

31 January 2016

The Merchants Trust PLC

Annual Report



www.merchantstrust.co.uk

Allianz 
Global Investors

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Company Overview

Throughout its 127 year history, The Merchants Trust PLC has provided shareholders with an opportunity to benefit from investment in a diversified portfolio of leading companies with strong balance sheets and the potential to pay attractive dividends.

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

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

Financial Highlights

NAV Total Return*	2016	-5.0%	Benchmark#	2016	-6.5%
Share Price	2016	414.0p	2015	484.0p	-14.5%
Net asset value per ordinary share*			Earnings per ordinary share		
437.7p			24.1p		
2015 486.1p			2015 23.6p		
-10.0%			+2.1%		
			Dividend		Yield
			24.0p		5.8%
			2015 23.8p		2015 4.9%
			+0.8%		

* Debt at market value #The benchmark is the FTSE 100 Index

Investment Policy

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 UK FTSE 100 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 100 Index, reflecting the emphasis within the portfolio.

Gearing

The company's policy is to remain substantially fully invested. The company has the facility to gear – borrow money – with the objective of enhancing future returns. Historically, the gearing has been in the form of long term, fixed-rate debentures. The board monitors the level of gearing and makes decisions on the

appropriate action based on the advice of the manager and the future prospects of the company's portfolio.

The company's authorised borrowing powers set out in the Articles state that the company's borrowings may not exceed its called up share capital and reserves. The board's policy is to maintain gearing (borrowings as a percentage of net assets) in the range of 10-25% (at the time of drawdown). Gearing averaged 21.8% in the year to 31 January 2016 (2015 - 21.3%).

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.

Chairman's Statement

Dear Shareholder

I am pleased to let you know that following our Annual General Meeting, The Merchants Trust will have an unbroken record of 34 years of dividend growth and that we are named in the 'dividend heroes' list promoted by the Association of Investment Companies. In addition to our aim of providing capital growth over time, we have seen recent interest in the 'income in retirement' page of our website.

Results

It has been a difficult year for equity markets, however we outperformed the benchmark. The NAV total return was -5.0% against a total return on our benchmark, the FTSE 100 Index, of -6.5% in the year to 31 January. As you can see from the performance attribution analysis on page 8, there were several factors leading to this outperformance. The main positives were strong relative performance from the equity portfolio and the benefit of the fall in the market value of debt, as it approaches maturity. The main negatives were the impact of gearing, in a period where market returns were negative, and the cost of finance.

Over the longer term, it is pleasing to note that the NAV with debt at market value (capital only, i.e., excluding dividends), has outperformed the FTSE 100 Index by 3.8% over the past three years and by 3.3% over the past five years.

The company's share price fell by 14.5% from 484.0p to 414.0p over the year, partly due to the discount to NAV on the shares widening. On a total return basis (which includes net dividends) the value of the shares fell 9.5%.

The board also monitors the company's yield relative to other investment trusts in the UK Equity Income sector. As at 31 January 2016, the company's yield of 5.8% ranked third in the sector.

As at 30 March 2016, the company's ordinary shares yielded 6.0% compared with the 4.1% yield on the FTSE 100 Index. There is more detail on the major contributors to the performance of the portfolio in the Investment Manager's Review starting on page 16 of the annual report.

Net Earnings and Dividends

Our net earnings have increased by 2.1% this year. In an era of low interest rates we aim to provide our shareholders with high and growing income. The board is recommending a final dividend of 6.0p, which will make this our 34th consecutive year of dividend growth. This dividend is fully covered by earnings leaving a modest addition to revenue reserves. The final dividend of 6.0p will be paid on 26 May 2016 to shareholders on the register on 22 April 2016. This payment will make our total dividend for the year 24.0p, an increase of 0.8%. As at 31 January 2016 and after providing for the final dividend payment, the company's revenue reserves amounted to £11.6m (10.6p per share).

The Board

Biographies of the directors are set out on page 30. We are each standing for re-election this year and will continue to do this annually.

Strategy and the Strategic Report

The Strategic Report starts on page 10. At our annual strategy day last year we had our usual in-depth look at the matters we consider at each board meeting, including our position relative to our peer group and benchmark, together with a number of other topics including the gearing structure and the future of our debentures. We will be looking in detail at our plans to refinance the proportion of our debt that reaches its maturity in 2018 and to continue to provide an attractive investment for shareholders' needs today.

Chairman's Statement *(continued)*

In this year's report, on page 14, we also include our first Viability Statement, which looks at the company's ability to continue in operation and meet its liabilities in the next few years.

Issue of new shares and the buy back of shares

For much of the year to 31 January 2016 we saw the company's share price continue to trade at a discount to the net asset value but not at a consistently high level to suggest a buy back of shares was advisable.

Our policy continues to be to issue shares at a premium to net asset value, cum income with debt at market value, at a price that is not dilutive to existing shareholders, to meet natural demand in the market and conversely, to buy back shares either for cancellation or for holding in treasury if the shares are trading at a consistently high discount. Buying back shares helps to reduce the volatility of the discount and enhances the underlying NAV. Any shares issued or sold from treasury will be at a premium to the NAV to ensure that existing shareholders benefit from the transaction.

Marketing Strategy

The Merchants Trust continues to be a popular choice with private and professional investors which is evidenced by the increasing number of shares held via investment platforms. We attribute this to:

- The company's consistent philosophy which aims to provide growth in capital and income over the medium to long-term;
- A 34 year track record of growing dividends;
- The company's status as a dividend hero as defined by the Association of Investment Companies;
- Stable portfolio management over many years; and
- Merchants is one of the highest yielding investment trusts in the sector.

We understand the importance of sustaining demand for the company's shares and this is reflected in our ongoing commitment to active marketing and communication strategies to promote Merchants to a wider audience. In September 2015 Merchants launched a new advertising campaign to highlight the benefits of the investment structure for those looking to save for retirement (see overleaf). Merchants supports the AIC's 'Freedom in Pensions' campaign which looks at how investment companies can be used to help build a long term pension portfolio.

The company's website continues to be the hub of our investor communications, now hosting video interviews with portfolio manager Simon Gergel on a regular basis. Our monthly shareholder communications have also been enhanced with a four page fact sheet that includes more in-depth commentary as well as more detailed performance and dividend information. Both of these communications are available to subscribers registering for updates on our website www.merchantstrust.co.uk.

Gearing

The company continues to have long term debt amounting to £111 million. This is all deployed in the market for investment purposes. Our gearing averaged 21.8% throughout the year, compared to 21.3% last year.

The board has conducted a thorough review of gearing policy at our strategy meetings. In the past we have defined our gearing as being acceptable at levels of up to 35% in normal market conditions. Historically, Merchants has fully invested its debt into the equity market. Market volatility can alter the company's gearing in the short term. We have decided to modify the policy to focus on the level of gearing at the time when debt is drawn down, as that is within the control of the board. The new policy is that the board will maintain gearing within a range of 10-25% at the time of debt drawdown.

The company's website continues to be the hub of our investor communications, now hosting video interviews with portfolio manager Simon Gergel on a regular basis.

Chairman's Statement *(continued)*

The board believes this strategy is entirely appropriate for the current environment and allows shareholders to benefit from the opportunities in the UK equity market, whilst receiving a high dividend yield.

Derivatives

We have continued our policy of selectively writing call options on a limited number of the company's holdings. Writing options has provided a small amount of additional income. There are more details in the Investment Manager's Review on pages 20 and 21.

Annual General Meeting

The annual general meeting of the company will be held on Tuesday 24 May 2016 at 12.00 noon at Old School Building, 60 Victoria Embankment, London EC4Y 0JP, and we look forward to seeing as many shareholders then as are able to attend.

Outlook

The stock market has been volatile in recent months but the underlying economic outlook has changed little over the last year. A slow recovery from the global financial crisis is continuing, although there are specific risks, such as slowing growth in emerging markets and the "Brexit" referendum. Nonetheless, our fund managers are finding many opportunities to invest in promising businesses on favourable valuations. The company's strategy remains to invest in a diversified collection of high yielding UK companies. The board believes this strategy is entirely appropriate for the current environment and allows shareholders to benefit from the opportunities in the UK equity market, whilst receiving a high dividend yield. This makes Merchants well placed to appeal to investors in the rapidly changing pensions and savings market.

Simon Fraser
Chairman
30 March 2016

The company launched a new advertising campaign to highlight the benefits of the investment trust sector for those looking to save for retirement.

Merchants' dividend hero status has attracted a significant amount of press coverage.

Performance Graphs

Performance – Review of the Year

Financial Summary

	For the year ended 31 January 2016	For the year ended 31 January 2015	% change	
Revenue				
Income	£30,984,794	£29,957,608	+3.4	
Net revenue earnings attributable to ordinary shareholders	£26,145,206	£24,950,147	+4.8	
Net revenue earnings per ordinary share	24.1p	23.6p	+2.1	
Ordinary dividends per ordinary share	24.0p	23.8p	+0.8	
Assets	2016	2015	Capital Return % change	Total Return % change
Total assets less current liabilities	£608,370,101	£672,481,424	-9.5	-
Net assets (debt at par)	£498,107,865	£562,008,943	-11.4	-
Net assets (debt at market value)	£475,880,871	£528,533,136	-10.0	-
Net asset value per ordinary share (debt at par)	458.1p	516.9p	-11.4	-6.7*
Net asset value per ordinary share (debt at market value)	437.7p	486.1p	-10.0	-5.0*
Ordinary share price	414.0p	484.0p	-14.5	-9.5*
FTSE 100 Index	6,083.8	6,749.4	-9.9	-6.5
Discount ordinary share price to net asset value	-9.6%	-6.4%	n/a	n/a
Discount (debt at market value)	-5.4%	-0.4%	n/a	n/a
Ongoing charges [†]	0.6%	0.6%	n/a	n/a

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

† The ongoing charges percentage is calculated in accordance with the explanation given on page 12.

Performance Attribution Analysis against FTSE 100 Index	Capital Return %	Income Return %	Total Return %
Return of Index	-9.9	3.4	-6.5
Relative return on portfolio	2.4	0.3	2.7
Return of portfolio	-7.5	3.7	-3.8
Impact of gearing on portfolio	-2.6	1.4	-1.2
Movement in the market value of the debt	2.1	-	2.1
Finance costs	-1.2	-0.6	-1.8
Management fee	-0.3	-0.1	-0.4
Administration expenses	-	-0.1	-0.1
Other	-0.5	0.7	0.2
Change in net asset value per ordinary share (debt at market value)	-10.0	5.0	-5.0

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

“This year’s AGM will mark ten years since I took over the management of the trust’s portfolio. It is interesting to look back over this longer period and to compare conditions now to those in 2006.”

Simon Gergel
Fund Manager

Strategic Report

at 31 January 2016

Strategy Review

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

- The company's market position compared with its peer group, including an analysis of benchmarks, dividend policies, yields, discount policies and fund raising;
- Gearing, and the future for our debentures and the appropriate debt structure; and
- An in-depth examination of investment analysis, including the contribution from non-FTSE 100 stocks.

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

- Make plans for the maturity of our first debenture in 2018;
- Consider the changes to the macro environment and the impact on our investment philosophy; and
- Consider Merchants' differentiation from its peer group.

Strategic Aims

The company's aims continue to be to:

- consistently meet our growth and income objectives
- appeal to a broad range of investors ensuring that the company remains relevant and attractive to new investors and investor groups
- ensure the costs of running the company remain reasonable and competitive
- be a widely recommended investment
- engage with shareholders and other relevant stakeholders to understand their needs and take their views into account in the development of future plans and strategy
- understand the implications of changes to future income growth prospects

Objectives

Our objective is to provide shareholders with an above average level of income and income growth with long term capital growth through a policy of investing mainly in higher yielding UK FTSE 100 companies.

We measure our success in attaining this objective by comparing the performance of the portfolio against the performance of the FTSE 100 Index. We also note how the yield on the company's shares compares with the yields in our peer group, in the UK Equity Income sector, and the growth of the dividend itself against the retail price index in the UK.

A review of the company's business, activities and prospects is given in the Chairman's Statement on pages 2 to 4, and in the Investment Manager's Review on pages 16 to 23.

Investment Strategy and Policy

We aim to achieve our objective through a strategy of investing in a portfolio of mainly higher yielding UK FTSE 100 companies and by using appropriate gearing to enhance returns. This strategy is designed for those investors who require a single investment in a diversified and professionally managed portfolio.

The fund manager manages the portfolio primarily on a bottom up basis - selecting the best stocks - rather than through sector allocation. The portfolio is managed on a high conviction basis and as at 31 January 2016 was concentrated into 43 listed equity stocks.

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

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

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

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

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

Strategic Report *(continued)*

at 31 January 2016

Gearing

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

Marketing

The company's marketing activity has increased year on year to assist with promoting the company to investors looking for exposure to capital growth in 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. Over the past two years we have increased the communication to investors through the website, providing more information and the views of the investment manager.

Dividend

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

Discount/premium

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

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)*

at 31 January 2016

Key Performance Indicators

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

Performance against the Benchmark Index

This is the most important KPI by which performance is judged and this is shown in graph form on page 7. The company's objective is to provide an above average level of income and income growth together with long-term growth of capital through a policy of investing mainly in higher yielding UK FTSE 100 companies, and for this reason the FTSE 100 is the benchmark index against which we measure our performance.

We set out performance figures in the tables on page 8 of this Annual Report, but the main indicator of performance is the Net Asset Value Total Return, and the figures for this year and the previous year were as follows:

Year to 31 January 2016 Merchants Total Return

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

Year to 31 January 2015 Merchants Total Return

NAV Debt at market value +4.7%
NAV Debt at par +5.8%
Benchmark +7.4%

Expenses of running the Company

The board has a policy of ensuring that the costs of running the company are reasonable and competitive. Ongoing charges are operating expenses incurred in the running of the company, whether charged to revenue or capital, but excluding financing costs. The ongoing charges figure (OCF) is calculated by dividing operating expenses, that is, the company's management fee and all other ongoing charges, by the average net asset value (with debt at market value) over the period. Since May 2012, ongoing charges have been published by the AIC.

Merchants	Peer Group
2016 0.58%	2016 1.0%
2015 0.62%	2015 1.0%

Performance against the Company's Peers

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

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

As at 31 January 2016, the company was ranked in the UK Equity Income sector as follows:

1 year - 17 out of 22
3 years - 19 out of 22
5 years - 16 out of 22

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

The company's yield, at 5.8% was third highest in the sector at 31 January 2016 (2015 - 4.9% second highest). Source: J.P. Morgan Cazenove).

Dividends

The board has a policy of paying a progressive dividend each year, taking into account inflation and subject to general earnings growth and dividends received in the portfolio. Dividends paid in the past ten years are set out in the Historical Record table on page 28. Dividends have risen in every year since 1982 and the graph on page 7 shows how the dividend has performed against inflation over the past ten years.

2016 24.0p +0.8%
2015 23.8p +0.8%

Gearing

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

2016 Highest 25.8% Lowest 18.7% Average 21.8%
2015 Highest 23.5% Lowest 19.6% Average 21.3%

Strategic Report *(continued)*

at 31 January 2016

Risk

The principal risks identified by the board are set out in the table on this page, together with the actions taken to mitigate these risks. In line with the requirements of the UK Corporate Governance Code, the directors have carried out a robust assessment of the principal risks facing the company. Whilst the board gives continuous consideration to these risks, a more detailed version of this table, in the form of a Risk Matrix, is reviewed and updated by the board twice yearly. The principal risks and uncertainties faced by the company relate to the nature of its objectives and strategy as an investment company and the markets in which it operates.

Description	Mitigating Actions
<p>Investment Activity and Strategy, including Gearing and Market Volatility An inappropriate investment strategy, e.g., on asset allocation or the level of gearing, may lead to significant under-performance against the company's benchmark index and peer group companies, and may also result in the company's shares trading on a wider discount.</p>	<p>The board manages these risks by diversification of investments and through its investment restrictions and guidelines which are monitored and on which the board receives reports. AllianzGI provides the directors with management information including performance data and reports and shareholder analyses. The board monitors the implementation and results of the investment process with the investment manager, who attends all board meetings, and reviews data which show risk factors and how they affect the portfolio. The board reviews investment strategy, including gearing, at each board meeting.</p>
<p>Corporate Governance, Shareholder Relations and Marketing If there is weak adherence to best practice in corporate governance, shareholder discontent could arise resulting in potential reputational damage to the company. Inadequate marketing and communication about the company could result in selling of the shares and a significant impact on the rating of the company.</p>	<p>The board receives reports on shareholder activity and on shareholder sentiment on a regular basis and contact is maintained with major shareholders. The board has continued to extend its marketing and public relations programme. Details of the company's compliance with corporate governance best practice, including information on relations with shareholders, are set out in the Corporate Governance Statement which can be found on the company's website www.merchantstrust.co.uk in the literature/trust documents section.</p>
<p>Financial and Regulatory Failure to contain financial risks could result in losses to the company. Failure to comply with relevant regulations could damage the company and its ability to continue in business.</p>	<p>The financial risks associated with the company include market risk (price, yield, foreign currency and interest rate), liquidity risk and credit risk. The audit committee also considers these risks as part of its remit. Further analysis of these risks can be found in Note 16 on pages 70 to 76. The board is guided by its advisers both within AllianzGI and external to the manager on matters such as compliance with the Companies Act 2006, Accounting Standards, the Listing Rules, Disclosure and Transparency Rules and other applicable regulations, including AIFMD.</p>
<p>Operational The company is dependent on third parties for the provision of all systems and services and there are risks of control failures and gaps in these systems and services resulting in loss or damage to the company.</p>	<p>The board receives a matrix of internal controls reports and bridging letters at least twice each year from all major service providers and reviews the assurances provided by these third parties.</p>

In addition to the specific principal risks identified in the table above, the company faces risks to the provision of services from third parties and more general risks relating to compliance with accounting, tax, legal and regulatory requirements, which could have an impact on reputation and market rating. These risks are formally reviewed by the board twice each year and how these risks are managed and mitigated is discussed and agreed for recording in the Risk Matrix. The board's reviews of the risks faced by the company also include an assessment of the residual risks after mitigating action has been taken.

Strategic Report *(continued)*

at 31 January 2016

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. Under new Corporate Governance Code provisions, the directors are required to provide a formal statement relating to their assessment of the company's prospects for a period longer than the one year required by the Going Concern principle. The directors believe that three years is the appropriate outlook period for this review as, firstly, this covers the first of the redemptions of the company's debentures and, secondly, this would give investors assurance that there is a realistic prospect that the company will continue to be viable and continue to seek to achieve its aim to provide an above average level of income and income growth together with long term capital growth, whilst acknowledging the difficulty of forecasting prospects for markets beyond a relatively short horizon.

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

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

- The company's investment strategy which, in the board's view, will continue to provide attractive returns to investors as it has done in the past;
- The financial position of the company, including the impact of foreseeable market movements on cash flows - the board monitors the financial position in detail at each board meeting and at least twice each year it stress-tests the portfolio against significant market falls;
- The company's ability to meet interest payments and debt redemptions as they fall due, in particular the repayment of £34million for the first of the debentures falling due in early 2018. This sum represents less than 5.6% of the assets of the company currently and so there is no significant risk that this repayment will not be met. The board will decide nearer the time how best to fund this repayment; and
- The liquidity of the portfolio, and the company's ability to pay dividends and to meet the budgeted expenses of running the company which is examined at each board meeting.

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

Human Rights and Gender Diversity

The company has no employees and has a board composed entirely of non-executive directors 40% of which are female. There are no disclosures to make in respect of employees.

There is more detail on board composition on page 30.

Environmental Policy and Corporate Social Responsibility

The board has instructed the manager to take into account the impact of environmental policies on the investment prospects of the company's underlying investments.

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

The manager's environmental and corporate social responsibility policies can be found at www.esgmatters.com.

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 4 and the investment manager discusses his view of the outlook for the company's portfolio in his review on pages 21 and 22.

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

On behalf of the board

Simon Fraser
Chairman
30 March 2016

The Merchants Trust PLC

Investment Manager's Review

Investment Manager's Review

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

Economic and Market background

Last year's theme of divergence continued into this year. Economic growth in the UK and US was steady, if modest, whilst the Eurozone saw a gradual recovery. However, Japanese growth remained lacklustre and emerging markets saw a sharp slowdown, with several countries in recession. The Chinese transition, from an economy based upon fixed asset investment towards consumption, has led to a slowing of demand for raw materials, and a collapse in commodity prices, exacerbated by OPEC's decision to no longer support oil prices. This particularly impacted commodity exporting nations, including Brazil and Russia.

Interest rate policy was also divergent. The US raised interest rates for the first time in over nine years in December, whilst the Eurozone and Japan both cut rates late in the year. Certain bonds in the Eurozone and Japan now have negative interest rates.

The UK equity market rose at the start of the year, with the FTSE 100 Index finally breaching its previous all-time high set on the last day of 1999. It reached a record high in April at around 7100, shortly before the Conservatives won a surprise majority in the general election. The index then retraced significantly, to below 5700 in January, before bouncing to close at 6084 at the year end. This gave a total return of -6.5% for the year ended 31 January 2016. Within the market, there was a wide divergence between sectors. Cyclical sectors led the declines, notably mining, banks and the

industrial sectors. Oil & gas, aerospace & defence, food retail and life insurance were also weak. Conversely, defensive sectors such as household goods, fixed line telecommunications and tobacco held up well, with double digit positive returns. Other notable outperformers included construction & materials, media and travel & leisure. Medium sized companies outperformed larger stocks with the FTSE 250 mid-cap index giving a total return of +3.7%. This partly reflected its sector composition, with lower exposure to the commodity industries.

One notable theme within the stock market was consolidation. Amongst the largest companies, SAB Miller received a takeover bid from AB Inbev, BG was taken over by Royal Dutch Shell and GlaxoSmithKline completed a significant asset swap with Novartis. Also, within the trust's portfolio, Greene King bought the pub company Spirit, Antofagasta purchased another Chilean copper mine, Kier bought Mouchel and, recently, Sainsbury announced the proposed takeover of Argos owner, Home Retail Group.

The Last Decade

This year's AGM will mark ten years since I took over the management of the trust's portfolio. It is interesting to look back over this longer period and to compare conditions now to those in 2006. In the 2006 report and accounts, my predecessor talked about UK economic growth of just under 2%, similar to today, but that was the 13th year of uninterrupted expansion! Interest rates were 4.75% compared to 0.5% today. The strongest stock

Source: Thomson Reuters Datastream

Investment Manager's Review *(continued)*

market sector that year was mining, up over 70%, with oil & gas up over 37%. It was a different world.

Since then, we have witnessed the US housing bust, a global financial crisis, a boom and bust in the commodities sector, including the so-called Chinese "Supercycle", and a major global recession. At the end of January 2006 the FTSE stood at 5760, within 6% of its level a decade later, but there was considerable volatility in the intervening years. The FTSE 100 Index has returned only 4.3% p.a. over 10 years, with almost all of the return coming from dividends rather than capital appreciation.

One of the charts on page 7 shows the total return of the FTSE 100 Index, the trust's share price and the Net Asset Value (with debt at market value). Overall, the NAV and share price total returns are ahead of the benchmark index, with the underlying equity portfolio giving a total return of 5.5% p.a. and a NAV return of 5.1% p.a. The trust's gearing tends to amplify returns. In a period when returns have been modest, the gearing and costs have offset part of the investment portfolio's outperformance.

A key focus for the trust's board is maintaining the dividend growth track record. The trust has raised its dividend every year, from 18.9p in 2006 to 24.0p in 2016, with a similar increase in the earnings per share. Dividends in the broad UK stock market have been less stable, with a significant cut in the aggregate dividend level in the wake of the financial crisis followed by some recovery since then.

Investment Performance

A full analysis of performance of the trust is shown on page 8. In the section below we discuss the performance of the investment portfolio compared to the performance of the FTSE 100 Index benchmark.

Over the year, the investment portfolio, before gearing and costs, produced a total return of -3.8%. This return was 2.7% ahead of the return on the FTSE 100 Index. The table below sets out the key stocks which contributed positively and negatively to this outperformance.

This positive relative performance has been driven by individual company specific factors as well as a few general trends. Inmarsat was the top performance contributor as the company successfully launched its next generation Global Express satellite communications network. This brings opportunities to sell additional products and services to their existing marine, government and aviation customers. Carnival also performed well as the cruise company's restructuring programme gained traction. It was helped by falling fuel costs, a robust consumer background and an emergent Chinese cruising market.

At a thematic level, the collapse in commodity prices had a notable impact. The portfolio's low exposure to the mining sector was a significant positive factor. Three of the top four individual stock contributors, Glencore, Rio Tinto and Anglo

The trust has raised its dividend every year, from 18.9p in 2006 to 24.0p in 2016, with a similar increase in the earnings per share.

Contribution to Investment Performance relative to FTSE 100 Index

Positive Contribution	%	Over/under weight	Negative Contribution	%	Over/under weight
Inmarsat	1.1	+	Antofagasta	-0.6	+
Glencore	0.9	-	Imperial Tobacco	-0.6	-
Rio Tinto	0.7	-	BT	-0.5	-
Anglo American	0.6	-	Amec Foster Wheeler	-0.5	+
Carnival	0.5	+	SAB Miller	-0.5	-
UBM	0.4	+	Brammer	-0.5	+
Standard Chartered	0.4	-	BG	-0.5	-
Glaxosmithkline	0.3	+	Lloyds Banking Group	-0.5	+
Rolls Royce	0.3	-	Reckitt Benckiser	-0.4	-
Greene King	0.3	+	Centrica	-0.4	+

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

Investment Manager's Review *(continued)*

Our investment process focuses on three main facets of a company; Fundamentals, Valuation and Themes.

American were companies that were not owned in the trust, but were large index constituents. As they fell heavily they depressed the FTSE's return. Another theme was the strong performance of companies involved in consolidation. UBM, GlaxoSmithKline and Greene King shares all performed well and benefitted from recent acquisitions.

The final two positive stock contributors among the top ten were Standard Chartered and Rolls Royce. Neither was owned in the portfolio and both stocks fell heavily in response to significant profits warnings.

The fall in commodity prices also had an impact on the negative side. The copper miner Antofagasta, which was purchased during the year, continued to slide as the copper price fell. Artec Foster Wheeler and Brammer both had profits warnings which were at least partly due to their exposure to the natural resources industries. Artec is a supplier of engineering services directly to the oil industry, which has been slashing investment. Brammer is a distributor of industrial components and suffered from weak trading in the Norwegian oil industry and the UK steel sector amongst other issues. In addition, Centrica is both a producer of gas and a seller of energy. It faced challenging trading conditions and cut its dividend.

The other theme amongst the top ten negative performance contributors was the portfolio's low exposure to many defensive industries. Imperial Tobacco, BT, SAB Miller and Reckitt Benckiser all performed well, as investors were prepared to pay high prices for their resilience in an uncertain economic environment. SAB Miller was also subject to a takeover approach. We believed that the valuations of these businesses were too high and so they were not held in the portfolio. Elsewhere, the portfolio did not own BG, which was bid for by Royal Dutch Shell. Finally, Lloyds Banking Group was added to the portfolio during the year, but performed poorly subsequent to its purchase, along with much of the banks sector.

Portfolio Changes

Our investment process focuses on three main facets of a company; Fundamentals, Valuation and Themes. "Fundamentals" includes the quality of the business, competitive position, growth prospects, corporate governance and so on. "Valuation" compares the valuation of a company with its own history, other companies in its industry and valuations in the wider stock market. "Themes" considers structural trends that can be positive or negative for the business as well as cyclical factors in the industry or the wider economy.

Largest Net Purchases		Largest Net Sales	
Company	£m	Company	£m
Lloyds Banking Group	26.6	British American Tobacco	16.6
Antofagasta	11.9	Cineworld	10.5
Prudential	9.9	Britvic	10.4
GlaxoSmithKline	7.0	Unilever	10.2
Barclays	6.5	Artec Foster Wheeler	8.8
Equiniti	6.4	Aviva	6.9
Tate & Lyle	6.3	Inmarsat	6.7
Kier	6.1	SSE	6.6
Brammer	5.7	Smiths Group	5.9
HSBC	4.0	Carnival	5.0

Source: Allianz Global Investors

Investment Manager's Review *(continued)*

When there is a wide dispersion of returns across the stock market, the valuations of individual shares can move considerably, even if the fundamentals and themes have not changed materially. Last year, such changes in valuation influenced activity within the portfolio. In particular, many of the new investments were in the financial or mining sectors. These two areas have seen notable underperformance, creating opportunities to buy businesses at attractive levels. Conversely many of the sales within the portfolio were from the defensive sectors, which have seen a substantial re-rating in recent years.

Overall we added six new companies to the portfolio and sold seven names completely. In the financial sector we bought the banks; Lloyds and Barclays, as described in the half year report. We also bought a position in the life insurer Prudential in the second half. Prudential is a high quality business with an excellent track record of growth in the Asian savings and life assurance markets in particular. It was unusually depressed due to specific concerns, including new insurance regulations in the UK and the outlook for Asian growth. This provided a good opportunity to invest, as we believe these concerns were over-discounted. In the mining sector we bought copper miner Antofagasta. Copper is an attractive commodity as supply is increasingly constrained and long term demand characteristics are favourable. The business has little debt and a good position on the industry cost curve, so it is well positioned for an eventual recovery in the market.

Inmarsat was the top performance contributor as the company successfully launched its next generation Global Express satellite communications network.

The remaining two new purchases in the portfolio were both new issues. Unusually, these companies were being sold on reasonable valuations. Equiniti is a technology based, white collar, outsourcing company specialising in the administration of share registers, pension plans and a number of related services, primarily for large companies and public sector bodies. It has a long standing customer base and a strong competitive position. The shares were priced very attractively, as it raised money to reduce borrowings, with a high free cash flow yield and a reasonable dividend yield expected in 2016.

The second new issue was Hostelworld. This is the market leader in online youth hostel booking around the world, owning the Hostelworld, Hostelbookers and Hostels.com brands. Our proprietary GrassrootsSM research highlighted the strength of the business franchise, with complimentary comments from hostel owners. The business has good opportunities to benefit from a growing hostel market, further penetration of their mobile phone App and various pricing initiatives. The initial valuation was also modest, especially for an online market leader.

Within the top ten net investments, we also added to five existing holdings, where our conviction in the investment cases increased or where valuations came down as shares weakened. These were GlaxoSmithKline, Tate & Lyle, Kier, Brammer and HSBC.

The largest net sales from the portfolio included stocks in industries such as tobacco, beverages,

Overall we added six new companies to the portfolio and sold seven names completely.

Investment Manager's Review *(continued)*

Other significant sales from the portfolio reflected businesses that had rallied and approached our target price.

food producers and utilities, which outperformed due to the resilience of their earnings. This took many valuations to expensive levels. We significantly reduced the position in British American Tobacco, took profits in SSE and sold out of Britvic and Unilever. We also sold the remaining smaller position in property stock Hammerson, which had rallied as prime property values benefited from very low interest rates.

A few shares were sold where the investment case deteriorated. Most notably, Artec Foster Wheeler was sold immediately after a severe profit warning. Whilst oil industry conditions have clearly been challenging for some time, we had believed that Artec should be relatively resilient, and furthermore, that the purchase of Foster Wheeler would give rise to significant synergy benefits. The latest downgrade to expectations undermined our confidence in the quality of the business and called into question the strength of the balance sheet.

We also sold out of the diversified engineering business, Smiths Group. Its largest business, John Crane, is highly exposed to the oil and petrochemicals industry and its high profit margins could come under pressure. The final complete sale was the industrial distributor Premier Farnell. We had invested for its restructuring potential. However, despite early promise, successive management teams failed to deliver a sustained turnaround. Our confidence in its recovery waned and we sold out. Subsequently the chief executive left the business and they cut their dividend.

Other significant sales from the portfolio reflected businesses that had rallied and approached our target price. In the consumer sector, we took profits in Carnival and sold out of Cineworld. In the life assurance industry we took profits out of Aviva, inherited from the takeover of Friends Life. This sale partly funded the purchase of Prudential. Finally amongst the top ten net sales, we took partial profits on the large position in Inmarsat.

Derivatives

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

Option activity gradually picked-up through the year, as increased volatility created more opportunities for writing options that met our specific criteria. The option strategy once again delivered its primary objective of income generation, with approximately £0.9m of option premiums accrued. The strategy was also

Investment Manager's Review *(continued)*

profitable, with few options exercised. Allowing for the opportunity costs of any option exercises, the strategy generated an overall gain of £0.5m.

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

Dividends

A high yield and consistently rising dividend payments are key objectives of the trust. During the year, the underlying income growth within the portfolio was modest. However approximately 30% of the portfolio's income is paid in US dollar dividends. A stronger dollar increased the sterling value of these dividend payments.

The trust's income from dividends was £30.0m (2015 - £29.0m), up 3.3% during the year, with total income of £31.0m (2015 - £30.0m). Earnings per share (revenue) was 24.05p (2015 - 23.56p) up 2.1%. The directors have proposed total dividends for the year of 24.0p (2014 - 23.8p) up 0.8%, fully covered by earnings.

There has been a considerable media focus on the risks to dividends at many of the large UK companies, especially in the natural resources sector, but the overall outlook is more balanced. The trust's dividend income is diversified across companies and sectors, with approximately 56% of the dividend income coming from the top ten stocks. The four largest income contributors in the portfolio are Royal Dutch Shell, HSBC, GlaxoSmithKline and BP. All four have recently maintained their 2015 dividends and reaffirmed their dividend policies, with HSBC posting a modest increase.

Whilst some dividend cuts are likely in the portfolio, many companies are likely to raise their dividends. At the turn of the year, approximately 10% of the portfolio stocks had a historic yield of 2% or less, with the potential to grow payments significantly in the future. These stocks included Lloyds Banking Group, which has recently announced a significant dividend increase for last year. The recent weakness of the pound is also helping the trust's income stream, like last year.

There are several other factors that the board take into account when setting dividend policy. Investment trusts have the ability to smooth dividends by tucking away reserves in good times to maintain pay-outs in tougher times. At the end of the year, the remaining revenue reserves were £24.6m, 22.6p per share, enough to cover 94% of the full year's dividend. Finally, one of the trust's debentures, which was taken out when interest rates were considerably higher, matures in January 2018. If the board decides to replace this bond with debt at current market rates, that should add to the trust's distributable income.

Economic and Market Outlook

On the surface, the economic outlook is reasonably positive. The USA and UK are growing at around 2% with unemployment falling, whilst the Eurozone is seeing a modest pick-up in activity. Employment trends in the US and the UK are positive, with unemployment at a low level and wage inflation starting to emerge. However these performances are fragile. Japan is struggling to generate any growth, whilst most emerging markets are slowing down or in recession. Furthermore, monetary policy is being kept extremely stimulative, in an attempt to generate growth and avoid deflation. Interest rates are now negative in the Eurozone and Japan, and still rock bottom in the UK. Only the USA has managed to raise interest rates so far this cycle.

The collapse in commodity prices, notably oil, has recently been interpreted negatively as a sign that China, the engine of world growth is slowing. It is also putting pressure on the budgets of oil and resource producing nations, and prompting asset sales by sovereign wealth funds, as well as raising credit quality concerns within the banking sector. However, there is a more positive view. Oil is a major cost to many consumers, businesses

On the surface, the economic outlook is reasonably positive. The USA and UK are growing at around 2% with unemployment falling, whilst the Eurozone is seeing a modest pick-up in activity.

Investment Manager's Review *(continued)*

Our central view remains that the Western economies will continue to gradually recover.

and indeed importing countries. Falling oil prices provide a significant stimulus to world growth and a cost benefit to many companies, even though there are clearly pressures in the oil and related industries.

Our central view remains that the Western economies will continue to gradually recover. However, the rate of growth will be constrained by the enormous debt burden in the system, which constrains spending. Central banks will continue to stimulate the economy and try to raise the inflation rate via low or negative interest rates and other policy tools. Interest rates may rise in the US and UK, although this will depend upon how the economic data develops. There remain significant risks to the central case, including the risk of economies slipping into recession or deflation taking hold.

One particular factor this year is the forthcoming Brexit referendum in June. Ahead of the referendum there could be a hiatus in investment into the UK. If the vote is for the UK to exit the EU, then there will be considerably more uncertainty and potentially significant issues for some businesses. The most affected are likely to be companies that trade in goods or services from the UK onto the continent, although it is not at all clear what type of trade arrangements will be agreed or when this will happen. Another issue to consider is the risk of another Scottish independence referendum, should the UK vote to leave. For many of the companies quoted on the UK stock market, and especially for the larger

companies in the FTSE 100 Index, the actual risks from Brexit should be limited. Most of our biggest companies, for example in the oil, mining, pharmaceutical and consumer goods sectors, are genuine multinationals. They may operate in many countries but are not that dependent upon trade to and from the UK. Even among the medium sized companies which tend to be more domestically exposed, the main risk for many would be a knock on effect on confidence or UK economic growth, rather than direct trade issues with the EU.

Whilst there is an element of uncertainty on the outlook, the UK stock market has retreated significantly and now offers better value. With the index close to its level a decade ago there are some very attractive investment opportunities. However, the disparity of valuations within the market has become notably greater. Defensive businesses, such as food and beverages companies and regulated utilities, are generally expensive. On the other hand, cyclical and financial stocks have fallen significantly, with some offering exceptional value. As such, looking at the aggregate stock market valuation can be misleading.

Portfolio Strategy

The wide and increasing disparity in valuations across the stock market is a key factor in our current portfolio strategy. Many of the themes we highlighted a year ago are still in place, though the strength of view and size of position may have increased. We continue to hold large positions in specific "mega-cap" companies; GlaxoSmithKline,

Our confidence on the oil sector is not simply based upon valuations but also on a view that the oil price will rise significantly over time.

Investment Manager's Review *(continued)*

HSBC, BP and Royal Dutch Shell, which are lowly priced and out of favour. The oil majors warrant a specific explanation.

Our confidence on the oil sector is not simply based upon valuations but also on a view that the oil price will rise significantly over time. The current depressed oil price puts short term profitability under pressure. However the low oil price today does not imply the longer term oil price outlook is negative, arguably the reverse. We are seeing huge cuts in investment across the oil industry and a significant tightening in financial conditions. This will inevitably constrain capacity growth in an industry where existing oil wells deplete rapidly, even with an expected recovery in Iranian production. At the same time, demand for oil is rising as the cheap price of petrol is encouraging purchases and usage of cars and other transport around the world. Therefore, over time, we see the oil price rising as falling supply meets rising demand, even without the added risk of a geopolitical event.

Another area of the market we favour is recovery situations. These are either industries where the outlook is improving, such as UK construction, or companies where there is some sort of restructuring or turnaround strategy in place. Investors typically do not like uncertainty. This means that the stock market often undervalues recovery situations, as the timing and strength of the trading improvements can be hard to forecast with any certainty. Companies where we see good turnaround potential include the retailers Marks & Spencer and Mothercare, the transport company First Group, the construction and infrastructure business Balfour Beatty and the betting company Ladbrokes.

Businesses offering structural growth are also attractive in an environment of low economic growth, but many are already highly valued within the stock market. However, there are situations where we can find strong businesses with good growth profiles at sensible valuations. These include Inmarsat, Brammer, SThree and

Hostelworld. In a similar vein, although there is a high level of uncertainty about the short term growth in emerging markets, we see structural growth in consumption in the developing world. Companies in the portfolio exposed to this theme and attractively priced include Prudential, GlaxoSmithKline and United Business Media (UBM).

Several financial stocks look attractive after recent weakness. Life assurance companies, such as Standard Life and Legal & General offer high dividend yields and decent dividend growth. The banking industry is emerging gradually from a substantial restructuring during the financial crisis. Banks are now more tightly regulated, better funded and have higher levels of capital. Lloyds, in particular, is now beginning to pay a healthy level of dividends after rebuilding its capital base. We believe that banks should be more resilient than previously and, in time, this will lead to a revaluation. Elsewhere within financials, we have investments in a diverse range of specialist businesses and industrial real estate companies.

The portfolio has a limited exposure to more defensive sectors such as health and personal care, food producers, beverages and tobacco. We believe that shareholder returns are likely to be poor investing at current valuations.

In summary, our central expectation is for a continued modest expansion of the economy. Whilst there are risks to this scenario, the stock market is discounting a high level of uncertainty. The market level is broadly unchanged in a decade, and within it there are many stocks trading at depressed levels. We are finding exciting opportunities to invest in strong businesses, offering attractive dividend yields, which should generate attractive shareholder returns in the years ahead.

Simon Gergel
Allianz Global Investors

The banking industry is emerging gradually from a substantial restructuring during the financial crisis.

Portfolio Holdings

at 31 January 2016

Listed Equity Holdings

Name	Value (£)	% of listed holdings	Principal Activities
GlaxoSmithKline	45,458,010	7.5	Pharmaceutical & Biotechnology
Royal Dutch Shell 'B'	38,417,519	6.4	Oil & Gas Producers
HSBC	37,324,542	6.2	Banks
BP	30,022,491	5.0	Oil & Gas Producers
UBM	29,357,397	4.9	Media
Lloyds Banking Group	20,934,400	3.5	Banks
BAE Systems	20,897,680	3.4	Aerospace & Defence
Inmarsat	20,612,172	3.4	Mobile Telecommunications
National Grid	16,847,322	2.8	Gas, Water & Multiutilities
Tate & Lyle	16,250,000	2.7	Food Producers
Top Ten Holdings	276,121,533	45.8	
Pennon	15,930,000	2.6	Gas, Water & Multiutilities
SSE	15,482,900	2.6	Electricity
Centrica	14,612,480	2.4	Gas, Water & Multiutilities
British American Tobacco	14,422,795	2.4	Tobacco
Greene King	14,300,000	2.4	Travel & Leisure
CRH	14,275,800	2.4	Construction & Materials
Carnival	13,452,810	2.2	Travel & Leisure
Marks & Spencer	12,659,385	2.1	General Retailers
SThree	12,583,451	2.1	Support Services
Kier Group	12,555,086	2.1	Construction & Materials
Standard Life	12,438,190	2.1	Life Insurance
Sainsbury (I)	12,093,120	2.0	Food & Drug Retailers
Diageo	12,060,800	2.0	Beverages
William Hill	11,738,580	1.9	Travel & Leisure
ICAP	11,729,595	1.9	Financial Services
Hansteen	11,677,880	1.9	Real Estate Investment Trusts
Balfour Beatty	10,981,648	1.8	Construction & Materials
Aviva	9,602,754	1.6	Life Insurance
Legal & General	9,488,700	1.6	Life Insurance
IG Group	9,388,115	1.5	Financial Services
Prudential	8,882,250	1.5	Life Insurance
Ladbroke's	8,298,850	1.4	Travel & Leisure
Antofagasta	6,461,700	1.1	Mining
BHP Billiton	6,234,264	1.0	Mining
Equiniti	6,022,976	1.0	Support Services
Ashmore Group	5,972,273	1.0	Financial Services
Brammer	5,758,216	0.9	Support Services

Portfolio Holdings *(continued)*

at 31 January 2016

Listed Equity Holdings *(continued)*

Name	Value (£)	% of listed holdings	Principal Activities
Mothercare	5,367,390	0.9	General Retailers
Man Group	5,363,686	0.9	Financial Services
Barclays	4,650,000	0.8	Banks
FirstGroup	4,598,550	0.8	Travel & Leisure
Segro	4,389,000	0.7	Real Estate Investment Trusts
Hostelworld	3,746,627	0.6	Travel & Leisure
Total Listed Equities	603,341,404	100.0	

Unlisted Equity Holdings

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

* These companies are the lenders of the company's Stepped Rate Loan and Fixed Rate Interest Loan; more details are available in Note 9 on page 66.

Written Call Options

As at 31 January 2016, the market value of the open option positions was £(214,350), resulting in an underlying exposure to 4.4% of the portfolio (valued at strike price).

Distribution of Total Assets

at 31 January 2016

	Percentage of Total Assets* at 31 January 2016	Percentage of Total Assets* at 31 January 2015
Oil & Gas		
Oil & Gas Producers	11.3	13.0
Oil Equipment, Services & Distribution	-	1.9
	11.3	14.9
Basic Materials		
Mining	2.1	2.5
	2.1	2.5
Industrials		
Aerospace & Defence	3.4	3.1
Construction & Materials	6.2	4.5
General Industrials	-	1.1
Support Services	4.0	3.1
	13.6	11.8
Consumer Goods		
Beverages	2.0	3.4
Food & Drug Retailers	2.0	1.4
Food Producers	2.7	3.1
Tobacco	2.4	4.6
	9.1	12.5
Health Care		
Pharmaceuticals & Biotechnology	7.5	5.8
	7.5	5.8
Consumer Services		
General Retailers	3.0	3.1
Media	4.8	4.5
Travel & Leisure	9.2	9.1
	17.0	16.7

Distribution of Total Assets *(continued)*

at 31 January 2016

	Percentage of Total Assets* at 31 January 2016	Percentage of Total Assets* at 31 January 2015
Telecommunications		
Mobile Telecommunications	3.4	3.2
	3.4	3.2
Utilities		
Electricity	2.6	3.6
Gas, Water & Multiutilities	7.8	6.7
	10.4	10.3
Financials		
Banks	10.3	6.2
Financial Services	5.3	4.9
Life Insurance	6.6	6.7
Real Estate Investment Trusts	2.6	3.5
	24.8	21.3
Total Investments	99.2	99.0
Net Current Assets	0.8	1.0
Total Assets	100.0	100.0

*Total Assets (less creditors due within one year) £608,370,101 (2015 - £672,481,424).

Historical Record

year ended 31 January 2016

Revenue and Capital	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Income (£'000s)	27,750	28,495	31,730	23,687	25,741	27,305	28,313	29,827	29,958	30,985
Net revenue earnings per ordinary share	22.17p	22.86p	27.25p	18.91p	21.22p	22.00p	22.90p	24.22p	23.56p	24.05p
Dividend per share	20.00p	21.60p	22.80p	22.50p	22.80p	23.00p	23.20p	23.60p	23.80p	24.00p
Ordinary dividend per share	20.00p	21.60p	22.30p	22.50p	22.80p	23.00p	23.20p	23.60p	23.80p	24.00p
Special dividend per share	-	-	0.50p	-	-	-	-	-	-	-
Tax credit per share	2.22p	2.40p	2.53p	2.50p	2.53p	2.56p	2.58p	2.62p	2.64p	2.67p
Gross dividend per share	22.22p	24.00p	25.33p	25.00p	25.33p	25.56p	25.78p	26.22p	26.44p	26.67p
Total net assets attributable to ordinary capital (£'000s)	588,835	506,187	314,804	384,747	440,846	415,025	481,464	529,478	562,009	498,108
Net asset value per ordinary share (debt at par)	567.5p	492.3p	306.2p	372.8p	427.1p	402.1p	466.5p	510.8p	516.9p	458.1p
Net asset value per ordinary share (debt at market value) ~	-	-	278.5p	356.4p	407.3p	366.2p	434.1p	486.8p	486.1p	437.7p
NAV total return (debt at par) % *	16.4	-9.6	-33.4	29.2	20.7	-0.5	21.8	14.5	5.8	-6.7
NAV total return (debt at market value) % ~	-	-	-	36.2	20.7	-4.5	24.9	17.5	4.7	-5.0
Ordinary share price	513.0p	425.0p	282.0p	329.1p	406.9p	363.0p	412.7p	491.5p	484.0p	414.0p
Discount/premium (debt at par) %	-9.6	-13.7	-7.9	-11.7	-4.7	-9.7	-11.5	-3.8	-6.4	-9.6
Discount/premium (debt at market value) % ~	-3.4	-5.8	1.3	-7.7	-0.1	-0.9	-4.9	+1.0	-0.4	-5.4

Notes

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

The Merchants Trust PLC

Directors' Review

Directors, Investment Manager and Advisers

Directors

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

Simon Fraser (Chairman)

Joined the board in August 2009 and became Chairman in 2010. He is Chairman of Foreign & Colonial Investment Trust PLC and Chairman of The Investor Forum and is a non-executive director of Ashmore Group plc and Fidelity European Values PLC. He spent his career at Fidelity International Limited, where he held a number of positions, including Chief Investment Officer from 1999-2005, President of Fidelity International's European and UK Institutional business and latterly President of the Investment Solutions Group.

Sybella Stanley

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, Innovation and Skills' Industrial Development Advisory Board. Before joining RELX Group in 1997, Sybella was a member of the M&A advisory teams at, successively, Citi and Barings. She is a trustee of the Britten-Pears Foundation and a member of the Somerville College Oxford Development Board. Sybella is a barrister.

Mike McKeon (Chairman of the Audit Committee and Senior Independent Director)

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

Paul Yates

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

Mary Ann Sieghart

Joined the board in November 2014. She is Chair of the Social Market Foundation, a non-executive director of The Henderson Smaller Companies Investment Trust plc and a director of DLN Digital Ltd. Mary Ann sits on the Council of Tate Modern and the Content Board of Ofcom and she is a trustee of the Radcliffe 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.

Directors, Investment Manager and Advisers *(continued)*

The Manager

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

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

As at 31 December 2015, Allianz Global Investors had €442 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 2015 had £1.17 billion of assets under management in a range of investment trusts. Website: www.allianzgi.co.uk

Head of Investment Trusts

Melissa Gallagher Email: melissa.gallagher@allianzgi.com

Investment Manager

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

Company Secretary and Registered Office

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

Registered Number

28276

Independent Auditors

PricewaterhouseCoopers LLP

Bankers

HSBC Bank plc,
Barclays Bank plc

Registrars

Capita Asset Services
(full details on page 80)

Solicitors

Herbert Smith Freehills LLP

Stockbrokers

J.P. Morgan Securities Limited

Depositary and Custodian

HSBC Bank PLC

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

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

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

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

The Depositary must ensure that:

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

- the instructions of the Alternative Investment Fund Manager ("the AIFM") are carried out (unless they conflict with the Regulations).

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

Report of the Depositary to the Shareholders of The Merchants Trust PLC (the company) for the period ended 31 January 2016.

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
19 February 2016

Further information about the relationship with the Depositary is on page 79.

Directors' Report

The directors present their report and the audited financial statements of the company for the year ended 31 January 2016.

Revenue

The net earnings attributable to ordinary shareholders for the year amounted to £26,145,206 or 24.1p per share (2015 - £24,950,147, 23.6p per share).

The first and second interim dividends of £6,523,708 each, or 6.0p per share, have been paid during the year. Since the year end the third interim dividend of £6,523,708, or 6.0p per share, was paid on 24 February. Subject to shareholder approval, a final dividend of 6.0p will be payable on 26 May 2016. In accordance with FRS 102 Section 32: 'Events after the end of the reporting period', the third interim dividend and final dividend are not recognised as liabilities within the financial statements on the basis that at the year end the third interim dividend had not been paid and the final dividend not approved by the shareholders.

Historical Record

The distribution of total assets is shown on pages 26 and 27, and the historical record of the company's revenue and capital over the past ten years is shown on page 28. Graphs appear on page 7 showing the performance on a total return basis over the past ten years of the net asset value of the company's ordinary shares against the FTSE 100 Index, the growth in net ordinary distributions made by the company against the Retail Price Index, the company's discount/premium to net asset value and the dividend yield compared to the FTSE 100 Index, UK gilt yield and cash, over the same period.

Invested Funds

Sales of investments during the year resulted in net gains based on historical costs of £25,305,862 (2015 - costs of £26,890,447). Provisions contained in the Finance Act 2010 exempt approved investment trusts from corporation tax on their chargeable gains.

Share issuance and buy back

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

Future Development

The future development of the company is dependent on the success of the company's investment strategy against the economic environment and market developments. The Chairman's Statement on pages 2 to 4 sets out the outlook for the company and the investment manager also discusses his view of the outlook for the company's portfolio in his report beginning on page 16. The future is also discussed in the Strategic Report on page 14.

Going Concern

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

Section 992 of the Companies Act 2006

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

Capital Structure

The company's capital structure is summarised in Note 12 on page 68. The details of the 4% perpetual debenture stock and the 3.65% cumulative preference stock are provided in Notes 11(iv) and 11(v) respectively on page 68.

Directors' Report *(continued)*

Voting Rights in the Company's Shares

The voting rights at 30 March 2016 were:

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

Every member on a show of hands has one vote. On a poll every member who is present in person or by proxy or representative has one vote for every £1 in nominal amount of preference stock or one vote for every ordinary share of 25p. The perpetual debenture stock and bonds carry no voting rights.

Interests in the Company's Share Capital

As at 30 March 2016 the following had declared a notifiable interest in the company's issued share capital:

Ordinary Shares

Name	Number of shares	Percentage of voting rights
Legal & General Group PLC	4,099,823	3.94

This represents no change since the year end.

The rules concerning the appointment and replacement of directors, amendment of the Articles and powers to issue or buy back the company's shares are contained in the Articles of the company and the Companies Act 2006.

Directors

Biographical details of the current directors at the date of the signing of this report are shown on page 30.

All of the directors are retiring at the annual general meeting and each offers themselves 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. Following a formal performance evaluation conducted by the chairman it was noted that each director's individual performance continues to be effective and each director demonstrates commitment to his or her role.

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

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

Contracts of service are not entered into with the directors, who hold office in accordance with the company's Articles.

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

Directors' Report *(continued)*

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 (2015 - 0.35%) of the value of the assets, calculated quarterly, after deduction of current liabilities, short term loans under one year and any funds within the portfolio managed by AllianzGI. The management contract is terminable at one year's notice (2015 - one year). Under the contract, other than a year's fees which may be paid in lieu of notice, there are no compensation payments due on termination.

The manager's performance under the contract and the contract terms are reviewed at least annually by the Management Engagement Committee. This committee consists of the directors not employed by the management company in the past five years and therefore includes the entire board. During the year, the committee met the manager to review the current investment framework, including the company's performance, marketing activity and total expense ratio.

The committee also reviewed the terms of the management contract and considered the level of the management fee. The committee was satisfied with its review and believes that the continuing appointment of the manager is in the best interests of shareholders as a whole.

Individual Savings Accounts

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

Political Donations

The company made no political donations in the year (2015 - nil).

Corporate Governance Statement

The board has considered the principles and recommendations of the AIC Code of Corporate Governance 2015 (AIC Code) and been guided by the AIC Corporate Governance Guide for Investment Companies (AIC Guide). Both documents can be found on the AIC website www.theaic.co.uk. As confirmed by the Financial Reporting Council, following the AIC Guide enables investment company boards to meet their obligations under the UK Corporate Governance Code. The company has complied with the current recommendations of the AIC Code and the relevant provisions of UK Corporate Governance Code, except in relation to the UK Corporate Governance Code provisions relating to: the role of the chief executive; executive directors' remuneration; the remuneration committee; and the need for an internal audit function. For the reasons set out in the AIC Guide, and in the preamble to the UK Corporate Governance Code, the board considers these provisions are not relevant to the company as it is an externally managed investment company.

The full text of the company's Corporate Governance Statement is on the website www.merchantstrust.co.uk in the literature/trust documents section.

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

Director	Board	Audit Committee	Nomination Committee	Management Engagement Committee
Number of meetings	6	3	1	1
Simon Fraser	6	3 [†]	1	1
Mike McKeon	6	3	1	1
Mary Ann Sieghart	6	3	1	1
Sybella Stanley	6	3	1	1
Paul Yates	6	3	1	1

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

Directors' Report *(continued)*

Special Rights Disclosure

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

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

Conflicts of Interest

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

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

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

Board Composition and Succession Planning

The board has issued a statement giving support to the intention of the Davies Review 'Women on boards' to encourage diversity on the boards of companies. The board considered its succession plans as part of the board evaluation exercise which took place in March this year. There are no current plans to recruit further new directors, but the board continues to keep this under review. The board's aim is to continue with a policy of shortlisting women in the search for new directors. Currently, there are three men and two women on the board.

Board Committees

Audit Committee

The Audit Committee Report is on pages 41 to 43.

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 40. The Independent Auditors' Report can be found on pages 48 to 52.

Directors' Report *(continued)*

Auditors' Information

Each of the persons who is a director at the date of approval of this report confirms that:

- (a) in so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- (b) the director has taken all the steps he or she ought to have taken as a director in order to make himself/ herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Internal Control

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

The board has established an ongoing process for identifying, evaluating and managing the risks faced by the company. The process has been fully in place throughout the year under review and up to the date of signing of this Annual Report.

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

- The board, assisted by the manager, undertook a full review of the company's business risks and these are analysed and recorded (see page 13). Every six months the board receives from the manager a formal report which details any known internal controls failures, including those that are not directly the responsibility of the manager. The board continues to check that good systems of internal control and risk management are embedded in the operations and culture of the company and its key suppliers.

- AllianzGI, as the manager, provides investment management, accounting and company secretarial services to the company. The manager therefore maintains the internal controls associated with the day to day operation of the company. These responsibilities are included in the management agreement between the company and the manager. The manager's system of internal control includes organisation arrangements with clearly defined lines of responsibility and delegated authority as well as control procedures and systems which are regularly evaluated by management and monitored by its internal audit department. The company receives full reports at least annually from the manager on its internal controls. The company, in common with other investment trusts, has no internal audit department, but the effectiveness of the manager's internal controls is monitored by AllianzGI's internal audit function.

- There is a regular review by the board of asset allocation and any risk implications. There is also regular and comprehensive review by the board of management accounting information including revenue and expenditure projections, actual revenue against projections and performance comparisons.
- Authorisation and exposure limits are set and maintained by the board.
- The audit committee assesses the systems of controls of third party service providers by reviewing internal control reports of those parties including the manager, the company's registrars, Capita Asset Services and the custodian, HSBC Bank plc.

The audit committee has received reports from each of its service providers on the anti-bribery policies of these third parties. It receives reports on compliance with the manager's anti-bribery policy.

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

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.

Directors' Report *(continued)*

The manager meets with institutional shareholders on a regular basis and reports to the board on matters raised at these meetings. The Chairman and, where appropriate, other directors, are available to meet with shareholders to discuss governance and strategy and to understand their issues and concerns. All correspondence with shareholders is reviewed by the board.

Shareholders who wish to communicate directly with the Chairman, the Senior Independent Director or other directors may write care of the Company Secretary, The Merchants Trust PLC, 199 Bishopsgate, London EC2M 3TY.

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

The UK Stewardship Code and Exercise of Voting Powers

The company's investments are held in a nominee name. The board has delegated discretion to discharge its responsibilities in respect of investments, including the exercise of voting powers on its behalf to the manager, AllianzGI. AllianzGI is a signatory to the UK Stewardship Code, which sets out good practice on engagement with investee companies. AllianzGI monitors our portfolio holdings and proactively engages with investee companies in line with the principles set out in the UK Stewardship Code and consistent with our investment objectives. AllianzGI's engagement activities cover a range of matters, including strategy, performance, risk management, capital allocation, corporate governance, and environmental and social impacts. Allianz Global Investors' policy statement on the Stewardship Code can be found on its website. The board has reviewed this policy statement and is satisfied that the company's delegated voting powers are being properly executed and that AllianzGI applies the principles of the Stewardship Code in practice.

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

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

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

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

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

In the UK, AllianzGI is a member of the Pensions and Life Savings Association and the International Corporate Governance Network, and abides by these organisations' founding principles. These guidelines also take into account international codes of corporate governance from a number of sources, including Employment Retirement Income Security Act legislation and Department of Labor recommendations in the U.S. where appropriate.

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

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

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.

Directors' Report *(continued)*

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 36,242,821 ordinary shares, representing approximately one third of the existing ordinary share capital. This authority is renewable annually and will expire at the conclusion of the annual general meeting in 2017.

2. Disapplication of Pre-emption Rights

A resolution was passed at the annual general meeting held on 20 May 2015 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 2016. 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 2017 or 24 August 2017 if earlier. This power is limited to a maximum number of 10,872,846 ordinary shares, being approximately 10% of the issued ordinary share capital of the company as at the date of this report, provided that there is no change in the issued share capital between the date of this report and the annual general meeting to be held on 24 May 2016.

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.

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 £400 million). The rules of the UK Listing Authority (Listing Rules) limit the price which may be paid by the company to 105% of the average middle-market quotation for an ordinary share on the five business days immediately preceding the date of the relevant purchase. The minimum price to be paid will be 25p per ordinary share (being the nominal value). Overall, this proposed share buy back authority, if used, could help to reduce the discount to net asset value when the company's shares trade at a discount.

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

Under the Listing Rules, the maximum number of its own shares which a listed company may purchase through the market pursuant to a general authority such as this is equivalent to 14.99% of its issued share capital. For this reason, the company is limiting its renewed authority to make such purchases to 16,298,396 ordinary shares, representing 14.99% of the issued share capital, provided that there is no change in the issued share capital between the date of this report and the annual general meeting to be held on 24 May 2016.

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

Directors' Report *(continued)*

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 2017 or the expiry of 15 months from the date of the passing of this resolution, whichever is the earlier. The authority will be subject to renewal by shareholders at subsequent annual general meetings.

4. Independent Auditors

The directors will place a resolution before the annual general meeting to reappoint PricewaterhouseCoopers LLP as statutory auditors for the ensuing year. A resolution to authorise the directors to determine the auditors' remuneration will also be proposed at the annual general meeting.

The board and the Annual Report

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

By order of the board

*Kirsten Salt
Company Secretary
30 March 2016*

Statement of Directors' Responsibilities

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Accounting Standards and applicable law). Company law also requires that the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the net return of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; 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 36.

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

The financial statements are published on www.merchantstrust.co.uk, which is a website maintained by the company's investment manager, AllianzGI. The directors are responsible for the maintenance and integrity of the company's website. The work undertaken by the auditors does not involve consideration of the maintenance and integrity of the website and, accordingly, the auditors accept no responsibility for any changes that have occurred to the financial statements since they were initially presented on the website. Visitors to the website need to be aware that legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Statement under Disclosure and Transparency Rule 4.1.12

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

- the financial statements, prepared in accordance with applicable accounting standards, give a true and fair view of the assets, liabilities, financial position and profit of the company;
- the Strategic Report includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that they face; and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the company's performance, business model and strategy.

For and on behalf of the board

*Simon Fraser
Chairman
30 March 2016*

Audit Committee Report

I am pleased to present the report of the audit committee for the year ended 31 January 2016.

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 recent experience as a Group Financial Director of a FTSE 100 company and previously in a similar capacity in other large companies and I am Chairman of the Audit Committee of another listed company.

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.

Non-audit services

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

Fees for non-audit services were £4,600 in the year (2015 - £5,175). These fees are considered by the audit committee to be proportionate to the fees for audit services of £31,000 (2015 - £38,130, including an additional one-off payment of £9,900). This non-audit work was found not to have a significant impact on the financial statements.

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. A further meeting of the committee was held during the year to consider the implications of the adoption of the new Association of Investment Companies Statement of Recommended Practice (AIC SORP) and the adoption of FRS 102. The regular meetings were attended by representatives of the manager including the UK heads of both the compliance and risk departments. At each regular meeting the committee received reports on the operation of financial controls relating to the company and the proper conduct of its business in accordance with the regulatory environment in which both the company and the manager operate. The committee also considered the auditors' report on the annual report, the planning and the process of the audit and the auditor's independence and objectivity. The audit committee believes the performance of the auditor is satisfactory and recommended the reappointment of PricewaterhouseCoopers LLP as auditor of the company to the board. The audit committee reviews the company's accounting policies and considers their appropriateness. The committee also reviews the terms of appointment of the auditors together with their remuneration.

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

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

Audit Committee Report *(continued)*

Resulting from the work of the audit committee, certain key risks are identified for disclosure and discussion in our annual report. These are principally in relation to Investment Activity and Strategy, including Gearing and Market Volatility; Corporate Governance, Shareholder relations and Marketing; Financial and Regulatory; and Operational. These together with mitigating actions are set out in the Strategic Report on page 13.

Viability Statement

Based on this review of risk, including the chief risks around Investment Activity and Strategy and the arrangements in place to manage and mitigate these risks, the committee reviewed a paper that supported the board's conclusion, set out on page 14 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.

Whistleblowing

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

Financial Report and Significant Issues

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

Significant issues considered by the audit committee in the year

Risk	Activity
Risks around the valuation of and the existence of investments.	The company's assets are principally invested in listed equities. 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 notes that investments are valued using stock exchange prices provided by third party financial data vendors. The committee also reviews the valuation of unlisted investments.
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 58 to 60, were noted and adhered to.
	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 £4.9m million, or about 1% of Net Assets, although the auditors would bring to the audit committee's attention any significant misstatements below that level.

Audit Committee Report *(continued)*

The audit, its effectiveness and the reappointment of the auditor

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

As part of the review of the auditor, the members of the committee and those representatives of the manager involved in the audit process reviewed and considered a number of areas including: the reputation and standing of the audit firm; the audit processes, evidence of partner oversight and external information about the firm; the skills, experience and specialist knowledge of the audit team, particularly relating to investment trusts; audit communication including details of planning, information on relevant accounting and regulatory developments, and recommendations on corporate reporting; the reasonableness of audit fees; and the Financial Reporting Council's Audit Quality Report on PricewaterhouseCoopers LLP for 2013/14.

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 auditor and the effectiveness of the external audit. The audit committee believes that the performance of the auditor is satisfactory and has recommended to the board that a resolution proposing the re-appointment of the auditor is put to shareholders at the annual general meeting.

Auditor's tenure

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

Mike McKeon
Audit Committee
Chairman

30 March 2016

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 2016. An ordinary resolution for the approval of the Directors' Remuneration Policy Report was put to a binding shareholder vote at the annual general meeting in 2014 and is next due to be placed before the shareholders for approval at the annual general meeting in 2017. The results of the vote at the 2014 AGM for this resolution were as follows: In favour 93.1%, Against 4.0% and Withheld 2.9% (in aggregate, 30,234,703 votes). The results of the advisory vote at the 2015 AGM for the resolution to approve the Implementation Report were as follows: In favour 91.8%, Against 4.6% and Withheld 3.6% (35,089,622 votes). The Directors' Remuneration Implementation Report will be put to an advisory shareholder vote at this year's AGM.

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

The Board

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

Directors' Shareholdings and Share Interests (Audited)

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

	2016	2015
Simon Fraser	20,000	20,000
Mike McKeon	5,450	5,450
Mary Ann Sieghart	1,000	1,000
Sybella Stanley	3,114	3,114
Paul Yates	10,000	10,000

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

Directors' Remuneration Policy

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

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

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

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

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

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

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

Directors' Remuneration Report *(continued)*

Annual Statement and Directors' Remuneration Implementation Report

Directors' Emoluments (Audited)

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

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

The fees were reviewed in January 2016 and it was determined that there would be no increase to directors' fees at that time.

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	
	2016 £	2015 £
Simon Fraser	36,500	35,000
Mike McKeon	29,000	27,500
Mary Ann Sieghart*	24,000	5,750
Sybella Stanley*	24,000	5,750
Henry Staunton ~	-	21,083
Paul Yates	24,000	23,000
Totals	137,500	118,083

* Appointed to the board on 3 November 2014

~ Retired from the board on 31 December 2014

There are no other benefits requiring reporting.

Analysis of Pay against Distributions

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

Expenditure by the company on remuneration and distributions to shareholders

	2016 £	2015 £
Remuneration paid to all directors	137,500	118,083
Distributions to shareholders	26,094,832	25,526,029

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

Directors' Remuneration Report *(continued)*

Performance Graph

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

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

Total shareholder return for the seven years to 31 January 2016

Signed on behalf of the board

*Simon Fraser
Chairman
30 March 2016*

The Merchants Trust PLC

Independent Auditors' Report

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

Report on the financial statements

Our opinion

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

- give a true and fair view of the state of the Company's affairs as at 31 January 2016 and of its net return and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited

The financial statements, included within the Annual Report comprise:

- the Balance Sheet as at 31 January 2016;
- the Income Statement for the year then ended;
- the Cash Flow Statement for the year then ended;
- the Statement of Changes in Equity; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

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

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

Our audit approach

Overview

	Overall materiality: £4.9 million which represents 1% of net assets.
Materiality	The Company is a standalone Investment Trust Company and engages Allianz Global Investors GmbH (the "Manager") to manage its assets.
Audit scope	We conducted our audit of the financial statements using information from Bank of New York Mellon (the "Administrator") to whom the Manager has, with the consent of the Directors, delegated the provision of certain administrative functions.
Areas of focus	We tailored the scope of our audit taking into account the types of investments within the Company, the involvement of the third parties referred to above, the accounting processes and controls, and the industry in which the Company operates.
	Valuation and existence of investments.
	Income.

The scope of our audit and our areas of focus

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

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

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

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

Area of focus	How our audit addressed the area of focus
<p>Valuation and existence of investments Refer to page 42 (Report of the Audit Committee), page 58 (Accounting Policies) and page 65 (notes).</p> <p>The investment portfolio at the year-end principally comprised listed equity investments.</p> <p>We focused on the valuation and existence of investments because investments represent the principal element of the net asset value as disclosed on the Balance Sheet in the financial statements.</p> <p>Refer to page 42 (Report of the Audit Committee), page 58 (Accounting Policies) and page 61 (notes).</p> <p>We focused on the accuracy and completeness of income recognition and its presentation in the Income Statement as set out in the requirements of The Association of Investment Companies Statement of Recommended Practice (the "AIC SORP").</p> <p>This is because incomplete or inaccurate dividend income could have a material impact on the Company's net asset value and dividend cover.</p>	<p>We tested the valuation of the listed equity investments by agreeing the prices used in the valuation to independent third party sources.</p> <p>No misstatements were identified by our testing which required reporting to those charged with governance.</p> <p>We tested the existence of the investment portfolio by agreeing the holdings for investments to an independent custodian confirmation.</p> <p>No differences were identified by our testing which required reporting to those charged with governance.</p> <p>We assessed the accounting policy for income recognition for compliance with accounting standards and the AIC SORP and performed testing to check that income had been accounted for in accordance with this stated accounting policy. We found that the accounting policies implemented were in accordance with accounting standards and the AIC SORP, and that income has been accounted for in accordance with the stated accounting policy.</p> <p>In addition, we tested dividend receipts by agreeing the dividend rates from investments to independent third party sources.</p> <p>No misstatements were identified which required reporting to those charged with governance.</p> <p>To test for completeness, we tested that the appropriate dividends had been received in the year by reference to independent data of dividends declared by investment holdings in the portfolio.</p> <p>Our testing did not identify any unrecorded dividends.</p> <p>We tested the allocation and presentation of dividend income between the revenue and capital return columns of the Income Statement in line with the requirements set out in the AIC SORP. We then tested the validity of revenue and capital special dividends to independent third party sources.</p> <p>We did not find any special dividends that were treated incorrectly in accordance with the AIC SORP.</p>

How we tailored the audit scope

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

The Company's accounting is delegated to the Administrator who maintain the Company's accounting records and controls and report to the Manager and the Directors.

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

As part of our risk assessment, we assessed the control environment in place at both the Manager and the Administrator to the extent relevant to our audit. This assessment involved obtaining and reading the relevant control reports, issued by the independent auditor of the Manager and the Administrator in accordance with generally accepted assurance standards for such work, to gain an understanding of both the Manager's and Administrator's control environment and to consider the operating and accounting structure at both the Manager and the Administrator. Following this assessment, we applied professional judgement to determine the extent of testing required over each balance in the financial statements.

Materiality

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

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

Overall materiality	£4.9 million (2015: £5.6 million).
How we determined it	1% of net assets.
Rationale for benchmark applied	We have applied this benchmark, which is a generally accepted auditing practice for investment trust audits.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £249,000 (2015: £281,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

Under the Listing Rules we are required to review the Directors' statement, set out on page 32, in relation to going concern. We have nothing to report having performed our review.

Under ISAs (UK & Ireland) we are also required to report to you if we have anything material to add or to draw attention to in relation to the Directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. We have nothing material to add or to draw attention to.

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

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

Other required reporting

Consistency of other information

Companies Act 2006 opinions

In our opinion, 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.

ISAs (UK & Ireland) reporting

Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

- | | |
|---|----------------------------------|
| Information in the Annual Report is: | We have no exceptions to report. |
| <ul style="list-style-type: none"> ■ materially inconsistent with the information in the audited financial statements; or ■ apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Company acquired in the course of performing our audit; or ■ otherwise misleading. | |
| <ul style="list-style-type: none"> ■ the statement given by the Directors on page 40, in accordance with provision C.1.1 of the UK Corporate Governance Code (the "Code"), that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Company acquired in the course of performing our audit. | We have no exceptions to report. |
| <ul style="list-style-type: none"> ■ the section of the Annual Report on page 42, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee. | We have no exceptions to report. |

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

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

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to:

- | | |
|---|---|
| <ul style="list-style-type: none"> ■ the Directors' confirmation on page 13 of the Annual Report, in accordance with provision C.2.1 of the Code that they have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. | <p>We have nothing material to add or to draw attention to.</p> |
| <ul style="list-style-type: none"> ■ the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated. | <p>We have nothing material to add or to draw attention to.</p> |
| <ul style="list-style-type: none"> ■ the Directors' explanation on page 14 of the Annual Report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the Company, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions. | <p>We have nothing material to add or to draw attention to.</p> |

Under the Listing Rules we are required to review the Directors' statement that they have carried out a robust assessment of the principal risks facing the Company and the Directors' statement in relation to the longer-term viability of the Company, set out on page 14. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge acquired by us in the course of performing our audit. We have nothing to report having performed our review.

Adequacy of accounting records and information and explanations received

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

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

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Directors' remuneration report - Companies Act 2006 opinion

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

Other Companies Act 2006 reporting

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

Corporate governance statement

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to ten further provisions of the UK Corporate Governance Code. We have nothing to report having performed our review.

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

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 40, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What an audit of financial statements involves

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the financial statements.

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

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

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Jeremy Jensen
(Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors, London
30 March 2016

The Merchants Trust PLC

Financial Statements

Income Statement

for the year ended 31 January 2016

	Notes	2016 Revenue £	2016 Capital £	2016 Total Return £	2015 Revenue £	2015 Capital £	2015 Total Return £
Net (losses) gains on investments at fair value	8	-	(56,416,352)	(56,416,352)	-	15,606,644	15,606,644
Income	1	30,984,794	-	30,984,794	29,957,608	-	29,957,608
Investment management fee	2	(795,370)	(1,477,115)	(2,272,485)	(805,548)	(1,496,017)	(2,301,565)
Administration expenses	3	(739,253)	(44)	(739,297)	(879,807)	(3,537)	(883,344)
Net profit (loss) before finance costs and taxation		29,450,171	(57,893,511)	(28,443,340)	28,272,253	14,107,090	42,379,343
Finance costs: interest payable and similar charges	4	(3,304,965)	(6,057,941)	(9,362,906)	(3,322,106)	(6,089,773)	(9,411,879)
Net profit (loss) before taxation		26,145,206	(63,951,452)	(37,806,246)	24,950,147	8,017,317	32,967,464
Taxation	5	-	-	-	-	-	-
Net profit (loss) after taxation		26,145,206	(63,951,452)	(37,806,246)	24,950,147	8,017,317	32,967,464
Net earnings (loss) per ordinary share (basic and diluted)	7	24.05p	(58.82p)	(34.77p)	23.56p	7.57p	31.13p

Dividends in respect of the financial year ended 31 January 2016 total 24.00p (2015 - 23.80p), amounting to £26,094,832 (2015 - £25,526,029). Details are set out in Note 6 on page 64.

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.

A Statement of Total Recognised Gains and Losses is not required as all gains and losses of the company have been reflected in the above statement.

The Notes on pages 58 to 77 form an integral part of these financial statements.

Statement of Changes in Equity

for the year ended 31 January 2016

	Notes	Called up Share Capital £	Share Premium Account £	Capital Redemption Reserve £	Capital Reserve £	Revenue Reserve £	Total £
Net assets at 1 February 2015		27,182,116	33,717,572	292,853	476,255,528	24,560,874	562,008,943
Revenue profit		-	-	-	-	26,145,206	26,145,206
Dividends paid	6	-	-	-	-	(26,094,832)	(26,094,832)
Capital loss		-	-	-	(63,951,452)	-	(63,951,452)
Net assets at 31 January 2016		27,182,116	33,717,572	292,853	412,304,076	24,611,248	498,107,865
Net assets at 1 February 2014		25,915,866	10,653,450	292,853	468,238,211	24,377,678	529,478,058
Revenue profit		-	-	-	-	24,950,147	24,950,147
Dividends paid	6	-	-	-	-	(24,766,951)	(24,766,951)
Capital profit		-	-	-	8,017,317	-	8,017,317
Shares issued during the year		1,266,250	23,064,122	-	-	-	24,330,372
Net assets at 31 January 2015		27,182,116	33,717,572	292,853	476,255,528	24,560,874	562,008,943

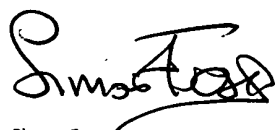
The Notes on pages 58 to 77 form an integral part of these financial statements.

Balance Sheet

as at 31 January 2016

	Notes	2016 £	2016 £	2015 £
Fixed Assets				
Investments held at fair value through profit or loss	8		603,369,373	666,055,587
Current Assets				
Other receivables	10	946,814		1,051,878
Cash and cash equivalents		6,457,992		8,654,487
		7,404,806		9,706,365
Current Liabilities				
Other payables	10	(2,189,728)		(2,970,328)
Derivative financial instruments	8	(214,350)		(310,200)
		(2,404,078)		(3,280,528)
Net current assets			5,000,728	6,425,837
Total assets less current liabilities			608,370,101	672,481,424
Creditors: amounts falling due after more than one year	11		(110,262,236)	(110,472,481)
Net assets			498,107,865	562,008,943
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		412,304,076	476,255,528
Revenue reserve	13		24,611,248	24,560,874
Equity shareholders' funds	14		498,107,865	562,008,943
Net asset value per ordinary share (basic and diluted)	14		458.1p	516.9p

The financial statements of The Merchants Trust PLC on pages 54 to 57 were approved and authorised for issue by the Board of Directors on 30 March 2016 and signed on its behalf by:



Simon Frasek
Chairman

The Notes on pages 58 to 77 form an integral part of these financial statements.

Cash Flow Statement

for the year ended 31 January 2016

	Notes	2016 £	2015 £
Operating activities			
Net (loss) profit before finance costs and taxation*		(28,443,340)	42,379,343
Less: Net losses (gains) on investments at fair value		56,416,352	(15,606,644)
Purchase of fixed asset investments		(138,769,318)	(160,831,485)
Sales of fixed asset investments		144,260,526	144,165,450
Decrease in other receivables		105,064	1,082,599
Decrease in other payables		(80,030)	(560,391)
Net cash inflow from operating activities		33,489,254	10,628,872
Financing activities			
Interest paid		(9,547,920)	(9,556,695)
Dividends paid on cumulative preference stock	4	(42,997)	(64,496)
Dividends paid on ordinary shares	6	(26,094,832)	(24,766,951)
Proceeds from issue of ordinary shares		-	24,379,130
Share issue costs		-	(48,758)
Net cash outflow from financing activities		(35,685,749)	(10,057,770)
(Decrease) Increase in cash and cash equivalents		(2,196,495)	571,102
Cash and cash equivalents at the start of the year		8,654,487	8,083,385
Cash and cash equivalents at the end of the year		6,457,992	8,654,487
Comprised of:			
Cash and cash equivalents		6,457,992	8,654,487

* Cash inflow from dividends was £30,074,093 (2015 - £29,603,970) and cash inflow from interest was £99 (2015 - nil).

The Notes on pages 58 to 77 form an integral part of these financial statements.

Statement of Accounting Policies

for the year ended 31 January 2016

- 1 **The financial statements** – have been prepared on the basis of the accounting policies set out below. The company is applying, for the first time, 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' (FRS 102), which forms part of the revised Generally Accepted Accounting Practice (New UK GAAP) issued by the Financial Reporting Council.

The financial statements have been prepared in accordance with The Companies Act 2006, FRS 102 and with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies and Venture Capital Trusts' issued by the Association of Investment Companies (AIC) in November 2014.

As a result of the first time adoption of FRS 102 there were no adjustments to the company's income statement for the financial years ended 31 January 2015 or 31 January 2016. There were no adjustments to the company's balance sheets at 31 January 2015, 1 February 2015 or 31 January 2016.

The company's cash flow statement reflects the presentational requirements of FRS 102, which are different from those of FRS 1. In addition the cash flow statement reconciles to cash and cash equivalents whereas under previous UK GAAP the cash flow statement reconciled to cash. In addition, certain disclosures have changed.

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, net capital returns may be distributed by way of dividend.

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

The directors believe that it is appropriate to continue to adopt the going concern basis in preparing the financial statements as the assets of the company consist mainly of securities which are readily realisable and significantly exceed liabilities. Accordingly, the directors believe that the company has adequate financial resources to continue in operational existence. 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 10 to 14.

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

Special dividends are recognised on an ex-dividend basis and treated as a capital or revenue item depending on the facts and circumstances of each dividend. The board 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 and stocklending fees are accounted for on an accruals basis.

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

- 3 **Investment management fees and administrative expenses** – The investment management fee is calculated on the basis set out in Note 2 to the financial statements and is charged to capital and revenue in the ratio 65:35 to reflect the Board's investment policy and prospective split of capital and income returns. The split is reviewed annually. Other administration expenses are charged in full to revenue, except custodian handling charges on investment transactions which are charged to capital. All expenses are recognised on an accrual basis.

- 4 **Valuation** – As the company's business is investing in financial assets with a view to profiting from their total return in the form of increases in fair value, financial assets are designated as held at fair value through profit or loss in accordance with FRS 102 Section 11: 'Basic Financial Instruments', and Section 12: 'Other Financial Instruments'. The company manages and evaluates the performance of these investments on a fair value basis in accordance with its investment strategy, and information about the investments is provided on this basis to the board of directors.

Statement of Accounting Policies *(continued)*

for the year ended 31 January 2016

- 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 September 2009.
- After initial recognition unquoted stocks are valued by the board on an annual basis.
- 5 **Derivatives** – Options may be purchased or written over securities held in the portfolio for generating or protecting capital returns, or for generating or maintaining revenue returns. Where the purpose of the option is the maintenance of capital the premium is treated as a capital item. In accordance with FRS 102 Section 12: 'Other Financial Instruments', options are valued at fair value and are included in current assets or current liabilities in the balance sheet. When an option is closed out or exercised the gain or loss is accounted for as capital.
- Where the purpose of the option is the generation of income, the premium is treated as a revenue item. Premiums received on written options are amortised to revenue over the period to expiry. If an option is exercised early unamortised premiums are taken to capital.
- 6 **Finance costs** – In accordance with the FRS 102 Section 11: 'Basic Financial Instruments' and Section 12: 'Other Financial Instruments', long term borrowings are stated at the amortised cost being the amount of net proceeds on issue plus accrued finance costs to date. Finance costs are calculated over the term of the debt on the effective interest rate basis.
- Where debt is issued at a premium, the premium is amortised over the term of the debt on the effective interest rate basis.
- Finance costs net of amortised premiums are charged to capital and revenue in the ratio 65:35 to reflect the board's investment policy and prospective split of capital and revenue returns.
- Dividends payable on the 3.65% cumulative preference stock are classified as an interest expense and are charged in full to revenue.
- 7 **Taxation** – Where expenses are allocated between capital and revenue, any tax relief obtained in respect of those expenses is allocated between capital and revenue on the marginal basis using the company's effective rate of corporation tax for the accounting period.
- Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax or a right to pay less tax in the future have occurred. Timing differences are differences between the company's taxable profits and its results as stated in the financial statements.
- A deferred tax asset is recognised when it is more likely than not that the asset will be recoverable. Deferred tax is measured on a non-discounted basis at the rate of corporation tax that is expected to apply when the timing differences are expected to reverse.
- 8 **Foreign currency** – In accordance with FRS 102 Section 30: 'Foreign Currency Translation', the company is required to nominate a functional currency, being the currency in which the company predominately operates. The functional and reporting currency is sterling, reflecting the primary economic environment in which the company operates. Transactions in foreign currencies are translated into sterling at the rates of exchange ruling on the date of the transaction. Foreign currency monetary assets and liabilities are translated into sterling at the rates of exchange ruling at the balance sheet date. Profits and losses thereon are recognised in the capital column of the income statement and taken to the capital reserve.
- 9 **Dividends** – In accordance with FRS 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.

Statement of Accounting Policies *(continued)*

for the year ended 31 January 2016

- 10 **Shares repurchased for cancellation and for holding in treasury** – For shares repurchased for cancellation, 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.

Notes to the Financial Statements

for the year ended 31 January 2016

1. Income

	2016 £	2015 £
Income from Investments*		
Franked equity dividends from UK investments [#]	29,086,457	28,061,371
Unfranked dividends from UK investments	492,498	595,889
Equity dividends from overseas investments	390,041	352,115
	29,968,996	29,009,375
Other Income		
Deposit interest	99	-
Premiums on derivative contracts	935,868	653,835
Underwriting commission	79,831	294,398
	1,015,798	948,233
Total income	30,984,794	29,957,608

* All equity income is derived from listed investments.

[#] Includes special dividends of £315,597 (2015 - £Nil).

During the year, the company received premiums totalling £945,609 (2015 - £698,620) for writing covered call options for the purpose of revenue generation. Premium income of £935,868 was amortised to income (2015 - £653,835). All derivatives transactions were based on FTSE 100 stocks or the related index. At the year end there were eight open positions with a net liability value of £214,350 (2015 - £310,200).

2. Investment Management Fee

	2016 Revenue £	2016 Capital £	2016 Total £	2015 Revenue £	2015 Capital £	2015 Total £
Investment management fee	795,370	1,477,115	2,272,485	805,548	1,496,017	2,301,565
Total	795,370	1,477,115	2,272,485	805,548	1,496,017	2,301,565

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: it provides for a management fee based on 0.35% (2015 - 0.35%) per annum of the value of the assets after deduction of current liabilities, short-term loans under one year and other funds managed by AllianzGI. Under the contract, AllianzGI provides the company with investment management, accounting, company secretarial and administration services.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

3. Administration Expenses

	2016 £	2015 £
Auditors' remuneration		
For audit services	31,000	38,130
Other services - for certification of loan covenants	4,600	5,175
VAT on auditors' remuneration	7,120	8,661
	42,720	51,966
Directors' fees	137,500	118,083
Marketing costs	217,559	250,702
Other administration expenses	341,474	459,056
	739,253	879,807

- (i) The above expenses include value added tax where applicable.
(ii) Directors' fees are set out in the Directors' Remuneration Report on page 45.
(iii) Custody handling charges of £44 were charged to capital (2015 - £3,537).

4. Finance Costs: Interest Payable and Similar Charges

	2016 Revenue £	2016 Capital £	2016 Total £	2015 Revenue £	2015 Capital £	2015 Total £
On Stepped Rate Interest Loan repayable in one to five years	1,328,890	2,467,939	3,796,829	1,341,992	2,492,271	3,834,263
On Fixed Rate Interest Loan repayable after more than five years	1,286,046	2,388,371	3,674,417	1,290,336	2,396,338	3,686,674
On 4% Perpetual Debenture Stock repayable after more than five years	19,250	35,750	55,000	19,250	35,750	55,000
On 5.875% Secured Bonds repayable after more than five years	627,782	1,165,881	1,793,663	627,531	1,165,414	1,792,945
On 3.65% Preference Stock repayable after more than five years	42,997	-	42,997	42,997	-	42,997
	3,304,965	6,057,941	9,362,906	3,322,106	6,089,773	9,411,879

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

5. Taxation

	2016 Revenue £	2016 Capital £	2016 Total £	2015 Revenue £	2015 Capital £	2015 Total £
(i) Analysis of tax charge for the year						
Overseas taxation	-	-	-	-	-	-
Current tax charge	-	-	-	-	-	-

(ii) Factors affecting current tax charge for the year

The tax assessed for the year is lower than the standard rate of corporation tax in the UK (20.16%) (2015 - 21.33%).

Reconciliation of tax charge

Profit (loss) before taxation	26,145,206	(63,951,452)	(37,806,246)	24,950,147	8,017,317	32,967,464
Tax on profit (loss) at 20.16% (2015 - 21.33%)	5,270,874	(12,892,613)	(7,621,739)	5,321,335	1,709,923	7,031,258

Reconciling factors

Non taxable income	(5,942,462)	-	(5,942,462)	(6,059,991)	-	(6,059,991)
Non taxable capital losses (gains)	-	11,373,537	11,373,537	-	(3,328,565)	(3,328,565)
Disallowable expenses	8,914	448	9,362	9,609	1,569	11,178
Excess of allowable expenses over taxable income	662,674	1,518,628	2,181,302	729,047	1,617,073	2,346,120
Current tax charge	-	-	-	-	-	-

The company's taxable income is exceeded by its tax allowable expenses, which include both the revenue and capital elements of the management fee and finance costs. As at 31 January 2016, the company had accumulated surplus expenses of £194.3 million (2015 - £183.5 million).

As at 31 January 2016 the company has not recognised a deferred tax asset of £35.0 million (2015 - £36.7 million) in respect of the accumulated expenses, based on a prospective corporation tax rate of 18% (2015 - 20%). The reduction in the standard rate of corporation tax was substantively enacted on 26 October 2015 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).

In the opinion of the directors, the company has conducted its affairs in such a manner that it continues to meet the eligibility conditions.

The company has not therefore provided tax on any capital gains and losses arising on the disposals of investments.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

6. Dividends on Ordinary Shares

	2016 £	2015 £
Dividends on Ordinary Shares of 25p		
Third interim dividend 6.0p paid 25 February 2015 (2015 - 5.9p)	6,523,708	6,110,244
Final dividend 6.0p paid 22 May 2015 (2015 - 5.9p)	6,523,708	6,178,094
First interim dividend 6.0p paid 14 August 2015 (2015 - 5.9p)	6,523,708	6,198,744
Second interim dividend 6.0p paid 12 November 2015 (2015 - 5.9p)	6,523,708	6,279,869
	26,094,832	24,766,951

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

	2016 £	2015 £
Third interim dividend 6.0p paid 24 February 2016 (2015 - 6.0p)	6,523,708	6,523,708
Final proposed dividend 6.0p payable 26 May 2016 (2015 - 6.0p)	6,523,708	6,523,708
	13,047,416	13,047,416

The proposed final dividend accrued is based on the number of shares in issue at the year end. However, the dividend payable will be based on the numbers of shares in issue on the record date and will reflect any share issues or share buy backs settled subsequent to the year end.

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

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

7. Net earnings (losses) per Ordinary Share

	2016 Revenue £	2016 Capital £	2016 Total Return £	2015 Revenue £	2015 Capital £	2015 Total Return £
Net earnings after taxation attributable to ordinary shareholders	26,145,206	(63,951,452)	(37,806,246)	24,950,147	8,017,317	32,967,464
Net earnings per ordinary share (basic and diluted)	24.05p	(58.82p)	(34.77p)	23.56p	7.57p	31.13p

The weighted average number of shares in issue during the year was 108,728,464 (2015 - 105,879,424).

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

8. Investments

	2016 £	2015 £
Listed on the London Stock Exchange at market valuation	603,341,404	666,027,618
Unlisted at fair value (see Note 9)	27,969	27,969
Fixed asset investments	603,369,373	666,055,587
Derivative financial instruments - written call options	(214,350)	(310,200)
Total investments	603,155,023	665,745,387
Market value of investments brought forward	665,745,387	631,181,415
Investment holding gains brought forward	(68,284,965)	(79,363,515)
Derivative holding losses (gains) brought forward	175,355	(13,439)
Cost of investments held brought forward	597,635,777	551,804,461
Additions at cost	138,086,514	161,514,289
Disposals at cost	(118,422,883)	(115,682,973)
Cost of investments held at 31 January	617,299,408	597,635,777
Investment holding (losses) gains at 31 January	(14,074,117)	68,284,965
Derivative holding (losses) gains at 31 January	(70,268)	(175,355)
Market value of investments held at 31 January	603,155,023	665,745,387
Net gains (losses) on investments		
Net gains on sales of investments based on historical costs	25,305,862	26,890,447
Adjustment for net investment holding losses recognised in previous years	32,811,756	24,376,379
Net gains on sales of fixed asset investments based on carrying value at previous balance sheet date	58,117,618	51,266,826
Net losses on derivative financial instruments	(19,104)	(16,459)
Net gains on sales of investments based on carrying value at previous balance sheet date	58,098,514	51,250,367
Net investment holding losses arising in the year	(115,170,838)	(35,454,929)
Special dividends credited to capital	550,885	-
Net derivative holding gains (losses) arising in the year	105,087	(188,794)
Net (losses) gains on investments	(56,416,352)	15,606,644

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.

Transaction costs and stamp duty on purchases amounted to £779,462 (2015 - £904,464) and transaction costs on sales amounted to £119,929 (2015 - £119,480).

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

9. Investments in Other Companies

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

Company	Class of Share held	Fair value £	% Equity
First Debenture Finance PLC (FDF)	'A' Shares	47	50.0
	'B' Shares	71	50.0
	'C' Shares	23,244	50.0
	'D' Shares	121	50.0
Fintrust Debenture PLC (Fintrust)	Ordinary Shares	4,486	50.0
Total		27,969	

In the opinion of the directors, the company is not in a position to exert significant influence over the financial operating policies of FDF or Fintrust, either through voting rights or through agreement with those companies' other shareholders, due to provisions in FDF's and Fintrust's Articles of Association and in certain contracts between the company and each of FDF and Fintrust. Accordingly, FDF and Fintrust are not considered to be associate undertakings as per FRS 102 Section 14 and are therefore included in the Balance Sheet at the director's valuation. FDF and Fintrust are the lenders of the company's Stepped Rate Interest Loan and Fixed Rate Interest Loan, as detailed in Notes 1.1(i) and 1.1(ii), respectively. Apart from the finance costs, there were no other transactions between FDF, Fintrust and the company during the year.

10. Other Receivables and Other Payables

	2016 £	2015 £
Other receivables		
Prepayments	25,480	25,446
Accrued income	921,334	1,026,432
	946,814	1,051,878
Other payables		
Amounts falling due within one year:		
Purchases for future settlement	-	682,804
Other payables	888,226	968,256
Interest on borrowings	1,301,502	1,319,268
	2,189,728	2,970,328
Interest on outstanding borrowing consists of:		
Stepped Rate Interest Loan	295,963	313,729
Fixed Rate Interest Loan	783,545	783,545
5.875% Secured Bonds 2029	208,243	208,243
4% Perpetual Debenture Stock	13,751	13,751
	1,301,502	1,319,268

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

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

		2016 £	2015 £
Creditors: Amounts falling due after more than one year			
Stepped Rate Interest Loan	11(i)	34,034,109	34,034,109
Fixed Rate Interest Loan	11(ii)	44,393,553	44,634,661
5.875% Secured Bonds 2029	11(iii)	29,281,574	29,250,711
4% Perpetual Debenture Stock	11(iv)	1,375,000	1,375,000
3.65% Cumulative Preference Stock	11(v)	1,178,000	1,178,000
		110,262,236	110,472,481

- (i) The Stepped Rate Interest Loan of £34,034,109 (2015- £34,034,109) comprises adjustable Stepped Rate Interest Loan Notes of £5,133,520 and Stepped Rate Interest Bonds of £20,534,079. The Loan Notes and Bonds were issued in 1987 at 97.4% and are repayable on 2 January 2018, together with a premium of £8,366,510.

The initial interest rate on the Loan Notes and Bonds was 7.16% per annum. This increased annually by 7.5% compound until January 1998 when it reached its current rate of 14.75%. This stepped interest rate, when combined with the accrual of the premium, results in an effective interest rate of 11.28% per annum.

Interest on Loan Notes and Bonds is payable in January and July each year.

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

FDF has a liability to its debenture stockholders to repay principal and interest on its £52.2 million of 11.125% Severally Guaranteed Debenture Stock 2018. The company has guaranteed the repayment of principal and interest on £34.0 million of FDF's debenture stock. This is in proportion to the principal amounts raised by the company in 1987 in respect of the Loan Notes and Bonds. There is a floating charge on all the company's present and future assets to secure this obligation. The company has also agreed to meet its proportionate share of any expenses incurred by FDF.

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

As security for this loan, the company has granted a floating charge over its assets in favour of the lender. This charge ranks *pari passu* with the floating charge noted in 11(i) above.

The loan of £30,000,000 taken out in 1993 is stated at £29,920,542 (2015 - £29,917,187), being the net proceeds of £29,858,947 plus accrued finance cost of £61,595 (2015 - £58,240). 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 2016, the loan is stated at £14,473,011 (2015 - £14,717,474), being the principal amount of £12,000,000 plus the unamortised premium of £2,473,011 (2015 - £2,717,474). The effective interest rate of this portion of the loan is 6.00%.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

(iii) The £30,000,000 of 5.875% Secured Bonds is stated at £29,281,574 (2015 - £29,250,711), being the net proceeds of £28,942,800 plus accrued finance costs of £338,774 (2015 - £307,911). 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) and 11(ii) above.

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

(v) The 3.65% cumulative preference stock is recognised as a creditor due after more than one year under the provisions of FRS 102 Section 11: 'Basic Financial Instruments' and Section 12: 'Other Financial Instruments'. The right of the preference stock holders to receive payments is not calculated by reference to the company's 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.

12. Called up Share Capital

	2016 £	2015 £
Allotted and fully paid		
108,728,464 ordinary shares of 25p (2015 - 108,728,464)	27,182,116	27,182,116

The directors are authorised by an ordinary resolution passed on 20 May 2015 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 24 May 2016 and accordingly a renewed authority will be sought at the annual general meeting on 24 May 2016.

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

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

13. Reserves

	Share Premium Account £	Capital Redemption Reserve £	Gains (Losses) on sales of Investments £	Capital Reserve Investment Holding Gains (Losses) £	Revenue Reserve £
Balance at 1 February 2015	33,717,572	292,853	408,145,918	68,109,610	24,560,874
Net gains on sales of fixed asset investments	-	-	58,117,618	-	-
Net losses on derivative financial instruments	-	-	(19,104)	-	-
Net movement in fixed asset investment holding losses	-	-	-	(115,170,838)	-
Net movement in derivative holding gains	-	-	-	105,087	-
Special dividends	-	-	550,885	-	-
Transfer on sale of investments	-	-	(32,811,756)	32,811,756	-
Investment management fee	-	-	(1,477,115)	-	-
Finance costs of borrowings	-	-	(6,057,941)	-	-
Other capital expenses	-	-	(44)	-	-
Dividends appropriated in the year	-	-	-	-	(26,094,832)
Profit retained for the year	-	-	-	-	26,145,206
Balance at 31 January 2016	33,717,572	292,853	426,448,461	(14,144,385)	24,611,248

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 (2015 - same).

14. Net Asset Value per Share

	Net Asset Value per share attributable	
	2016	2015
Ordinary shares of 25p	458.1p	516.9p
	Net Asset Value attributable	
	2016	2015
Ordinary shares of 25p	£498,107,865	£562,008,943

The net asset value per ordinary share is based on 108,728,464 ordinary shares in issue at the year end (2015 - 108,728,464).

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

15. Contingent Liabilities and Commitments

At 31 January 2016 there were no contingent liabilities (2015 - £Nil).

Details of the guarantee provided by the company as part of the terms of the Loans are provided in Note 11(i), 11(ii) and 11(iii) Current assets and Creditors on pages 67 and 68.

16. Financial Risk Management Policies and Procedures

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

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

(a) Market Risk

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

(i) Market Price Risk

Market price risk arises mainly from the uncertainty about future prices of financial instruments held. It represents the potential loss the company might suffer through holding market positions in the face of price movements.

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

Market price risk sensitivity

The value of the company's listed investments (i.e fixed asset investments, excluding unlisted equities) which were exposed to market price risk as at 31 January 2016 was as follows:

	2016 £	2015 £
Listed investments held at fair value through profit or loss	603,341,404	666,027,618
Derivative financial instruments - written call options	(214,350)	(310,200)
Total listed investments	603,127,054	665,717,418

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

The following illustrates the sensitivity of the return and the net assets to an increase or decrease of 20% (2015: 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.

	2016 20% Increase in fair value £	2016 20% Decrease in fair value £	2015 20% Increase in fair value £	2015 20% Decrease in fair value £
Revenue earnings				
Investment management fees	(147,819)	147,819	(163,177)	163,177
Capital earnings				
Net gains (losses) on investments at fair value	120,625,411	(120,625,411)	133,143,484	(133,143,484)
Investment management fees	(274,520)	274,520	(303,043)	303,043
Change in net earnings and net assets	120,203,072	(120,203,072)	132,677,264	(132,677,264)

Management of market price risk

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

(ii) Market Yield Risk

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

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 24 and 25. 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 61 for detail of income received.).

Further explanation of the derivative strategy is included in the Investment Manager's Review on pages 20 and 21.

Management of market yield risk

The directors regularly review the current and projected yield of the investment portfolio, and discuss with the investment manager the extent to which it will enable the company to meet its investment income objective.

(iii) Foreign Currency Risk

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

Management of foreign currency risk

The company invests predominantly in UK listed equities and has no significant exposure to currencies other than sterling (2015 - no significant exposure).

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

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

(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.

	2016 Fixed rate interest £	2016 Floating rate interest £	2016 Nil interest £	2016 Total £	2015 Fixed rate interest £	2015 Floating rate interest £	2015 Nil interest £	2015 Total £
Financial assets	-	6,457,992	603,369,373	609,827,365	-	8,654,487	666,055,587	674,710,074
Financial liabilities	(110,262,236)	-	(214,350)	(110,476,586)	(110,472,481)	-	(310,200)	(110,782,681)
Net financial (liabilities) assets	(110,262,236)	6,457,992	603,155,023	499,350,779	(110,472,481)	8,654,487	665,745,387	563,927,393
Short term receivables and payables				(1,242,914)				(1,918,450)
Net assets per balance sheet				498,107,865				562,008,943

As at 31 January 2016, the interest rates received on cash balances or paid on bank overdrafts, was nil and 1.35% per annum respectively (2015 - nil and 1.35% per annum).

The fixed rate interest bearing liabilities bear the following coupon and effective rates as at 31 January 2016 and 31 January 2015

	Maturity date	Amount borrowed £	Coupon rate	Effective rate since inception*
First Debenture Finance PLC (FDF) - Bonds	02/01/2018	20,534,079	14.75%	11.28%
First Debenture Finance PLC (FDF) - Notes	02/01/2018	5,133,520	14.75%	11.28%
Fintrust Debenture PLC (Fintrust) - Original Loan	20/05/2023	30,000,000	9.25125%	9.51%
Fintrust Debenture PLC (Fintrust) - Additional Loan	20/05/2023	12,000,000	9.25125%	6.00%
5.875% Secured Bonds 2029	20/12/2029	30,000,000	5.875%	6.23%
4% Perpetual Debenture Stock	n/a	1,375,000	4.00%	4.00%
3.65% Cumulative Preference Stock	n/a	1,178,000	3.65%	3.65%
		100,220,599		

* The effective rates are calculated in accordance with FRS 102 Section 12: 'Other Financial Instruments' as detailed in the Statement of Accounting Policies on page 59.

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

The weighted average effective rate of the company's fixed interest bearing liabilities (excluding the 3.65% Cumulative Preference Stock and the 4% Perpetual Debenture Stock) is 8.54% (2015 8.54%) and the weighted average period to maturity of these liabilities is 8.2 years (2015 - 9.2 years).

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

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

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 2016, 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. Movement in interest rates will not have a material effect on the finance costs and financial liabilities of the company as all the borrowings of the company are subject to fixed rates of interest.

(b) Liquidity Risk

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

Maturity of financial liabilities

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

Cash flows in respect of the principal and interest on the Stepped Rate Interest Loan, Fixed Rate Interest Loan and 5.875% Secured Bonds 2029 reflect the maturity dates as set out in Note 11 on pages 67 to 68. 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.

	Three months or less £	Between three months and one year £	Between one and five years £	More than five years £	Total £
2016					
Other payables					
Finance costs of borrowing	-	9,510,471	-	-	9,510,471
Other payables	888,226	-	-	-	888,226
Derivative financial instruments	214,350	-	-	-	214,350
Creditors - amounts falling due after more than one year					
Amounts payable on maturity of borrowings	-	-	34,034,109	74,553,000	108,587,109
Finance cost of borrowings	-	-	26,770,936	27,084,216	53,855,152
	1,102,576	9,510,471	60,805,045	101,637,216	173,055,308
2015					
Other payables					
Finance costs of borrowing	-	9,510,471	-	-	9,510,471
Other payables	1,651,060	-	-	-	1,651,060
Derivative financial instruments	310,200	-	-	-	310,200
Creditors - amounts falling due after more than one year					
Amounts payable on maturity of borrowings	-	-	34,034,109	74,553,000	108,587,109
Finance cost of borrowings	-	-	30,556,584	32,732,541	63,289,125
	1,961,260	9,510,471	64,590,693	107,285,541	183,347,965

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

Management of liquidity risk

Liquidity risk is not significant as the company's assets mainly comprise of realisable securities, which can be sold to meet funding requirements if necessary. Short term flexibility can be achieved through the use of overdraft facilities, where necessary. As at the 31 January 2016, the company had an undrawn committed borrowing facility of £10 million (2015 - £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 2016 (31 January 2015 - 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 investment manager.

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

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

	2016 £	2015 £
Other Receivables		
Prepayments	25,480	25,446
Accrued income	921,334	1,026,432
	946,814	1,051,878
Cash and cash equivalents	6,457,992	8,654,487
	7,404,806	9,706,365

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 considered to be 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*:

	2016 Book value £	2016 Fair value £	2015 Book value £	2015 Fair value £
Stepped Rate Interest Loan	34,330,072	39,216,899	34,347,838	42,660,173
Fixed Rate Interest Loan	45,177,098	57,036,734	45,418,206	61,337,594
5.875% Secured Bonds 2029	29,489,817	35,368,040	29,458,954	39,176,930
4% Perpetual Debenture Stock	1,388,751	1,210,028	1,388,751	1,167,261
3.65% Cumulative Preference Stock	1,178,000	959,031	1,178,000	925,598
	111,563,738	133,790,732	111,791,749	145,267,556

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

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

	2016 £	2015 £
Net assets per balance sheet	498,107,865	562,008,943
Add: financial liabilities at book value	111,563,738	111,791,749
Less: financial liabilities at fair value*	(133,790,732)	(145,267,556)
Net assets (debt at fair value)	475,880,871	528,533,136
Net asset value per ordinary share (debt at fair value)	437.7p	486.1p

* The fair value has been derived from the closing market value as at 31 January 2016 and 31 January 2015.

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

The company has chosen to adopt Sections 11 and 12 from FRS 102 to account for its financial instruments.

The fair value as at the reporting date has been estimated using the following fair value hierarchy:

Level (a) Quoted prices for identical instruments in active markets

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Level (b) Prices of a recent transaction for identical instruments

When quoted prices are unavailable, the price of a recent transaction for an identical asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant lapse of time since the transaction took place.

Level (c) Valuation techniques that use:

- (i) Observable market data or
- (ii) Non-observable data

When the market for the asset is not active and recent transactions of an identical asset on their own are not a good estimate, the fair value is estimated by using an alternative valuation technique. Such valuation techniques will, where possible, maximise the use of observable market data inputs as opposed to non-observable entity determined data inputs.

The Investment Manager considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

The analysis of the valuation basis for the financial instruments based on the hierarchy is as follows:

2016	Level (a) £	Level (b) £	Level (c) (i) £	Level (c) (ii) £	Total £
Financial assets at fair value through profit or loss					
Equity investments	603,341,404	-	-	-	603,341,404
Financial instruments	-	-	-	27,969	27,969
	603,341,404	-	-	27,969	603,369,373
Financial liabilities at fair values through profit or loss					
Derivative financial instruments - written call options	(214,350)	-	-	-	(214,350)
Total net assets	603,127,054	-	-	27,969	603,155,023
2015	Level (a) £	Level (b) £	Level (c) (i) £	Level (c) (ii) £	Total £
Financial assets at fair value through profit or loss					
Equity investments	666,027,618	-	-	-	666,027,618
Financial instruments	-	-	-	27,969	27,969
	666,027,618	-	-	27,969	666,055,587
Financial liabilities at fair values through profit or loss					
Derivative financial instruments - written call options	(310,200)	-	-	-	(310,200)
Total net assets	665,717,418	-	-	27,969	665,745,387

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 c (ii)) 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 recorded at fair value during the year as at 31 January 2016 and 31 January 2015.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2016

17. Capital Management Policies and Procedures

The company's objective is to provide an above average level of income and income growth together with long term capital growth. It invests in high yielding stocks and receives premium income from options.

The company's capital at 31 January 2016 comprises:

	2016 £	2015 £
Debt		
Creditors: amounts falling due after more than one year	110,262,236	110,472,481
	110,262,236	110,472,481
Equity		
Called up share capital	27,182,116	27,182,116
Share premium account and other reserves	470,925,749	534,826,827
	498,107,865	562,008,943
Total Capital	608,370,101	672,481,424
Debt as a percentage of total capital	18.1%	16.4%

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. Transaction with the Investment Manager and related parties

The amounts paid to the investment manager together with details of the investment management contract are disclosed in Note 2 on page 61. The existence of an independent board of directors demonstrates that the company is free to pursue its own financial and operating policies and therefore, under FRS 102 Section 33: 'Related Party Disclosures', the investment manager is not considered to be a related party.

The company's related parties are its directors. Fees paid to the company's board are disclosed in the Directors' Remuneration Report on page 45.

There are no other identifiable related parties at the year end, and as of 30 March 2016.

Investor Information (unaudited)

AIFM and Depositary

The Alternative Investment Fund Managers Directive (AIFMD) aims to create a comprehensive and effective regulatory and supervisory framework for alternative investment fund managers within the EU.

In July 2014 the company announced that the current manager, Allianz Global Investors GmbH (AllianzGI), was appointed as the designated AIFM. AllianzGI 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 61).

The company has also appointed HSBC Bank PLC as its depositary in accordance with AIFMD under a depositary agreement between the company, AllianzGI and HSBC. This agreement replaced the custody agreement between the company and HSBC Bank PLC. Depositary fees are charged in addition to custody fees and are calculated on the basis of net assets. A statement on the depositary's responsibilities appears on page 31.

Leverage and Risk Policies under AIFMD

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

Remuneration Disclosure

Employee remuneration of Allianz Global Investors GmbH for the financial year ending 31 December 2014 (all values in Euro), the first full reporting period under AIFMD.

	Number of employees	
	All employees	Managers
Fixed Remuneration	161,559,776	8,774,536
Variable Remuneration	91,586,770	25,673,412
Total Remuneration	253,146,546	34,447,948

Remuneration Policy

The compensation structure at AllianzGI Europe is set up to avoid any kind of excessive risk-taking. Variable compensation awards are delivered via deferral programs 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, aggregate and individual basis, to further ensure effective risk mitigation.

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.

Investor Information (unaudited) *(continued)*

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.

Ordinary Dividends

It is anticipated that dividends will be paid as follows:

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

Preference Dividends

Payable half-yearly 1 February and 1 August.

Benchmark

The company's benchmark is 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 6.0p to be payable on 26 May 2016 to shareholders on the Register of Members at the close of business on 22 April 2016, making a total distribution of 24.0p per share for the year ended 31 January 2016, an increase of 0.8% over last year's distribution. The ex dividend date is 21 April 2016.

Cash dividends will be sent by cheque to first-named shareholders at their registered address together with a tax voucher. Dividends may be paid directly into shareholders' bank accounts. Details of how this may be arranged can be obtained from Capita Asset Services. Dividends mandated in this way are paid via Bankers' Automated Clearing Services (BACS). Tax vouchers will then be sent directly to shareholders at their registered address unless other instructions have been given.

Registrars

Capita Asset Services, The Registry,
34 Beckenham Road, Beckenham, Kent BR3 4TU
Telephone: 020 8639 3399.
Lines are open 9.00 a.m. to 5.30 p.m.
(London time) Monday to Friday.
Email: ssd@capita.co.uk
Website: www.capitaassetservices.com

Shareholder Enquiries

In the event of queries regarding their holdings of shares, lost certificates, dividend payments, registered details, etc., shareholders should contact the registrars on 020 8639 3399. Lines are open 9.00 a.m. to 5.30 p.m. (London time) Monday to Friday. 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.

Dividend Reinvestment Plan for Ordinary Shareholders (DRIP)

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

Share Dealing Services

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

Investor Information (unaudited) *(continued)*

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

Share Portal

Capita Asset Services offer shareholders a free online service called The Share Portal, enabling shareholders to access a comprehensive range of shareholder related information. Through The Share Portal, shareholders can: view their current and historical shareholding details; obtain an indicative share price and valuation; amend address details; view details of dividend payments; and apply for dividends to be paid directly to a bank or change existing bank details.

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

CREST Proxy Voting

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

International Payment Services

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

The International Payment Service will generally cost less than the fees charged by your local bank to convert your sterling dividend into your local currency. A £5 administration fee per dividend

payment applies. Your dividends are paid as cleared funds directly into your bank or sent to you as a draft.

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

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

For further information on these services please contact: 020 8639 3405. Lines are open between 9.00am and 5.30pm, Monday to Friday (London time) or email IPS@capita.co.uk.

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.

Warning to Shareholders

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

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

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

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

Capita Asset Services operate an international payment service for shareholders, whereby they can elect either for their dividend to be paid by foreign currency draft or they can request an international bank mandate.

Notice of Meeting (unaudited)

Notice is hereby given that the annual general meeting of The Merchants Trust PLC will be held at the offices of J.P. Morgan, Old School Building, 60 Victoria Embankment, London EC4Y 0JP on Tuesday 24 May 2016 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 2016 together with the Auditors' Report thereon.
- 2 To declare a final dividend of 6.0p per ordinary share.
- 3 To re-elect Simon Fraser as a director.
- 4 To re-elect Mike McKeon as a director.
- 5 To re-elect 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 PricewaterhouseCoopers LLP as Auditors of the company, to hold office until the conclusion of the next general meeting at which financial statements are laid before the company.
- 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 36,242,821 ordinary shares provided that:
 - (i) the authority granted shall expire one year from the date upon which this resolution is passed but may be revoked or varied by the company in general meeting and may be renewed by the company in general meeting for a further period not exceeding one year; and
 - (ii) the authority shall allow and enable the directors to make an offer or agreement before the expiry of that authority which would or might require relevant securities to be allotted after such expiry and the directors may allot relevant securities in pursuance of any such offer or agreement as if that authority had not expired.
- 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 subsection (1) of section 561 of the Act did not apply to any such allotment provided that:
 - (i) the power granted shall be limited to the allotment of equity securities wholly for cash up to a maximum number of 10,872,846 ordinary shares;
 - (ii) the power granted shall (unless previously revoked or renewed) expire at the conclusion of the next annual general meeting of the company after this resolution is passed, or 24 August 2017 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 16,298,396;
 - (ii) the minimum price which may be paid for an ordinary share is 25p;
 - (iii) the maximum price which may be paid for an ordinary share is an amount equal to 105% of the average of the middle-market quotations for an ordinary share taken from the London Stock Exchange Official List for the five business days immediately preceding the day on which the ordinary share is purchased or such other amount as may be specified by the London Stock Exchange from time to time;

Notice of Meeting (unaudited) *(continued)*

- (iv) the authority hereby conferred shall expire at the conclusion of the annual general meeting of the company in 2017 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
30 March 2016*

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 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 6pm on 20 May 2016 (the record date).
8. If the meeting is adjourned to a time not more than 48 hours after the record date applicable to the original meeting, that time will also apply for the purpose of determining the entitlement of members to attend and vote (and for the purpose of determining the number of votes they may cast) at the adjourned meeting. If, however, the meeting is adjourned for a longer period then, to be so entitled, members must be entered on the company's Register of Members at the time which is 48 hours before the time fixed for the adjourned meeting or, if the company gives new notice of the adjourned meeting, at the record date specified in that notice.
9. The right to appoint a proxy does not apply to persons whose shares are held on their behalf by another person and who have been nominated to receive communications from the company in accordance with section 146 of the Companies Act 2006 (nominated persons). Nominated persons may have a right under an agreement with the registered shareholder who holds the shares on their behalf to be appointed (or to have someone else appointed) as a proxy. Alternatively, if nominated persons do not have such a right, or do not wish to exercise it, they may have a right under such an agreement to give instructions to the person holding the shares as to the exercise of voting rights. Nominated persons should contact the registered member by whom they were nominated in respect of these arrangements.
10. Corporate representatives are entitled to attend and vote on behalf of the corporate member in accordance with section 323 of the Companies Act 2006. Pursuant to the Companies (Shareholders' Rights) Regulations 2009 (SI 2009/1632), multiple corporate representatives appointed by the same corporate member can vote in different ways provided they are voting in respect of different shares.

Notice of Meeting (unaudited) *(continued)*

11. Members have a right under section 319A of the Companies Act 2006 to require the company to answer any question raised by a member at the AGM, which relates to the business being dealt with at the meeting, although no answer need be given (a) if to do so would interfere unduly with the preparation of the meeting or involve disclosure of confidential information; (b) if the answer has already been given on the company's website; or (c) it is undesirable in the best interests of the company or the good order of the meeting.
12. Members satisfying the thresholds in section 527 of the Companies Act 2006 can require the company, at its expense, to publish a statement on the company website setting out any matter which relates to the audit of the company's accounts that are to be laid before the meeting. Any such statement must also be sent to the company's auditors no later than the time it is made available on the website and must be included in the business of the meeting.
13. As at 30 March 2016, the latest practicable date before this notice is given, the total number of ordinary shares and preference stock in the company in respect of which members are entitled to exercise voting rights was 108,728,464 ordinary shares of 25p each and 1,178,000 3.65% Cumulative Preference Stock of £1 each. Each carries the right to one vote and therefore, the total number of voting rights in the company is 109,906,464.
14. Further information regarding the meeting which the company is required by section 311A of the Companies Act 2006 to publish on a website in advance of the meeting (including this notice), can be accessed at www.merchantstrust.co.uk.
15. Contracts of service are not entered into with the directors, who hold office in accordance with the company's Articles.

Annual General Meeting venue

The Merchants Trust PLC
199 Bishopsgate
London
EC2M 3TY

Tel: +44 (0)20 3246 7000
www.merchantstrust.co.uk