the board. This means that any changes to the directors' interests can be noted and recorded, and any potential conflicts identified and dealt with by the board.

Directors' Report *(continued)*

Procedure for assessing conflicts and potential conflicts
A director with a potential conflict might be asked to step out of the room, or be permitted to remain in the room but not participate in the discussion or take part in a vote on a course of action. The Merchants board composition has always included directors who sit on the boards of trading companies in which the portfolio manager may be invested, and also includes from time to time directors who sit on the boards of public bodies.

The board has agreed that only directors who have no interest in the matter being considered will be able to take the relevant decision on approval of any conflicts or potential conflicts, 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, such as ensuring that a director who also serves on the board of a company in the portfolio does not participate in any discussions on the investment decision.

Directors' Interests Register
The Merchants directors' interests register covers directors' outside interests (e.g., directorships, significant holdings) and where the directors use the services of suppliers to the company (e.g., accountancy firms) in their own capacity. The register also contains notes of any hospitality and gifts received from service providers, including the management company.

Confirmation to shareholders
The board confirms that the detailed procedures have been followed during the year and that its powers of authorisation are operating effectively.

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 after the year end, as reported on page 56. The changes to the board in 2019 are reported on page 56 and in the Chairman's Statement on page 6.

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 63 to 65.

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.

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 62. The Independent Auditors' Report can be found on pages 70 to 75.

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.

Directors' Report *(continued)*

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 pages 46 to 49). 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 organisational 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, Link 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.

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

Directors' Report *(continued)*

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 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 directors hold directorships on the boards of companies in which the company is invested, they do not participate in decisions made concerning those investments, such as Sybella Stanley (Tate & Lyle) and Timon Drakesmith (Hammerson).

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

Criminal Finances Act 2017

The company has a commitment to zero tolerance towards the criminal facilitation of tax evasion.

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 11 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 36,309,488 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 2020.

2. Disapplication of Pre-emption Rights

A resolution was passed at the annual general meeting held on 16 May 2018 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 2019. Special resolution 12 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 2020 or 16 August 2020 if earlier. This power is limited to a maximum number of 5,446,423 ordinary shares, being approximately 5% 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 2019.

Authority will also be sought in Resolution 12, 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.

Directors' Report *(continued)*

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 12, 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 13, 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 £450 million). The rules of the UK Listing Authority (Listing Rules) limit the price which may be paid by the company to 105% of the average middle-market quotation for an ordinary share on the five business days immediately preceding the date of the relevant purchase. The minimum price to be paid will be 25p per ordinary share (being the nominal value). Overall, this proposed share buy back authority, if used, 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 16,328,376 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 2019.

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 2020 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 BDO LLP as statutory auditors for the ensuing year. Further information on the proposed appointment is in the Audit Committee Report on page 65.

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
28 March 2019

Statement of Directors' Responsibilities in respect of the Financial Statements

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). Under company law 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;
- state whether applicable UK Accounting Standards have been followed, comprising FRS 102, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; 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 58.

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 position and performance, business model and strategy.

For and on behalf of the board

Simon Fraser
Chairman
28 March 2019

Audit Committee Report

I am pleased to present the report of the audit committee for the year ended 31 January 2019.

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. At the meeting following the year end 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 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, and, as signalled last year, conducted an audit tender.

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 existing risks 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.

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 market decline, investment strategy and investment performance. The risks identified together with mitigating actions are set out in the Strategic Report on pages 47 to 49.

Viability Statement
Based on this review of risk, including the chief risks around Investment Performance and Market Volatility 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 50 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.

Audit Committee Report *(continued)*

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 position and 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 we receive reports on current and future changes to regulatory and accounting reporting from the manager and auditor.

During the year we carried out a project to refresh and invigorate the annual report to make it more appealing and informative to readers.

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. The committee then met with the auditors following the year end to discuss the results of the audit.

Significant issues considered by the audit committee in the year

Area of focus	Activity
Risks around the valuation of and the ownership of investments and risks of management override	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 80 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 80 and 81, 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)*

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 £5.3 million, or about 1% of Net Assets, although the auditors would bring to the audit committee's attention any significant misstatements below that level.

Auditor Tenure and Auditor Reappointment

This is BDO LLP's first year as the company's independent auditor, following the tender process we reported on last year. The company is subject to mandatory auditor rotation requirements and so will put the external audit out to tender at least every ten years, and change auditor at least every twenty years. The next tender will therefore be required no later than 2028. Peter Smith is the audit partner and the auditor is required to rotate partners every five years.

The audit and its effectiveness

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 BDO LLP for 2017/18.

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 was satisfactory.

Non-audit services

Non-audit services relate 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 £nil in the year (2018: £12,900). These fees are considered by the audit committee to be proportionate to the fees for audit services of £22,500 (2018: £31,585). This non-audit work was found not to have a significant impact on the financial statements.

Timon Drakesmith
Audit Committee Chairman
28 March 2019

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 2019. An ordinary resolution for the approval of the Directors' Remuneration Policy Report was first put to a binding shareholder vote at the annual general meeting in 2014 and was placed before shareholders for approval at the AGM in 2017. It will next be put to shareholders in 2020. The results of the vote at the 2018 AGM for this resolution were as follows: In favour 94.9%, against 5.1% and 693,409 shares were withheld (in aggregate, 31,770,124 votes). The results of the advisory vote at the 2018 AGM for the resolution to approve the Implementation Report were as follows: In favour 95.0%, against 4.9% and 587,638 shares were withheld (in aggregate 27,971,236 votes). The Directors' Remuneration Implementation Report is to be put to the AGM, annually, as an advisory shareholder vote.

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:

	2019	2018
Simon Fraser	20,000	20,000
Timon Drakesmith	15,000	15,000
Mary Ann Sieghart	1,000	1,000
Sybella Stanley	3,114	3,114
Paul Yates	20,133	20,000

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 in May 2018.

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 £25,000 per annum with an additional £5,500 for the Chairman of the Audit Committee and the Chairman at a rate of £37,500 per annum. The current fees have applied since 1 February 2017.

The fees were reviewed in January 2019 and it was determined that in order to keep pace with rates in the investment trust industry there would be the following increases to directors' fees with effect from 1 February 2019: Chairman £38,250, Directors £25,500, 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	2019 £	2018 £
Simon Fraser	37,500	37,500
Timon Drakesmith	30,500	30,500
Mary Ann Sieghart	25,000	25,000
Sybella Stanley	25,000	25,000
Paul Yates	25,000	25,000
Total	**143,000**	**143,000**

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 the shareholders

	2019 £	2018 £
Remuneration paid to all directors	143,000	143,000
Distributions to shareholders	27,617,030	26,638,473

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.

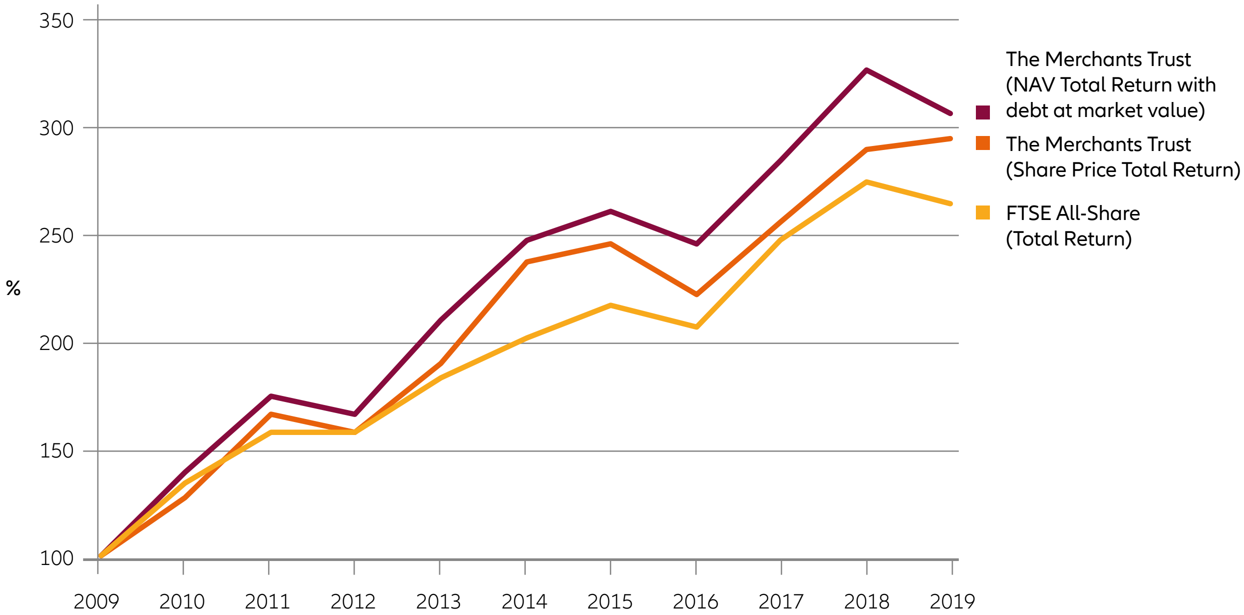
Directors' Remuneration Report *(continued)*

Performance Graph

The graph below measures the company's share price and net asset value performance against its benchmark index of the FTSE All-Share Index and is re-based to 100.

The company's performance is measured against the FTSE All-Share 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 ten years to 31 January 2019



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

Signed on behalf of the board

Simon Fraser
Chairman
28 March 2019

Financial Statements

Satellite communications company, Inmarsat, is exploiting growing demand for data on the move, especially on aeroplanes and ships.

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

Opinion

We have audited the financial statements of The Merchants Trust plc (the 'Company') for the year ended 31 January 2019 which comprise the Income Statement, Statement of Changes in Equity, Balance sheet, Cash Flow Statement and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland (United Kingdom Generally Accepted Accounting Practice).

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 January 2019 and of its profit or loss 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.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to principal risks, going concern and viability statement

We have nothing to report in respect of the following information in the annual report, in relation to which the ISAs (UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report set out on pages 46 to 49 that describes the principal risks and explains how they are being managed or mitigated;
- the directors' confirmation set out on page 46 in the annual report 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;
- the directors' statement set out on page 62 in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the Company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- whether the directors' statement relating to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 50 in the annual report 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.

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matter	How the matter was addressed in the audit
Valuation and ownership of investments: (Page 80 and Note 8 on page 86) Investments represent the most significant balance in the financial statements; there is a potential risk that the Company has not appropriate confirmation of title over investments. The Manager is responsible for preparing the valuation of investments, which are reviewed and approved by the Board. Notwithstanding this review, there is a potential risk of misstatement in the investment valuations due to errors in the calculations.	We responded to this matter by testing the valuation and ownership of 100% of the portfolio of investments. We performed the following procedures: In respect of the quoted investment valuations (over 99% of the total portfolio by value) we have: – Confirmed the year-end bid price was used by agreeing to externally quoted prices. – Assessed if there were contra indicators, such as liquidity constraints, to suggest bid price is not the most appropriate indication of fair value by analysing the trading volume of individual stocks. – Obtained direct confirmation from the custodian regarding all of investments held at the balance sheet date.
Revenue recognition: (Page 80 and Note 1 on page 82) Income arises from the investment portfolio and a key factor in demonstrating the performance of the portfolio. Revenue recognition is considered significant audit risk as it is the key driver of dividend returns to investors and judgement is required in determining the allocation of income to revenue or capital and in considering the appropriateness of the recognition.	We performed the following procedures: – For quoted investments, we utilised data analytics to test 100% of the portfolio. We derived an independent expectation of income based on the investment holding and distributions per independent sources. We also cross checked the portfolio against corporate actions and special dividends and challenged if these had been appropriately accounted for as income or capital. – We analysed the whole population of dividend receipts to identify any unusual items that could indicate a capital distribution, for example where a dividend represented a particularly high yield. – We traced the sample of dividend income through from the nominal ledger to bank. – We recalculated a sample of the premium on written call options.

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

Our application of materiality

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements. For planning, we consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonable users that are taken on the basis of the financial statements. In order to reduce to an appropriately low level the probability that any misstatements exceed materiality we use a lower materiality level, performance materiality, to determine the extent of testing needed. Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the Financial Statements. The application of these key considerations gives rise to two levels of materiality, the quantum and purpose of which are tabulated below.

Materiality measure	Purpose	Key considerations and benchmarks	2019 Quantum (£)
Financial statement materiality. (1% of net assets)	Assessing whether the financial statements as a whole present a true and fair view.	– The value of gross investments. – The level of judgement inherent in the valuation. – The range of reasonable alternative valuations	£5,300,000
Performance materiality. (70% of the financial statement materiality)	Lower level of materiality applied in performance of the audit when determining the nature and extent of testing applied to individual balances and classes of transactions.	– Financial statement materiality. – Risk and control environment.	£3,700,000
Specific materiality – classes of transactions and balances which impact on net revenue returns. (10% of the net revenue returns to the ordinary shareholders)	Assessing those classes of transactions, balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements	– Net revenue returns to the ordinary shareholders	£3,000,000

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £80,000, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

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

An overview of the scope of our audit

Our audit approach was developed by obtaining an understanding of the Company's activities, and the overall control environment. Based on this understanding we assessed those aspects of the Company's transactions and balances which were most likely to give rise to a material misstatement.

As part of designing our audit, we determined materiality and assessed 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 the valuation of investments which have a high level of estimation uncertainty involved in determining the unquoted investment valuations.

We gained an understanding of the legal and regulatory framework applicable to the Company and the industry in which it operates, and considered the risk of acts by the Company which were contrary to applicable laws and regulations, including fraud. These included but were not limited to compliance with Companies Act 2006, the FCA listing and DTR rules, the principles of the UK Corporate Governance Code, industry practice represented by the Statement of Recommended Practice: Financial Statements of Investment Trust Companies and Venture Capital Trusts ("the SORP") issued in November 2014 and updated in February 2018 with consequential amendments and FRS 102. We also considered the Company's qualification as an Investment Trust under UK tax legislation.

We designed audit procedures to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery, misrepresentations or through collusion.

We focused on laws and regulations that could give rise to a material misstatement in the Company financial statements. Our tests included, but were not limited to:

- agreement of the financial statement disclosures to underlying supporting documentation;
- enquiries of management;
- review of minutes of board meetings throughout the period; and
- considering the effectiveness of the control environment in monitoring compliance with laws and regulations

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

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

In this context, we also have nothing to report in regard to our responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- Fair, balanced and understandable set out on page 61 – the statement given by the directors that they consider the annual report and financial statements 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, is materially inconsistent with our knowledge obtained in the audit; or
- Audit committee reporting set out on pages 63 to 65 – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee; or
- Directors' statement of compliance with the UK Corporate Governance Code set out on page 56 – the parts of the directors' statement required under the Listing Rules relating to the Company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.
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.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or the director's report.
We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

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

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 62, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

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

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters which we are required to address

Following the recommendation of the audit committee, we were first appointed by the Company on 16 May 2018 to audit the financial statements for the year ending 31 January 2019 and subsequent financial periods.
The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company and we remain independent of the Company in conducting our audit.

Our audit opinion is consistent with the additional report to the audit committee.

Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions, we have formed.

Peter Smith (Senior Statutory Auditor)
For and on behalf of BDO LLP, Statutory Auditor
London
United Kingdom
28 March 2019

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

Income Statement

for the year ended 31 January 2019

	Note	2019 Revenue £	2019 Capital £	2019 Total Return £	2018 Revenue £	2018 Capital £	2018 Total Return £
(Losses) gains on investments held at fair value through profit or loss	8	-	(56,214,287)	(56,214,287)	-	54,592,570	54,592,570
Gains (losses) on foreign currencies		-	414	414	-	(17,161)	(17,161)
Income	1	34,104,274	-	34,104,274	32,633,321	-	32,633,321
Investment management fee	2	(842,584)	(1,564,801)	(2,407,385)	(844,297)	(1,567,980)	(2,412,277)
Administration expenses	3	(834,705)	(1,586)	(836,291)	(814,610)	(1,403)	(816,013)
Profit (loss) before finance costs and taxation		**32,426,985**	**(57,780,260)**	**(25,353,275)**	**30,974,414**	**53,006,026**	**83,980,440**
Finance costs: interest payable and similar charges	4	(2,331,235)	(4,249,587)	(6,580,822)	(3,242,407)	(5,939,250)	(9,181,657)
Profit (loss) on ordinary activities before taxation		**30,095,750**	**(62,029,847)**	**(31,934,097)**	**27,732,007**	**47,066,776**	**74,798,783**
Taxation	5	-	-	-	-	-	-
Profit (loss) after taxation attributable to ordinary shareholders		**30,095,750**	**(62,029,847)**	**(31,934,097)**	**27,732,007**	**47,066,776**	**74,798,783**
Earnings (loss) per ordinary share (basic and diluted)	7	**27.68p**	**(57.05p)**	**(29.37p)**	**25.50p**	**43.29p**	**68.79p**

Dividends in respect of the financial year ended 31 January 2019 total 26.00p (2018: 24.80p), amounting to £28,269,401 (2018: £26,964,659). Details are set out in Note 6 on page 85.

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

The Statement of Accounting Policies and Notes on pages 80 to 98 form an integral part of these Financial Statements.

Statement of Changes in Equity

for the year ended 31 January 2019

	Notes	Called up Share Capital £	Share Premium Account £	Capital Redemption Reserve £	Capital Reserve £	Revenue Reserve £	Total £
Net assets at 1 February 2018		27,182,116	33,717,572	292,853	506,426,346	25,858,973	593,477,860
Revenue profit		-	-	-	-	30,095,750	30,095,750
Dividends on ordinary shares	6	-	-	-	-	(27,617,030)	(27,617,030)
Capital loss		-	-	-	(62,029,847)	-	(62,029,847)
Net assets at 31 January 2019		**27,182,116**	**33,717,572**	**292,853**	**444,396,499**	**28,337,693**	**533,926,733**
Net assets at 1 February 2017		27,182,116	33,717,572	292,853	459,359,570	24,765,439	545,317,550
Revenue profit		-	-	-	-	27,732,007	27,732,007
Dividends on ordinary shares	6	-	-	-	-	(26,638,473)	(26,638,473)
Capital profit		-	-	-	47,066,776	-	47,066,776
Net assets at 31 January 2018		**27,182,116**	**33,717,572**	**292,853**	**506,426,346**	**25,858,973**	**593,477,860**

The Statement of Accounting Policies and Notes on pages 80 to 98 form an integral part of these Financial Statements.

Balance Sheet

at 31 January 2019

Fixed Assets	Notes	2019 £	2019 £	2018 £
Investments held at fair value through profit or loss	8		622,073,420	685,349,523
Current Assets				
Other receivables	10	1,133,804		724,372
Cash and cash equivalents		22,951,619		20,095,813
		24,085,423		20,820,185
Current Liabilities				
Other payables	10	(2,016,323)		(2,197,081)
Derivative financial instruments	8	(10,490)		(51,450)
		(2,026,813)		**(2,248,531)**
Net current assets			22,058,610	18,571,654
Total assets less current liabilities			**644,132,030**	**703,921,177**
Creditors: amounts falling due after more than one year	11		(110,205,297)	(110,443,317)
Total net assets			**533,926,733**	**593,477,860**
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		444,396,499	506,426,346
Revenue reserve	13		28,337,693	25,858,973
Equity shareholders' funds	14		**533,926,733**	**593,477,860**
Net asset value per ordinary share	14		**491.1p**	**545.8p**

The financial statements of the Merchants Trust PLC on pages 76 to 79 were approved and authorised for issue by the Board of Directors on 28 March 2019 and signed on its behalf by:

Simon Fraser
Chairman

The Statement of Accounting Policies and Notes on pages 80 to 98 form an integral part of these Financial Statements.

Cash Flow Statement

for the year ended 31 January 2019

	Notes	2019 £	2018 £
Operating activities			
(Loss) profit before finance costs and taxation*		(25,353,275)	83,980,440
Less: Losses (gains) on investments held at fair value		56,214,287	(54,592,570)
Less: (Gains) losses on foreign currency		(414)	17,161
Purchase of fixed asset investments held at fair value through profit or loss		(181,992,796)	(155,820,497)
Sales of fixed asset investments held at fair value through profit or loss		189,013,652	167,788,923
Increase in other receivables		(409,432)	(220,240)
(Decrease) increase in other payables		(146,648)	53,361
Net cash inflow from operating activities		**37,325,374**	**41,206,578**
Financing activities			
Repayment of Stepped Rate Interest Loan		-	(34,000,000)
Proceeds from 2.96% Fixed Loan Notes 2052		-	34,655,594
Interest paid		(6,809,955)	(9,552,550)
Dividend paid on cumulative preference stock	4	(42,997)	(42,997)
Dividends paid on ordinary shares	6	(27,617,030)	(26,638,473)
Net cash outflow from financing activities		**(34,469,982)**	**(35,578,426)**
Increase in cash and cash equivalents		**2,855,392**	**5,628,152**
Cash and cash equivalents at the start of the year		20,095,813	14,484,822
Effect of foreign exchange rates		414	(17,161)
Cash and cash equivalents at the end of the year		22,951,619	20,095,813
Comprising:			
Cash and cash equivalents		22,951,619	20,095,813

* Cash inflow from dividends was £33,116,522 (2018: £31,649,577) and cash inflow from interest was £596 (2018: £26).

The Statement of Accounting Policies and Notes on pages 80 to 98 form an integral part of these Financial Statements.

Statement of Accounting Policies

for the year ended 31 January 2019

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 54.

The principal activity of the company and the nature of its operations are set out in the strategic report on pages 43 to 50. 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 and updated in February 2018.

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 43 to 50.

2 **Income** – Dividends received on equity shares are accounted for on an ex-dividend basis. 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 revenue returns. The split is reviewed annually. Other administration expenses are charged in full to revenue, except custodian handling charges on investment transactions which are charged to capital. All expenses are recognised on an accrual basis.

4 **Investments** – 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 2018.

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

Statement of Accounting Policies *(continued)*

for the year ended 31 January 2019

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 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 consider whether there are any judgements, estimates, and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. There are no significant judgements, estimates, and assumptions.

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 2019

1. Income

	2019 £	2018 £
Income from Investments*		
Equity dividends from UK investments#	30,621,249	30,884,484
Unfranked dividends from UK investments	1,275,415	542,666
Equity dividends from overseas investments~	1,535,787	420,495
	33,432,451	**31,847,645**
Other Income		
Deposit interest	88,036	26
Premiums on derivative contracts	551,396	671,191
Underwriting commission	32,391	114,459
	671,823	**785,676**
Total income	**34,104,274**	**32,633,321**

* All equity income is derived from listed investments.
# Includes special dividends of £391,500 (2018: £358,173).
~ Includes special dividends of £470,706 (2018: £Nil).

During the year, the company received premiums totalling £430,710 (2018: £683,229) for writing covered call options for the purpose of revenue generation. Premium income of £551,396 was amortised to income (2018: £671,191). All derivatives transactions were based on FTSE 100 stocks or the related index. At the year end there was one open position with a net liability value of £10,490 (2018: £51,450).

2. Investment Management Fee

	2019 Revenue £	2019 Capital £	2019 Total £	2018 Revenue £	2018 Capital £	2018 Total £
Investment management fee	**842,584**	**1,564,801**	**2,407,385**	**844,297**	**1,567,980**	**2,412,277**

Under the terms of the Management and Administration Agreement the company's manager is Allianz Global Investors 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 in 2019: it provides for a management fee based on 0.35% (2018: 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 any funds within the portfolio 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 2019

3. Administration Expenses

	2019 £	2018 £
Auditors' remuneration		
For audit services	22,500	31,585
Non-audit services - for certification of loan covenants	-	12,900
VAT on auditor's remuneration	4,500	8,897
	27,000	**53,382**
Directors' fees	143,000	143,000
Marketing costs	248,355	254,290
Other administration expenses	416,350	363,938
	834,705	**814,610**

(i) The above expenses include value added tax where applicable.
(ii) Directors' fees are set out in the Directors' Remuneration Report on page 67.
(iii) Custody handling charges of £1,586 were charged to capital (2018: £1,403).
(iv) 71% of marketing costs are payable to AllianzGI (2018: 67%).

4. Finance Costs: Interest Payable and Similar Charges

	2019 Revenue £	2019 Capital £	2019 Total £	2018 Revenue £	2018 Capital £	2018 Total £
On Stepped Rate Interest Loan repayable	-	-	-	1,227,324	2,279,317	3,506,641
On Fixed Rate Interest Loan repayable after more than five years	1,273,983	2,365,970	3,639,953	1,276,497	2,370,638	3,647,135
On 4% Perpetual Debenture Stock repayable after more than five years	19,250	35,750	55,000	19,355	35,946	55,301
On 5.875% Secured Bonds repayable after more than five years	630,415	1,170,771	1,801,186	629,627	1,169,308	1,798,935
On 3.65% Preference Stock repayable after more than five years	42,997	-	42,997	42,997	-	42,997
On 2.96% Fixed Rate Notes repayable after more than five years	364,590	677,096	1,041,686	45,253	84,041	129,294
On Sterling overdraft	-	-	-	1,354	-	1,354
	2,331,235	**4,249,587**	**6,580,822**	**3,242,407**	**5,939,250**	**9,181,657**

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

5. Taxation

	2019 Revenue £	2019 Capital £	2019 Total £	2018 Revenue £	2018 Capital £	2018 Total £
Overseas taxation	-	-	-	-	-	-
Total tax	**-**	**-**	**-**	**-**	**-**	**-**
Reconciliation of tax charge						
Profit before taxation	30,095,750	(62,029,847)	(31,934,097)	27,732,007	47,066,776	74,798,783
Tax on profit at 19.00% (2018: 19.18%)	**5,718,193**	**(11,785,671)**	**(6,067,478)**	**5,317,707**	**9,025,214**	**14,342,921**
Effects of						
Non taxable income	(6,109,837)	-	(6,109,837)	(6,002,836)	-	(6,002,836)
Non taxable capital gains	-	10,680,636	10,680,636	-	(10,465,020)	(10,465,020)
Disallowable expenses	8,732	1,345	10,077	8,556	848	9,404
Excess of allowable expenses over taxable income	382,912	1,103,690	1,486,602	676,573	1,438,958	2,115,531
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 2019, the company had accumulated surplus expenses of £218.7 million (2018: £216.3 million).

The company has not recognised a deferred tax asset of £37.2 million (2018: £36.8 million) in respect of these expenses, based on a prospective corporation tax rate of 17% (2018: 17%) because there is no reasonable prospect of recovery. The reduction in the standard rate of corporation tax was substantively enacted on 6 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 at 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 and will do so on an annual basis.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

6. Dividends on Ordinary Shares

Dividends paid on ordinary shares	2019 £	2018 £
Third interim dividend 6.2p paid 2 March 2018 (2017: 6.1p)	6,741,165	6,632,436
Final dividend 6.3p paid 30 May 2018 (2017: 6.1p)	6,849,893	6,632,436
First interim dividend 6.4p paid 22 August 2018 (2017: 6.1p)	6,958,622	6,632,436
Second interim dividend 6.5p paid 15 November 2018 (2017: 6.2p)	7,067,350	6,741,165
	27,617,030	**26,638,473**

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 80 - Statement of Accounting Policies). Details of these dividends are set out below.

	2019 £	2018 £
Third interim dividend 6.5p paid 6 March 2019 (2018: 6.2p)	7,067,350	6,741,165
Final proposed dividend 6.6p payable 22 May 2019 (2018: 6.3p)	7,176,079	6,849,893
	14,243,429	**13,591,058**

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 per Ordinary Share

	2019 Revenue £	2019 Capital £	2019 Total £	2018 Revenue £	2018 Capital £	2018 Total £
Profit (loss) after taxation attributable to ordinary shareholders	30,095,750	(62,029,847)	(31,934,097)	27,732,007	47,066,776	74,798,783
Earnings (loss) per ordinary share (basic and diluted)	**27.68p**	**(57.05p)**	**(29.37p)**	**25.50p**	**43.29p**	**68.79p**

The earnings per ordinary share is based on a weighted number of shares 108,728,464 (2018: 108,728,464) ordinary shares in issue.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

8. Fixed Asset Investments

	2019 £	2018 £
Listed on the London Stock Exchange at market valuation	622,068,934	685,321,554
Unlisted at fair value (see Note 9)	4,486	27,969
Fixed asset investments	**622,073,420**	**685,349,523**
Derivative financial instruments - written call options	(10,490)	(51,450)
Total investments	**622,062,930**	**685,298,073**

Market value of investments brought forward	685,298,073	643,347,301
Investment holding gains brought forward	(56,185,202)	(26,192,327)
Derivative holding gains brought forward	(41,891)	(31,414)
Cost of investments held brought forward	**629,070,980**	**617,123,560**
Additions at cost	181,992,796	155,147,125
Disposals at cost	(163,626,561)	(143,199,705)
Cost of investments held at 31 January	**647,437,215**	**629,070,980**
Investment holding (losses) gains at 31 January	(25,387,595)	56,185,202
Derivative holding gains at 31 January	13,310	41,891
Market value of investments held at 31 January	**622,062,930**	**685,298,073**

(Losses) gains on investments		
Gains on sales of investments based on historical costs	19,824,923	23,575,112
Adjustment for net investment holding losses recognised in previous years	(19,924,133)	(25,371,214)
Losses on sales of fixed asset investments based on carrying value at previous balance sheet date	**(99,210)**	**(1,796,102)**
(Losses) gains on derivative financial instruments	(57,822)	6,668
Losses on sales of investments based on carrying value at previous balance sheet date	**(157,032)**	**(1,789,434)**
Investment holding (losses) gains arising in the year	(61,648,664)	55,364,089
Special dividends credited to capital	5,619,990	1,007,438
Derivative holding (losses) gains arising in the year	(28,581)	10,477
(Losses) gains on investments	**(56,214,287)**	**54,592,570**

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 (2018: none).

Transaction costs and stamp duty on purchases amounted to £1,037,451 (2018: £780,986) and transaction costs on sales amounted to £87,200 (2018: £103,363).

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

9. Investments in Other Companies

The company held more than 3% of the share capital of the following company, which is incorporated in Great Britain and registered in England and Wales:

Company	Class of Shares held	Fair Value £	% Equity
Fintrust Debenture PLC (Fintrust)	Ordinary Shares	4,486	50.0
Total		**4,486**	

In the opinion of the directors, the company is not in a position to exert significant influence over the financial operating policies of Fintrust, either through voting rights or through agreement with the company's other shareholders, due to provisions in Fintrust's Articles of Association and in certain contracts between the company and Fintrust. Accordingly, Fintrust is not considered to be an Associate Undertaking as per FRS 102 Section 14 and is therefore included in the Balance Sheet at the director's valuation. Fintrust is the lender of the company's Fixed Rate Interest Loan, as detailed in Note 11(i). Apart from the finance costs, there were no other transactions between Fintrust and the company during the year.

10. Other Receivables and Other Payables

	Notes	2019 £	2018 £
Other receivables			
Prepayments		46,555	40,053
Accrued income		1,087,249	684,319
		1,133,804	**724,372**
Other payables: Amounts falling due within one year			
Stepped Rate Interest Loan	10(i)	-	34,109
Other payables		882,595	1,029,243
Interest on borrowings		1,133,728	1,133,729
		2,016,323	**2,197,081**
Interest on outstanding borrowing consists of:			
Fixed Rate Interest Loan 2023		783,545	783,545
5.875% Secured Bonds 2029		208,243	208,243
4% Perpetual Debenture Stock		13,863	13,864
2.96% Fixed Rate Notes 2052		128,077	128,077
		1,133,728	**1,133,729**

(i) £34m was repaid to First Debenture Finance PLC (FDF) on 2 January 2018. Subsequent to this FDF was put into voluntary liquidation. The outstanding amount as at 31 January 2018 of £34,109 related to the share capital.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

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

	Notes	2019 £	2018 £
Fixed Rate Interest Loan 2023	11(i)	43,599,051	43,880,622
5.875% Secured Bonds 2029	11(ii)	29,391,271	29,352,885
4% Perpetual Debenture Stock	11(iii)	1,375,000	1,375,000
3.65% Cumulative Preference Stock	11(iv)	1,178,000	1,178,000
Fixed Rate Notes 2052	11(v)	34,661,975	34,656,810
		110,205,297	**110,443,317**

Analysis of Fixed Rate Interest Loan 2023

	2019 £	2019 £	2018 £	2018 £
Fixed Rate Interest Loan (Original Loan)	30,000,000		30,000,000	
Less: Finance costs	(141,053)		(141,053)	
Net proceeds	**29,858,947**		**29,858,947**	
Add: Accrued Finance costs	87,898		79,444	
		29,946,845		**29,938,391**
Fixed Rate Interest Loan (Additional Loan)		12,000,000		12,000,000
Premium	5,286,564		5,286,564	
Amortised premium	(3,634,358)		(3,344,333)	
Add: Unamortised premium		**1,652,206**		**1,942,231**
Total Fixed Rate Interest Loan		**43,599,051**		**43,880,622**

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

(i) The Fixed Rate Interest Loan 2023 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.

The loan of £30,000,000 taken out in 1993 is stated at £29,946,845 (2018: £29,938,391), being the net proceeds of £29,858,947 plus accrued finance cost of £87,898 (2018: £79,444). 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 2019, the loan is stated at £13,652,206 (2018: £13,942,231), being the principal amount of £12,000,000 plus the unamortised premium of £1,652,206 (2018: £1,942,231). The effective interest rate of this portion of the loan is 6.00%.

(ii) The £30,000,000 of 5.875% Secured Bonds is stated at £29,391,271 (2018: £29,352,885), being the net proceeds of £28,942,800 plus accrued finance costs of £448,471 (2018: £410,085). 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 Note 11(i) above.

(iii) 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.

(iv) 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 net return and, in the event of a return of capital is limited to a specific amount, being £1,178,000. Dividends on the preference stock are payable on 1 February and 1 August each year. The preference stock is non-redeemable.

(v) The £35,000,000 of Fixed Rate Notes is stated at £34,661,975 (2018: £34,656,810), being the net proceeds of £34,655,594 plus accrued finance costs of £6,381 (2018: £1,216). The Bonds are repayable on 18 December 2052 and carry interest at 2.96% per annum on the principal amount. Interest is payable in June and December each year. The effective interest rate of this loan is 3.03% per annum.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

12. Called up Share Capital

	2019 £	2018 £
Allotted and fully paid		
108,728,464 ordinary shares of 25p (2018 - 108,728,464)	**27,182,116**	**27,182,116**

The directors are authorised by an ordinary resolution passed on 16 May 2018 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 2019 and accordingly a renewed authority will be sought at the annual general meeting on 16 May 2019.

No ordinary shares were issued or repurchased during the year. Since the year end 200,000 new ordinary shares were issued.

13. Reserves

			Capital Reserve		
	Share Premium Account £	Capital Redemption Reserve £	Gains (losses) on sales of Investments £	Investment Holding Gains (losses) £	Revenue Reserve £
Balance at 1 February 2018	33,717,572	292,853	450,196,008	56,230,338	25,858,973
Losses on sales of fixed asset investments	-	-	(99,210)	-	-
Losses on derivative financial instruments	-	-	(57,822)	-	-
Net movement in fixed asset investment holding losses	-	-	-	(61,648,664)	-
Movement in derivative holding losses	-	-	-	(28,581)	-
Special dividends	-	-	5,619,990	-	-
Gains on foreign currencies	-	-	411	3	-
Transfer on sale of investments	-	-	19,924,133	(19,924,133)	-
Investment management fee	-	-	(1,564,801)	-	-
Finance costs of borrowings	-	-	(4,249,587)	-	-
Other capital expenses	-	-	(1,586)	-	-
Dividends appropriated in the year	-	-	-	-	(27,617,030)
Profit retained for the year	-	-	-	-	30,095,750
Balance at 31 January 2019	**33,717,572**	**292,853**	**469,767,536**	**(25,371,037)**	**28,337,693**

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 (2018: same).

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

14. Net Asset Value per Share

	Net asset value per share attributable 2019 £	2018 £
Ordinary shares of 25p	**491.1p**	**545.8p**

	Net asset value attributable 2019 £	2018 £
Ordinary shares of 25p	**533,926,733**	**593,477,860**

The net asset value per ordinary share is based on 108,728,464 ordinary shares in issue at the year end (2018: 108,728,464).

Since the year end 200,000 new shares were issued and as at the date of this report, there are 108,928,464 ordinary shares in issue.

15. Contingent Liabilities and Commitments

At 31 January 2019 there were no contingent liabilities (2018: £Nil).

Details of the guarantee provided by the company as part of the terms of the Loans are provided in Notes 10(i), 11(i) and 11(ii) Creditors: Amounts falling due after one year on pages 87 and 88.

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 44. 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, are 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 36 and 37.

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 page 98. This takes into account the investment manager's view on the market, covenant requirements and the future prospects of the company's performance.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

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 2019 was as follows:

	2019 £	2018 £
Listed investments held at fair value through profit or loss	622,068,934	685,321,554
Derivative financial instruments - written call options	(10,490)	(51,450)
Total listed investments	**622,058,444**	**685,270,104**

The following illustrates the sensitivity of the return and the net assets to an increase or decrease of 20% (2018: 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 the recent years. The sensitivity analysis on the net return after tax is based on the impact of a 20% increase or decrease in the value of the company's listed equity investments at each balance sheet date and the consequent impact on the investment management fees for the year, with all other variables held constant.

	2019 20% Increase in fair value £	2019 20% Decrease in fair value £	2018 20% Increase in fair value £	2018 20% Decrease in fair value £
Revenue earnings				
Investment management fees	(152,407)	152,407	(167,904)	167,904
Capital earnings				
Gains (losses) on investments at fair value	124,411,689	(124,411,689)	137,054,021	(137,054,021)
Investment management fees	(283,041)	283,041	(311,821)	311,821
Change in net earnings and net assets	**123,976,241**	**(123,976,241)**	**136,574,296**	**(136,574,296)**

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 36 and 37. 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 82 for detail of income received).

Further explanation of the derivatives strategy is included in the Glossary on page 42.

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.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

(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 although there is no direct impact there is implicit exposure as some of the companies in the portfolio generate income and cashflows in foreign currencies. (2018: same).

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

(iv) Interest Rate Risk

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

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.

	2019 Fixed rate interest £	2019 Floating rate interest £	2019 Nil Interest £	2019 Total £	2018 Fixed rate interest £	2018 Floating rate interest £	2018 Nil Interest £	2018 Total £
Financial assets	-	22,951,619	622,073,420	645,025,039	-	20,095,813	685,349,523	705,445,336
Financial liabilities	(110,205,297)	-	(10,490)	(110,215,787)	(110,443,317)	-	(51,450)	(110,494,767)
Net financial (liabilities) assets	(110,205,297)	22,951,619	622,062,930	534,809,252	(110,443,317)	20,095,813	685,298,073	594,950,569
Short term receivables and payables				**(882,519)**				**(1,472,709)**
Net assets per balance sheet				**533,926,733**				**593,477,860**

As at 31 January 2019, the interest rates received on cash balances or paid on bank overdrafts, was 0.16% and 0.27% per annum respectively (2018: 0.14% and 0.35% per annum).

The fixed rate interest bearing liabilities bear the following coupon and effective rates as at 31 January 2019 and 31 January 2018.

	Maturity date	Amount borrowed £	Coupon rate	Effective rate since inception*
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%
Fixed Rate Notes 2052	18/12/2052	35,000,000	2.96%	3.03%
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%
		109,553,000		

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

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

* 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 80.

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 6.08% (2018: 6.08%) and the weighted average period to maturity of these liabilities is 15.8 years (2018: 16.8 years).

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

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 2019, 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 Fixed Rate Notes 2052, Stepped Rate Interest Loan, Fixed Rate Interest Loan and 5.875% Secured Bonds 2029 reflect the maturity dates as set out in Notes 10 and 11 on pages 87 to 89. 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.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

2019	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	-	6,760,824	-	-	6,760,824
Other payables	882,595	-	-	-	882,595
Derivative financial instruments	10,490	-	-	-	10,490
Creditors - Amounts falling due after more than one year					
Amounts payable on maturity of borrowings	-	-	-	109,553,000	109,553,000
Finance cost of borrowings			25,186,526	42,126,004	67,312,530
	893,085	**6,760,824**	**25,186,526**	**151,679,004**	**184,519,439**

2018	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	-	6,760,824	-	-	6,760,824
Other payables	1,029,243	-	-	-	1,029,243
Derivative financial instruments	51,450	-	-		51,450
Creditors - Amounts falling due after more than one year					
Amounts payable on maturity of borrowings	-	-	-	109,553,000	109,553,000
Finance costs of borrowing	-	-	27,129,288	46,867,566	73,996,854
	1,080,693	**6,760,824**	**27,129,288**	**156,420,566**	**191,391,371**

Management of liquidity risk
Liquidity risk is not significant as the company's assets mainly comprise realisable securities, which can be sold to meet funding requirements if necessary. Short term flexibility can be achieved through the use of overdraft facilities, where necessary. As at the 31 January 2019, the company had an undrawn committed borrowing facility of £10 million (2018: £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 2019 (2018: 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 A2 by Moody's rating agency and UBS, rated A1 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.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

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

	2019 £	2018 £
Other Receivables:		
Accrued income	1,087,249	684,319
Cash and cash equivalents	22,951,619	20,095,813
Total	**24,038,868**	**20,780,132**

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*:

	2019 Book Value £	2019 Fair Value £	2018 Book Value £	2018 Fair Value £
Stepped Rate Interest Loan	-	-	34,109	-
Fixed Rate Interest Loan	44,382,596	54,545,400	44,664,168	57,661,800
5.875% Secured Bonds 2029	29,599,514	38,790,000	29,561,128	39,360,000
4% Perpetual Debenture Stock	1,388,863	1,724,113	1,388,863	1,852,537
3.65% Cumulative Preference Stock	1,178,000	1,358,705	1,178,000	1,459,071
2.96% Fixed Rate Notes 2052	34,790,052	36,249,500	34,784,886	35,126,000
Total	**111,339,025**	**132,667,718**	**111,611,154**	**135,459,408**

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

	2019 £	2018 £
Net assets per balance sheet	533,926,733	593,477,860
Add: financial liabilities at book value #	111,339,025	111,611,154
Less: financial liabilities at fair value *	(132,667,718)	(135,459,408)
Net assets (debt at fair value)	**512,598,040**	**569,629,606**
Net asset value per ordinary share (debt at fair value)	**471.4p**	**523.9p**

Book value, par value and amortised cost are used interchangeably throughout the Annual Report.

* The fair value has been derived from the closing market value as at 31 January 2019 and 31 January 2018. Fair value and market value are used interchangeably throughout the Annual Report.

The net asset value per ordinary share is based on 108,728,464 ordinary shares in issue at 31 January 2019 (2018: 108,728,464).

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

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

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

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 (ie developed using market data) for the asset or liability, either directly or indirectly.

Level 3: Inputs are unobservable (ie 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.

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

2019	**Level 1 £**	**Level 2 £**	**Level 3 £**	**Total £**
Financial assets at fair value through profit or loss				
Equity investments	622,068,934	-	-	622,068,934
Financial instruments	-	-	4,486	4,486
Derivatives financial instruments - written call options	-	(10,490)	-	(10,490)
	622,068,934	**(10,490)**	**4,486**	**622,062,930**

2018	**Level 1 £**	**Level 2 £**	**Level 3 £**	**Total £**
Financial assets at fair value through profit or loss				
Equity investments	685,321,554	-	-	685,321,554
Financial instruments	-	-	27,969	27,969
Derivatives financial instruments - written call options	-	(51,450)	-	(51,450)
	685,321,554	**(51,450)**	**27,969**	**685,298,073**

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 using valuation techniques level 3 have, in the absence of relevant trading prices or market data, been valued based on the directors' best estimate.

There were no transfers between levels for financial assets and financial liabilities during the year recorded at fair value as at 31 January 2019 and 31 January 2018.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2019

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:

	2019 £	2018 £
Debt		
Stepped Rate Interest Loan due within one year	-	34,109
Creditors: amounts falling due after more than one year	110,205,297	110,443,317
	110,205,297	**110,477,426**
Equity		
Called up share capital	27,182,116	27,182,116
Share premium account and other reserves	506,744,617	566,295,744
	533,926,733	**593,477,860**
Total capital	**644,132,030**	**703,955,286**
Debt as a percentage of total capital	**17.1%**	**15.7%**

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 banks 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. Transactions with the Investment Manager and related parties

The amounts paid to the investment manager together with details of the investment management contract are disclosed in Note 2 on page 82. 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 FRS102 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 67.

There are no other identifiable related parties at the year end, and as of 27 March 2019.

19. Post Balance Sheet events

Since the year end the company issued 200,000 new ordinary shares. There are no other significant events after the end of the reporting period requiring disclosure.

Investor Information

The tobacco sector was a significant area of new investment during the year. The sector has de-rated significantly and tobacco companies have offered growing dividends and respectable yields.

Investor Information

AIFM and Depositary

Allianz Global Investors GmbH (AllianzGI), is designated the Alternative Investment Fund Manager (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 82).

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 2018 (all values in Euro).

Number of employees: 1,718

	All employees	Risk Taker	Board Member	Other Risk Taker	Employees with Control Function	Employees with Comparable Compensation
Fixed remuneration	152,084,831	8,487,988	1,962,234	405,616	1,226,734	4,893,404
Variable remuneration	119,079,444	28,858,193	12,335,788	323,424	4,789,449	11,409,531
Total remuneration	**271,164,275**	**37,346,181**	**14,298,022**	**729,040**	**6,016,183**	**16,302,935**

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.

Key Information Document (KID)

The Key Information Document (KID) is a new document which came into force in January 2018 for investment trusts and many other investment products operating under the Packaged Retail and Insurance-based Investment Products (PRIIP) Regulation. The KID is a standardised pan-European document that contains product, risk, charges and other information. It is a regulatory requirement that you are provided with a KID before you invest, and you will be required to declare that you have seen the latest KID when you make your investment. The Merchants Trust KID is available from the Literature Library at www.merchantstrust.co.uk. However, your chosen platform provider or stockbroker should provide you with a copy before accepting your investment instructions. Please note that existing investors do not need to review the KID unless planning to add to an investment. The KID's standardised format is intended to allow potential investors to compare funds easily, on a like-for-like basis. Investors should be aware that the performance and risk numbers in the KID are based on the last five years' experience and note that past experience is not always a guide to the future.

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 *(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/March
Final	May

Preference Dividends

Payable half-yearly 1 February and 1 August.

Benchmark

With effect from 1 February 2017 the company's benchmark was changed to the FTSE All-Share Index, from the FTSE 100 Index.

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 6.6p to be payable on 22 May 2019 to shareholders on the Register of Members at the close of business on 12 April 2019, making a total distribution of 26.0p per share for the year ended 31 January 2019, an increase of 4.8% over last year's distribution. The ex dividend date is 11 April 2019.

A Dividend Reinvestment Plan (DRIP) is available for this dividend and the relevant Election Date is 19 April 2019.

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 Link Asset Services. Dividends mandated in this way are paid via Bankers' Automated Clearing Services (BACS).

Registrars

Link Asset Services (formerly Capita Asset Services), The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU.
Telephone: 0371 664 0300.
Lines are open 9.00 am to 5.30 pm (London time) Monday to Friday. Email: enquiries@linkgroup.co.uk.
Website: www.linkassetservices.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 am to 5.30 pm (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 *(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

Link 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: http://www.linksharedeal.com for online dealing or 0371 664 0445 for telephone dealing. Lines are open 8.00 am to 4.30 pm 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

Link 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.signalshares.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

Link 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 nominal administration fee per dividend payment applies. Your dividends are paid as cleared funds directly into your bank or sent to you as a draft.

Link 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: http://ips.linkassetservices.com/services/share-dealing-services or by contacting Link as detailed below.

For further information on these services please contact: 0371 664 0300. Lines are open between 9.00 am and 5.30 pm, Monday to Friday (London time) or email IPS@linkgroup.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, Link 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

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 Thursday 16 May 2019 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 2019 together with the Auditors' Report thereon.
2. To declare a final dividend of 6.6p per ordinary share.
3. To re-elect Simon Fraser as a director.
4. To re-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 Implementation Report.
9. To reappoint BDO 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.
10. 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 11 will be proposed as an ordinary resolution and resolutions 12 and 13 as special resolutions:

11. 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 36,309,488 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.

12. 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 11 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 5,446,423 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 2020 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.

13. 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 16,328,376;

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

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

(iv) the authority hereby conferred shall expire at the conclusion of the annual general meeting of the company in 2020 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
28 March 2019

Notice of Meeting *(continued)*

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 14 May 2019 (the record date).
8. If the meeting is adjourned to a time not more than 48 hours after the record date applicable to the original meeting, that time will also apply for the purpose of determining the entitlement of members to attend and vote (and for the purpose of determining the number of votes they may cast) at the adjourned meeting. If, however, the meeting is adjourned for a longer period then, to be so entitled, members must be entered on the company's Register of Members at the time which is 48 hours before the time fixed for the adjourned meeting or, if the company gives new notice of the adjourned meeting, at the record date specified in that notice.
9. The right to appoint a proxy does not apply to persons whose shares are held on their behalf by another person and who have been nominated to receive communications from the company in accordance with section 146 of the Companies Act 2006 (nominated persons). Nominated persons may have a right under an agreement with the registered shareholder who holds the shares on their behalf to be appointed (or to have someone else appointed) as a proxy. Alternatively, if nominated persons do not have such a right, or do not wish to exercise it, they may have a right under such an agreement to give instructions to the person holding the shares as to the exercise of voting rights. Nominated persons should contact the registered member by whom they were nominated in respect of these arrangements.
10. Corporate representatives are entitled to attend and vote on behalf of the corporate member in accordance with section 323 of the Companies Act 2006. Pursuant to the Companies (Shareholders' Rights) Regulations 2009 (SI 2009/1632), multiple corporate representatives appointed by the same corporate member can vote in different ways provided they are voting in respect of different shares.
11. Members have a right under section 319A of the Companies Act 2006 to require the company to answer any question raised by a member at the AGM, which relates to the business being dealt with at the meeting, although no answer need be given (a) if to do so would interfere unduly with the preparation of the meeting or involve disclosure of confidential information; (b) if the answer has already been given on the company's website; or (c) it is undesirable in the best interests of the company or the good order of the meeting.
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 27 March 2019, 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 108,928,464 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 110,106,464.
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.


Moorgate
Liverpool Street
Gresham Street
GROCERS' HALL
Lothbury
Bank of England
Threadneedle Street
Poultry
Cornhill
Queen Victoria Street
King William Street
Fenchurch Street
Cannon Street
Monument

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