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F I R S T F O L D

Third Fold and Tuck in

BUSINESS REPLY SERVICE
Licence No. MB 122

2

IRG plc
Proxies Department,
Bourne House,
34 Beckenham Road,
BECKENHAM,
Kent
BR3 4BR

Second Fold

Investment Objective

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

Benchmark

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

Financial Highlights

for the years ended 31st January

Revenue	2000	1999	% change
Revenue	£22,590,052	£20,119,042†	+12.3
Available for Ordinary Dividend	£18,344,607	£15,566,914	+17.8
Earnings per Ordinary Share	17.93p	15.21p	+17.9
Dividend per Ordinary Share	16.00p	15.00p†	+6.7
Assets as at 31st January			
Total Net Assets	£391,495,283	£426,036,821	-8.1
Net Asset Value per Ordinary Share	381.4p	415.2p	-8.1
Ordinary Share Price	337.0p	393.0p	
Discount of net asset value to Ordinary Share price	11.6%	5%	

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

‡ Restated in accordance with Financial Reporting Standard 16 "Current Taxation" (see Accounting Policy (ii) on page 21).

Form of Proxy

THE MERCHANTS TRUST PLC FORM OF PROXY FOR ANNUAL GENERAL MEETING

Notes on how to complete the proxy form

If you are a registered Shareholder and you are unable to attend the Meeting you may appoint a proxy to attend and, on a poll, to vote on your behalf.

(A) Appointing a proxy

If you wish to appoint someone other than the Chairman as your proxy please cross out the words "the Chairman of the Meeting", initial the deletion, and insert the name and address of your proxy. A proxy need not be a member of the Company, but must attend the Meeting in order to represent you.

(B) Telling your proxy how to vote

Tick the appropriate box indicating how your proxy should vote on the Resolutions. If you do not give instructions, your proxy will vote or abstain at his discretion.

(C) How to sign the form

(i) Please print your name and address in the space provided and sign and date the form.

(ii) If someone else signs the form on your behalf, the authority entitling them to do so, or a certified copy of it, must accompany the form.

(iii) In the case of a corporation, this form must be executed either under its common seal or be signed on its behalf by an attorney or duly authorised officer of the corporation.

(iv) In the case of joint holders, the signature of the first-named on the Register of Members, in respect of the joint holding, shall be accepted to the exclusion of the other joint holders.

Returning the form

The form must reach the office of the Registrars of the Company no later than 48 hours before the time of the Meeting. If you are a registered Shareholder and you subsequently decide to attend the Meeting you may do so.

Appointment of Proxy

(A) I/We, the undersigned, being (a) member(s) of the above-named Company hereby appoint the Chairman of the Meeting or

SURNAME Mr/Mrs/Miss/TITLE
FORENAMES
ADDRESS
Postcode

as my/our proxy to attend and vote for me/us and on my/our behalf as directed below at the Annual General Meeting of the Company to be held on Monday 8th May 2000 at 12.30 pm and at any adjournment thereof.

(B) Routine Business

- | | For | Against |
|--|--------------------------|--------------------------|
| 1 To receive the Report and Accounts..... | <input type="checkbox"/> | <input type="checkbox"/> |
| 2 To declare a final dividend of 4.05p | <input type="checkbox"/> | <input type="checkbox"/> |
| 3 To re-elect Sir John Banham as a Director..... | <input type="checkbox"/> | <input type="checkbox"/> |
| 4 To elect Mr. R. A. Barfield as a Director..... | <input type="checkbox"/> | <input type="checkbox"/> |
| 5 To elect Mr. H. A. Stevenson as a Director..... | <input type="checkbox"/> | <input type="checkbox"/> |
| 6 To re-appoint PricewaterhouseCoopers as Auditors..... | <input type="checkbox"/> | <input type="checkbox"/> |
| 7 To authorise the Directors to determine the remuneration of the Auditors | <input type="checkbox"/> | <input type="checkbox"/> |

Special Business

- | | | |
|--|--------------------------|--------------------------|
| 8 To authorise the Company to make market purchases of its own shares..... | <input type="checkbox"/> | <input type="checkbox"/> |
| 9 To renew the Directors' authority to allot shares..... | <input type="checkbox"/> | <input type="checkbox"/> |
| 10 To renew the Directors' authority to allot shares for cash..... | <input type="checkbox"/> | <input type="checkbox"/> |
| 11 To adopt new Articles of Association | <input type="checkbox"/> | <input type="checkbox"/> |

(C) Shareholders Details

SURNAME Mr/Mrs/Miss/TITLE
FORENAMES
ADDRESS
Postcode

SIGNATURE	DATE
-----------	------

Notice of Meeting

Investor Information

9 THAT for the purposes of Section 80 of the Companies Act 1985 the Directors be generally and unconditionally authorised to exercise all the powers of the Company to allot relevant securities (within the meaning of the said section) up to an aggregate nominal amount of £1,275,578 provided that:

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

10 THAT the Directors be empowered in accordance with Section 95 of the Companies Act 1985 to allot equity securities (within the meaning of Section 94 of that Act) for cash as if sub-section (1) of Section 89 of the Act did not apply to any such allotment provided that:—

- (i) the power granted shall be limited to the allotment of equity securities wholly for cash up to an aggregate nominal amount of £1,275,578 (being within 5 per cent of the issued Ordinary Share capital at the date of this Notice).
- (ii) the power granted shall (unless previously revoked or renewed) expire at the conclusion of the next Annual General Meeting of the Company after the passing of this resolution; and
- (iii) the said power shall allow and enable the Directors to make an offer or agreement before the expiry of that power which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offer or agreement as if that power had not expired.

11 THAT the regulations contained in the current articles of association of the Company shall no longer apply and that in place of those regulations the new articles of association, a copy of which has been initiated by the Chairman for the purposes of identification, be adopted by the Company and that the Secretary be directed immediately to register them with the Registrar of Companies.

10 Fenchurch Street,
London EC3M 3LB
7th April 2000
By Order of the Board
N. Schragger von Altishofen
Secretary

Notes: Members entitled to attend and vote at this Meeting may appoint one or more proxies to attend and, on a poll, vote in their stead. The proxy need not be a Member of the Company. Proxies must reach the office of the Registrars at least 48 hours before the Meeting. A form of proxy is provided with the Annual Report. Completion of the enclosed form of proxy does not preclude a Member from attending the Meeting and voting in person. To be entitled to attend and vote at the Meeting (and for the purpose of the determination by the Company of the number of votes they may cast), Members must be entered on the Company's register of Members at 12.30 pm on 6th May 2000 ("the specified time"); if the Meeting is adjourned to a time not more than 48 hours after the specified time applicable to the original Meeting, that time will also apply for the purpose of determining the entitlement of Members to attend and vote (and for the purpose of determining the number of votes they may cast) at the adjourned Meeting. If, however, the Meeting is adjourned for a longer period then, to be so entitled, Members must be entered on the Company's register of Members at the time which is 48 hours before the time fixed for the adjourned Meeting or, if the Company gives notice of the adjourned Meeting, at the time specified in that notice. Contracts of service are not entered into with the Directors, who hold office in accordance with the Articles of Association.

Results

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

Ordinary Dividends

First quarterly paid late August.
Second quarterly paid late November.
Third quarterly paid late February.
Final paid late May.

Preference Dividends

Payable half-yearly 1st August and 1st February.

Interest on 4% Perpetual Debenture Stock

Payable half-yearly 1st May and 1st November.

Dividend Payment Schedule

Year to:

Year to:	Dividend	Payment Date
January 1996	First Interim	21.08.95
	Second Interim	17.11.95
	Third Interim	23.02.96
	Final	24.05.96
January 1997	First Interim	23.08.96
	Second Interim	18.11.96
	Third Interim	21.02.97
	Final	23.05.97
January 1998	First Interim	09.06.97
	Second Interim	18.11.97
	Third Interim	26.02.98
	Final	20.05.98
January 1999	First Interim	21.08.98
	Second Interim	18.11.98
	Third Interim	22.02.99
	Final	19.05.99
January 2000	First Interim	24.08.99
	Second Interim	10.11.99
	Third Interim	22.02.00
	Final (proposed)	18.05.00

ø† See page 9 "Historical Record" for details of FID enhancements paid.

Investor Information

Market and Portfolio Information

The Company's Ordinary Shares are listed on the London Stock Exchange. The market price, price range, gross yield and net asset value are shown daily in the Financial Times and The Daily Telegraph. The net asset value of the Ordinary Shares is calculated daily and published on the London Stock Exchange TOPIC Service. The geographical spread of investments and ten largest holdings are published monthly on the London Stock Exchange TOPIC Service. They are also available to any enquirer from the Investment Trust Helpline or the Dresdner RCM website: www.dresdnercm-its.co.uk.

Share Prices

The share prices quoted in London Stock Exchange Daily Official List for 31st January 2000 were 333p-341p. For CGT indexation purposes at 31st March 1982 the share price, after adjustment for bonus issues, was 48.75p.

Savings Plan

The Dresdner RCM Global Investors Investment Trusts Savings Plan provides a convenient and economical way for shareholders to increase their existing holdings. Investments can be in the form of a regular payment or an individual lump sum and there is an arrangement for the reinvestment of dividends. There are also facilities for selling and switching.

Investment Trust Maxi ISA

Shareholders can invest in the shares of the Trust through the Dresdner RCM Investment Trust ISA. Full details are available from the Investment Trust Helpline on 020 7475 5832.

Website

Further information about the Trust is available on the Dresdner RCM website www.merchantstrust.co.uk.

Dresdner RCM Global Investors

Dresdner RCM Global Investors is the global asset management arm of the Dresdner Bank Group, providing management and advisory services with respect to over £51.3 billion of assets. It manages ten listed investment trusts, including the Merchants Trust PLC, with an aggregate market capitalisation of some £2 billion as at 31st January 2000.

Dresdner RCM Global Investors gives enhanced access to a full range of global, regional and country investment capabilities and asset allocation expertise, assisted by their Grassroots market research network throughout Europe and the rest of the world. It is backed by the financial strength and stability of the Dresdner Bank Group – one of the world's largest financial institutions with a presence in 70 countries around the globe.

Payment of Dividends Direct to Bank Accounts

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

Association of Investment Trust Companies (AITC)

The Company is a member of the AITC, which provides a range of literature including fact sheets and a monthly statistical service. Copies of these publications can be obtained from the AITC, Durrant House, 8-13 Chiswell Street, London EC1Y 4YY.

Category: UK Income Growth

'its' Campaign

The Company is a supporter of the Association of Investment Trust Companies 'its' campaign.

Notice of Meeting

Notice is hereby given that the Annual General Meeting of **The Merchants Trust PLC** will be held at **20 Fenchurch Street, London EC3P 3DB**, on Monday, 8th May 2000 at 12:30 p.m. to transact the following business:

Routine Business

- 1 To receive and adopt the Report of the Directors and the Accounts for the year ended 31st January 2000 together with the Auditors' Report thereon.
- 2 To declare a final ordinary dividend of 4.05p per Ordinary Share.
- 3 To re-elect Sir John Banham as a Director.
- 4 To elect Mr. R. A. Barfield as a Director.
- 5 To elect Mr. H. A. Stevenson as a Director.
- 6 To re-appoint PricewaterhouseCoopers as Auditors of the Company.
- 7 To authorise the Directors to determine the remuneration of the Auditors.

Special Business

Resolution 9 will be proposed as an Ordinary Resolution and resolutions 8, 10 and 11 as Special Resolutions:

- 8 THAT the Company be and is hereby generally and unconditionally authorised in accordance with section 166 of the Companies Act 1985 (the "Act") to make market purchases (within the meaning of section 163 of the Act) of Ordinary Shares of 25p each in the capital of the Company ("Ordinary Shares"), provided that:
 - (i) the maximum number of Ordinary Shares hereby authorised to be purchased shall be 15,349,339;
 - (ii) the minimum price which may be paid for an Ordinary Share is 25p;
 - (iii) the maximum price which may be paid for an Ordinary Share is an amount equal to 105 per cent of the average of the middle market quotations for an Ordinary Share taken from the London Stock Exchange Official List for the 5 business days immediately preceding the day on which the Ordinary Share is purchased or such other amount as may be specified by the London Stock Exchange from time to time;
 - (iv) the authority hereby conferred shall expire at the conclusion of the annual general meeting of the Company in 2001 or, if earlier, on the expiry of 18 months from the passing of this resolution, unless such authority is renewed prior to such time; and
 - (v) the Company may make a contract to purchase Ordinary Shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiration of such authority and may make a purchase of Ordinary Shares pursuant to any such contract.

Directors' Report

Copies of the new Articles of Association of the Company will be available for inspection during normal business hours up to the date of the AGM at the registered office of the Company and at the AGM for at least 15 minutes prior to and during the meeting.

Auditors

PricewaterhouseCoopers have indicated their willingness to continue in office and resolutions concerning their re-appointment and authorising the Directors to determine their remuneration will be proposed at the forthcoming Annual General Meeting.

By Order of the Board
N. Schragner von Altshofen
Secretary

3rd April 2000

Contact Details

Shareholder Enquiries

IRG plc are the Company's registrars and maintain the share register. In the event of queries regarding their holdings of shares, lost certificates, dividend cheques, registered details, etc., shareholders should contact them on 020 8639 2000. 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, 10 Fenchurch Street, London EC3M 3LB.

Managers and Advisers

Fund Manager

Nigel Lanning AIMR ACIS
A director of Dresdner RCM Global Investors (UK) Ltd.

Secretary and Registered Office

Nicola Schragner von Altshofen ACIS
10 Fenchurch Street, London EC3M 3LB
Telephone: 020 7475 2700

Registered Number 28276

Registrars and Transfer Office

IRG plc
Bourne House, 34 Beckenham Road,
Beckenham, Kent BR3 4TU
Telephone: 020 8639 2000

Auditors

PricewaterhouseCoopers, Chartered Accountants
Southwark Towers
32 London Bridge Street, London SE1 9SY

Bankers

Barclays Bank PLC
Lloyds TSB Bank plc
Kleinwort Benson Investment Management Limited

Stockbroker

Cazenove & Co.

Dresdner RCM Investment Trust Helpline

020 7475 5832

Dresdner RCM Website

www.dresdnerrcm-its.co.uk

Chairman's Statement

The results for the year ended 31st January 2000 show net earnings per Ordinary Share of 17.93p including special dividends totalling 1.31p per share. The underlying earnings per share of 16.62p compares with the 15.21p recorded in 1998/9, representing an increase of 9.3%. These results show a continuation of the Trust's long term record of achieving real growth in earnings. Ignoring the benefit of special dividends, earnings per share have now grown by 37% over the last five years.

The Board is recommending a final dividend of 4.05p, giving a total of 16.00p for the full year. Shareholders will recall that last year's total of 15.59p per share included a 0.59p enhancement relating to the portion of the total paid as a foreign income dividend. The 16.00p per share total for the year just ended is 6.7% above the underlying payment of 15.00p per share for 1998/9. Over the last five years net dividends have grown by over 39%. This represents average dividend growth of 6.4% per annum, which compares favourably with our sector average of 5.3%.

The volatile market conditions seen in 1998/9 continued into the latest financial year. Despite the 7.9% rise in net asset value to 447.9p per share recorded in the first half of 1999/2000, the figure at the year end stood at 381.4p, representing a fall of 8.1% for the year as a whole. The total return for the year on a net income basis was - 4.3%. Shareholders will be aware of the contrasting performance between established companies and the so-called "new" economy shares in recent months. This can be illustrated by the rise of over 130% recorded by information technology shares during the Trust's last financial

year, much of this occurring in the final three months. In contrast, the FTSE 100 index rose by 6.3% whilst the FTSE 350 High Yield Index rose by only 1.8%. The portfolio's high yield characteristics have meant that, in the short run, the Trust has suffered more than most income growth trusts from these trends. On a more satisfactory note, the AITC data confirms that the Trust's dividend record is amongst the leaders in the UK Income Growth sector over the last five years and, at a compound rate of 6.8% per annum, it is some 1.5% per annum above the average for such trusts.

Borrowings

On 20th December 1999, the Trust increased its borrowings through the issue of £30m of Secured Bonds maturing in 2029. The total of interest and other amortised costs associated with the bonds is 6.1% per annum, which is significantly below our expectations for UK equity returns over the next thirty years. This attractive opportunity arose as a consequence of technical factors affecting the long end of the gilt market and this new low cost source of funds is expected to contribute materially to the Trust's performance in the years ahead.

Prospects

The dramatic rise in values seen for technology shares, and the associated weakness in other sectors, raises far-reaching questions relating to investment in the UK, as well as other stock markets in the future. It is clear that not only are there fundamental changes taking place to commercial life, but that the pace of change itself is also quickening. This is likely to give rise to a

Directors' Report

Under the rules of the London Stock Exchange, the maximum number of shares which a listed company may purchase through the market pursuant to a general authority such as this is equivalent to 14.99% of its issued share capital. For this reason, the Company is limiting its renewed authority to make such purchases to 15,349,339 Ordinary Shares, representing 14.99% of the issued share capital at the date of this document. The authority will last until the Annual General Meeting of the Company to be held in 2001 or the expiry of 18 months from the date of the passing of this resolution, whichever is the earlier. The authority will be subject to renewal by shareholders at subsequent Annual General Meetings.

Allotment of new shares

Approval is sought for the renewal of the Directors authority to allot relevant securities, in accordance with section 80 of the Companies Act 1985, up to a maximum aggregate nominal amount of £1,275,578. This authority, previously granted by ordinary resolution on 15th May 1995, would expire 5 years from the date of renewal, if not previously revoked or varied.

A Resolution was passed at the Annual General Meeting held on 10th May 1999 to authorise the Directors to allot the unissued share capital for cash. The power to allot new shares for cash other than pro rata to existing shareholders, limited to the aggregate nominal amount of £1,275,578 Ordinary capital, being approximately 4.99 per cent of the issued Ordinary Share capital of the Company as at the date of this report, is renewable annually and expires at the conclusion of the Annual General Meeting in 1999. A Special Resolution is therefore proposed under special business at the forthcoming Annual General Meeting to renew this authority for a further year.

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

Memorandum and Articles of Association

It is proposed that at the Annual General Meeting a resolution be passed to adopt a new set of Articles of Association of the Company. These new Articles of Association make a number of changes to the existing Articles of Association. These changes are summarised below:

- The provisions relating to retirement of Directors by rotation have been amended to bring them into line with the requirements of the Combined Code;
- the maximum number of Directors permitted under the Articles of Association has been increased from 7 to 9;
- the provisions relating to the Company's ability to use its capital profits have been amended to make it clear that the Company may use its capital profits in order to fund repurchases of its own shares, notwithstanding the requirements of Section 266 of the Companies Act 1985. Previously, a company which was an investment company under Section 266 was prohibited from using its capital profits to make distributions. However, during the year this provision was amended by legislation to allow an investment company to use its capital profits to fund purchases and redemptions of its own shares. This amendment allows the company to benefit from this change;
- a number of changes have been made to bring the Articles of Association up to date in order to reflect the fact that the Ordinary Shares of the Company may be traded through the CREST settlement system; and
- Directors have been given specific authority to determine the accounting treatment of special dividends received.

Directors' Report

Chairman's Statement

Analysis of Share Register

Shareholder Type	Shareholder Accounts		Shareholding	
	Number	%	000's	%
	2000	1999	2000	1999
Private holders*	10,802	10,877	37,472	38,759
Nominees	3,993	3,699	53,654	51,985
Insurance Companies	67	92	2,265	2,478
Other holders	617	548	3,816	3,889
Pension Funds	7	8	59	50
Investment Trusts and Funds	378	421	5,063	5,168
	15,864	15,645	102,329	102,329
			100.0	100.0
			100.0	100.0

*Including PEP, ISA and Saving Plan Nominees.

Based on an analysis of the Ordinary Share register at 28th February 2000 (18th January 1999).

Directors' and Officers' Liability Insurance

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

Annual General Meeting

Purchase of own shares

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

Where purchases are made at prices below the prevailing net asset value of the Ordinary Shares, this will enhance net asset value for the remaining shareholders. It is therefore intended that purchases would only be made at prices below net asset value, with the purchases to be funded from the realised capital profits of the Company (which are currently in excess of £357 million). The rules of the London Stock Exchange limit the price which may be paid by the Company to 105% of the average middle-market quotation for an Ordinary Share on the 5 business days immediately preceding the date of the relevant purchase. The minimum price to be paid will be 25p per Ordinary Share (being the nominal value). Additionally, the Board believes that the Company's continued ability to purchase its own shares should create additional demand for the Ordinary Shares in the market and that this increase in liquidity should assist shareholders wishing to sell their Ordinary Shares.

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

new set of challenges for all investors, and particularly for those seeking a relatively high measure of dividend income.

Taking account of the recent volatility affecting all markets, the new funds raised through recent borrowings were initially invested in short dated gilt-edged securities. The correction in share values since the end of 1999 has provided a good opportunity for the Managers to deploy the new funds raised in December. This will help to secure a further year of positive earnings growth, especially as there are now a large number of good quality companies offering high dividend yields. The encouraging aspect of the UK market is that the overall economic scene remains good, particularly with regard to growth and inflation. However, there are strong grounds for believing that we will need to remain vigilant and flexible in the months ahead.

Investment Policy

As part of the Board's regular review of the Trust's investment policy, it has considered whether any change is appropriate given recent economic and market developments. The Board has concluded that there are developments taking place which will lead to lasting changes in the dividend characteristics of the UK share market. Accordingly it is now considered appropriate to adjust the portfolio's yield objective to accommodate a broader spread of companies. However the Board and the Managers remain committed to growing the Trust's dividends at least in line with inflation over the next few years.

Our confidence that this objective can be

achieved is reinforced by the size of the Trust's Revenue Reserve, which stood at £10.3m, or 10.05p per share, at 31st January 2000. We believe this change will have beneficial consequences for the Trust's capital performance. The Manager's projections suggest that dividends are likely to be partly paid from reserves over the next three years. Thereafter earnings and dividends paid are forecast to return to equilibrium.

Dividend Growth

In the light of the changes outlined above, we have forecast total payments for 2000/01 of at least 16.4p per share, an increase of 2.5% over the total paid for 1999/2000. At a share price of 343p, the prospective yield will be 4.7% on this basis. In the absence of unforeseen circumstances, this improvement is indicative of the likely growth rate in subsequent years.

AGM

Re-purchase by the Company of its own Shares

Your Board are seeking powers to repurchase up to 15% of the issued ordinary share capital as it believes that it should have the flexibility to do so where this could enhance the return to the Trust but without undue effect on the level of gearing. A special resolution is proposed in this respect at the forthcoming Annual General Meeting. Further details are given in the Directors' Report on page 39.

Articles of Association

In addition to the above matters, we will be taking the opportunity to seek Shareholders' approval to make certain minor amendments to the Trust's

Chairman's Statement

Articles of Association, to reflect changes in law and regulatory practice.

Changes to the Board

There are a number of changes to the Board to draw to shareholders' attention. Sir Derek Birkin retired from the Board last September and has since acted as a consultant to the Trust. His present role will cease following the AGM in May. Sir Derek joined the Board in 1986 and has since given us the benefit of his great commercial experience gained principally at Rio Tinto, where he was Chairman, and latterly as a Director of Unilever, Carlton Communications and Merck. The Board and the Managers will miss his shrewd judgement and his sense of humour and wish him a long and happy retirement.

Dick Barfield became a Director last May. He is a Director of Equitas and Chairman of its Investment Committee. He is also a Director of Baillie Gifford Japan Trust and Apax Partners & Co. Asset Management as well as several other companies and is a member of the Executive Committee of the Association of Investment Trust Companies. He was formerly Chief Investment Manager at Standard Life Assurance.

Hugh Stevenson was appointed to the Board last year as Chairman Designate. He has

had a distinguished City career in a number of roles and was Chairman of Mercury Asset Management Group until 1997. He is currently Chairman of Equitas, a Director of Standard Life Assurance and the Investment Management Regulatory Organisation as well as being a member of the Investment Committee of the Wellcome Trust. He brings a wealth of experience covering investment management as well as a number of related spheres. He will become Chairman of the Trust in May.

I shall be retiring following the AGM after eight years as a Director and seven years as Chairman of The Merchants Trust. I would like to pay tribute to my fellow Directors, both past and present, who have been more than supportive over these years. It has been a privilege to work with them all. Looking ahead, I am sure that the future of the Trust is in very good hands and that the outlook for shareholders is a prosperous one.

C. H. Black
Chairman
3rd April 2000

Directors' Report

Sir John Banham is the Director retiring by rotation in accordance with the Articles of Association who, being eligible, offers himself for re-election. Mr. Barfield and Mr. Stevenson both seek election by the shareholders at the forthcoming Annual General Meeting, having been appointed after the last Annual General Meeting. Mr. C. H. Black will retire from the Board at the conclusion of the Annual General Meeting on 8th May 2000.

The present Board and their interests in the share capital of the Company as at 31st January 2000 and 1999 (or date of appointment if later) are listed below:

	2000		1999	
	Beneficial	Non-Beneficial	Beneficial	Non-Beneficial
C. H. Black	5,000	—	5,000	—
R. A. Barfield	400	—	—	—
Sir John Banham	800	—	800	—
A. D. A. W. Forbes	1,000	—	1,000	—
Sir Bob Reid	500	—	500	—
P. J. Scott Plummer	1,000	—	1,000	—
H. A. Stevenson	25,000	—	—	—

On 23rd March 2000 Mr. C. H. Black acquired a further 10,000 Ordinary Shares in the Company and on 24th March 2000 Mr. R. A. Barfield acquired a further 1,443 Ordinary Shares in the Company. No other transactions in the securities of the Company had been reported to the Company from 31st January 2000 up to the date of this report.

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

Management Agreement

The management agreement with Dresdner RCM Global Investors (UK) Limited provides for a fee of 0.35% per annum (1999—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 Dresdner RCM. The management agreement is terminable at one year's notice (1999—one year).

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

The Company has entered into an annual agreement with Dresdner RCM to operate the Savings Plan. The cost to the Company for the year ended 1st February 2001 will be £57,423 (excluding VAT) (2000—£51,021 excluding VAT). The fee relates to generic costs and is partially calculated on a usage and market capitalisation basis.

Individual Savings Accounts/PEPs

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

Directors' Report

Business Review

A review of the Company's activities is given in the Chairman's Statement on pages 6 to 8 and in the Investment Managers' Review on pages 11 and 12.

Revenue

Revenue for the year after deducting management and general expenses and finance costs of borrowings amounted to £ 18,608,754 (221,150) and there remained a balance of £ 18,387,604 from which has been deducted the dividend on £1,178,000 of Preference Stock leaving available for distribution to the Ordinary Shareholders £ 18,344,607

Dividends

Provision has been made in the Accounts for dividends announced on the Ordinary Shares of 25p as follows:

1st Interim 3.95p per Share paid 24th August 1999	£ (4,041,993)
2nd Interim 3.95p per Share paid 10th November 1999	(4,041,993)
3rd Interim 4.05p per Share paid 22nd February 2000	(4,144,322)
Final 4.05p per Share proposed payable on 18th May 2000	(4,144,322)
	<u>(16,372,630)</u>
leaving a balance to be transferred to Revenue Reserve of	<u>1,971,977</u>

Subject to the final dividend being approved payment will be made on 18th May 2000 to shareholders on the Register of Members at the close of business on 14th April 2000 at the rate of 4.05p per Ordinary Share. Further details are provided in Note 6 on page 24.

Substantial Shareholdings

In accordance with section 198 of the Companies Act 1985 and the Disclosure of Interests in Shares (Amendment) Regulations 1993, as at the date of this report, the Company has been advised of the following substantial share interests in its relevant share capital:

3.65% Cumulative Preference Stock: —
 CGU plc — £294,690 (25.0%); The Prudential Corporation PLC — £176,000 (14.9%); Ecclesiastical Insurance Office PLC — £134,690 (11.4%); Eagle Star Holdings PLC — £90,000 (7.6%); Royal Insurance PLC — £60,000 (5.1%).

Ordinary Shares of 25p: —
 Barclays PLC and its subsidiaries — 4,209,758 (4.1%).

Directors and Management

On 10th May 1999 Mr D. H. L. Hopkinson retired from the Board and Mr R. A. Barfield was appointed a Director. Sir Derek Birkin retired from the Board on 13th September 1999 and, on the same day, Mr H. A. Stevenson was appointed a Director and Chairman Designate. All other Directors listed below served throughout the financial year under review.

Historical Record

Years ended 31st January

Revenue and Capital	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Revenue (£000's)	12,375°	13,823°	14,456°	13,563†*°	15,514°	17,466°	17,351°	18,769°	20,399°	20,119°	22,590
Earnings per share (net)	9.09pt	10.46pt	10.92pt	10.20pt†*	11.04p	12.12p	12.41p	13.66p	14.88p	15.21p	17.93p
Paid net per Share	8.00p	9.00p	10.00p	10.60p	11.00p	11.50p	12.25p	13.65p	14.25p	15.59p†	16.00p
Tax Credit per Share	2.67p	3.00p	3.30p	3.31p	2.75p	2.88p	3.06p	3.41p#	3.56p	3.90p\$	1.78p
Gross Ordinary Dividend	10.67p	12.00p	13.30p	13.91p	13.75p	14.38p	15.31p	17.06p	17.81p	19.49p	17.78p
Total Net Assets (£000's)	231,322†	197,514†	220,007†	242,331†*	311,127	253,604	303,934°	335,212	421,504	426,037	391,495
Net Assets attributable to Ordinary Capital (£000's)	230,144†	196,336†	218,829†	241,153†*	309,949	252,426	302,756°	334,034	420,326	424,859	390,317
Net Asset Value per Ordinary Share	225.0pt	191.9pt	213.9pt	235.7pt*	302.9p	246.7p	295.9°	326.4p	410.8p	415.2p	381.4p
NAV Total Return (%)*	+13.1	-10.7	+16.7	+15.1	+33.2	-14.8	+24.9	+14.9	+30.2	+4.9	-4.3
Retail Price Index Increase (%)	+7.7	+9.0	+4.1	+1.7	+2.5	+3.3	+2.9	+2.8	+3.3	+2.4	+1.9

Notes

° Restated in accordance with Financial Reporting Standard 16 "Current Taxation" (see Accounting Policy (ii) on page 21).

† Restated to reflect the change in accounting policy during the year ended 31st January 1994 for finance costs of long-term borrowings.

* Restated to reflect the change in accounting policy during the year ended 31st January 1994 for dividends and interest receivable on investments.

° NAV total return reflects both the change in net asset value per ordinary share and the net ordinary dividends declared in respect of each year.

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

Excluding this enhancement the "normal" distribution for 1997 was therefore 13.25p.

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

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

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

Geographical Distribution

	Percentage of Valuation										
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
United Kingdom	91.5	95.7	98.8	99.1	99.5	99.5	99.6	99.6	99.8	99.8	99.9
North America	8.5	4.3	1.2	0.9	0.5	0.5	0.4	0.4	0.2	0.2	0.1
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Thirty Largest Equity Holdings

at 31st January 2000

	Valuation £'000s	%	Unrealised Gain (Loss) over Book Cost £'000s
British Telecommunications	33,628	6.62	19,916
BP Amoco	23,936	4.71	4,332
Shell Transport	20,950	4.12	8,726
*National Grid	17,677	3.48	2,352
Glaxo Wellcome	15,860	3.12	3,475
National Westminster	14,256	2.80	7,247
Scottish & Southern Energy	13,007	2.56	(3,939)
Vodafone Airtouch	10,155	2.00	(39)
Imperial Tobacco	9,471	1.86	(3,216)
Tarmac	8,775	1.73	865
†British Aerospace	8,627	1.70	(2,047)
Prudential Corporation	8,565	1.69	7,175
BG	8,407	1.65	204
Hallifax	8,299	1.63	(3,852)
BOC	7,968	1.57	1,827
FKI	7,868	1.55	1,963
Woolwich	7,784	1.53	(2,709)
Johnson Matthey	7,695	1.51	1,785
Sainsbury (J)	7,480	1.47	(182)
Abbey National	7,470	1.47	(3,233)
Lloyds TSB	7,470	1.47	(1,379)
Barclays	7,101	1.40	2,539
‡Telewest	7,083	1.39	1,443
Tesco	7,020	1.38	(598)
Boots	6,986	1.37	(2,074)
Reed International	6,979	1.37	1,051
Wimpey	6,650	1.31	(2,592)
Gallaher	6,535	1.29	(1,748)
‡Bell Atlantic	6,261	1.23	728
Reuters	6,085	1.20	1,489
	<u>316,048</u>	<u>62.18</u>	% of Total Invested Funds

†Consists of Convertible Preference Shares

‡Consists of Convertible Bonds

*Includes £8,752,181 of Convertible Bonds

Portfolio Percentage by Type of Security

	£	%
Equities	446,554,298	87.86
Convertible Preference Shares	8,626,875	1.70
Convertible Bonds	26,357,564	5.18
Treasury Stocks	26,707,500	5.26
	<u>508,246,237</u>	<u>100.00</u>

Directors' Report

Status

The Company operates as an approved investment trust within the meaning of Section 842 of the Income and Corporation Taxes Act 1988, confirmation of which has been received from the Inland Revenue for the year ended 31st January 1999. Such approval is expected to be granted for the accounting year now under review. The Company is not a close company. The Company is an Investment Company within the meaning of Part VIII of the Companies Act 1985.

Going Concern

After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

Share Capital

There were no changes in the share capital of the Company during the year ended 31st January 2000.

Payment Policy

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

Year 2000

Dresdner RCM have confirmed that all areas of its business have successfully moved into the new millennium and are operating a normal service. It will continue to monitor the compliance status of its systems and services, particularly at the time of their first usage.

Invested Funds

Sales of investments during the year resulted in net gains based on historical costs of £39,653,628 (1999 – £63,880,922). Provisions contained in the Finance Act 1980 exempt approved Investment Trusts from corporation tax on their chargeable gains. Invested funds at 31st January 2000 had a value of £508,246,237 before deducting net liabilities of £116,750,954 (1999 – £508,503,479 and £82,466,658).

Net Asset Value

The Net Asset Value of the Ordinary Shares of 25p at the year end, after deducting the provision for final dividend, was 381.4p as compared with a value of 415.2p at 31st January 1999.

Donations and Subscriptions

Aggregate charitable donations and subscriptions in respect of the year amounted to £1,599 (1999 – £1,599). No political donations were made during the year.

Historical Record

There is included on page 10 a schedule of the Company's thirty largest equity investments. The distribution of total assets is shown on page 15, and the historical record of the Company's revenue, capital and invested funds over the past ten years is shown on page 9. Graphs are included on page 16 showing the performance on a total return basis over the past five years of the net asset value of the Company's Ordinary Shares against the Company's benchmark indices, the growth in net ordinary distributions made by the Company against the Retail Price Index, and the Company's discount to net asset value over the same period.

Directors and Management

Directors

Colin Black (Chairman)*

(Born February 1930) joined the Board in January 1992. A former Chairman of the Association of Investment Trust Companies, Kleinwort Benson Investment Management Ltd, and Scottish Widows' Fund and Life Assurance Society, he is Chairman of Govett Asian Smaller Companies Trust Ltd, a Director of Postern Fund Management Ltd and a former Director of Temple Bar Investment Trust plc.

Hugh Stevenson* (Chairman designate)

(Born September 1942) Formerly Chairman of Mercury Asset Management Group plc, he is Chairman of Equitas Limited, a Director of Standard Life Assurance Company and the Investment Management Regulatory Organisation and is a member of the Investment Committee of the Wellcome Trust.

Sir John Banham*

(Born August 1940) joined the Board in August 1992. Formerly Director General of the CBI, he is Chairman of Kingfisher PLC and ECI Ventures Ltd, and Chairman designate of Whitbread PLC. He is also a Director of Armvescap Plc.

Dick Barfield*

(Born April 1947) Formerly Chief Investment Manager of Standard Life Assurance Company, he is a Director of Equitas Limited, Baillie Gifford Japan Trust PLC, Marshalls PLC, New Look Group PLC, Quintain Estates and Development plc, Apax Partners & Co. Asset Management Limited and other companies.

Anthony Forbes*

(Born January 1938) joined the Board in July 1994. Formerly joint senior partner of Cazenove & Co, he is a Director of Royal and Sun Alliance Insurance Group plc and Cariton Communications plc.

Sir Bob Reid*

(Born May 1934) joined the Board in January 1995. Formerly Chairman of Shell (UK), British Rail, London Electricity plc, and Sears PLC. He is a Deputy Governor of the Bank of Scotland.

Joe Scott Plummer*

(Born August 1943) joined the Board in May 1997. He is Chairman of Martin Currie Limited and is a Director of Candover Investments PLC and Martin Currie Portfolio Investment Trust PLC.

*All of the above Directors are non-executive and independent of the Manager, and each serves on the Company's Audit and Nomination Committees.

Investment Managers' Review

Economic Background

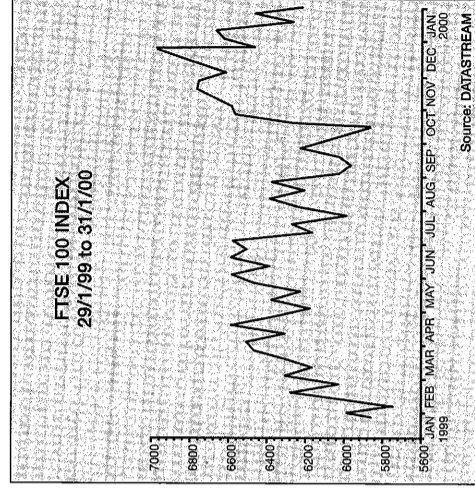
Despite more cautious forecasts at the start of the year, 1999 proved to be another year of steady growth for the UK. The latest estimates suggest that the economy expanded by about 2% and thus 1999 was the seventh consecutive year of growth. With the rate of expansion increasing as the year unfolded, the Monetary Policy Committee became concerned that there might be inflationary consequences as the slack within the economy was absorbed. There was also concern that the sharp rise in the cost of oil would feed through to retail prices. Thus base rates were increased by 0.25% to 5.25% in September, ending the financial year at 5.75% before rising to 6% in early February.

All of these factors tended to be positive for the sterling exchange rate, which gained additional support from the lack of confidence surrounding the Euro in its first year of existence. Given this background, and despite the strong rise in raw material prices, the level of UK inflation at the end of 1999 was the lowest in Europe, at just over 1% on a comparable basis. For many market sectors, this background represented a considerable challenge and it seems that exporting companies have responded particularly well to these circumstances. Given the lack of pricing power within the economy, the experience of 1999 lends weight to the view that, in general, quoted companies are now much better equipped to deal with domestic and international competition than has historically been the case.

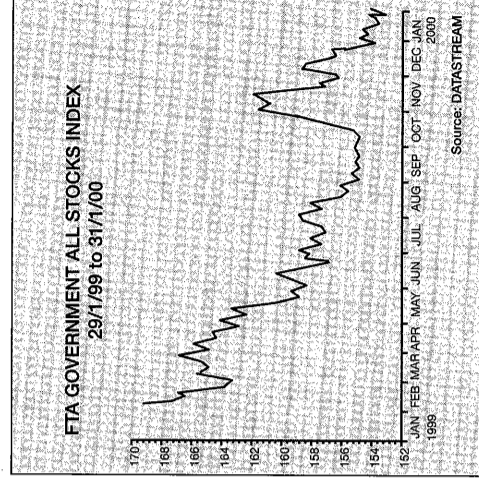
Market Trends

The FTSE 100 Index appreciated sharply at the start of the 1999/2000 year, rising from 5,896 at the start to over 6,600 in early July. The surprise September interest rate rise prompted a set back to about 5,900 before a rapid rise in "new" economy, principally technology, shares drove the Index up to 6,900 at the end of 1999. After the New Year, January saw a sharp correction, with the FTSE 100 Index ending the financial year at

6,268. Although volatility was itself a feature of 1999/2000, the key development was the rapid rise in technology shares, largely in the last three months of the financial year.



In this latter period, the best performing sectors were Information Technology (+81.06%), Media (+62.0%), and Telecoms (+25.8%). It is also worth remarking that in parallel a number of key sectors for income funds were weak, despite a sound background for earnings and dividends. The latter category would include Tobacco (-31.7%), Food Producers (-21.3%) and Banks (-18.7%). In summary, the recent emphasis has been on those companies with long term profit aspirations, rather than on those with tangible earnings and dividends.



Investment Managers' Review

Portfolio changes

Given the general concern over the prospects for those companies with more pedestrian growth potential, it has been essential to re-assess a number of the Trust's holdings, despite their having low ratings in many instances. Industrial companies faced a particularly tough outlook, compounded by the strength in sterling, and it was decided to sell the holdings in BICC, Delta, Invensys and Woiseley amongst others. The food manufacturing sector also fell into this category and the holdings in Northern Foods and Unigate were also sold. Additionally the bids for Hillisdown and Terranova helped to reduce the weighting here.

In the property sector there were disposals of MEPC and Slough, whilst the banking sector saw reductions in the cases of Alliance & Leicester, Barclays and Royal Bank of Scotland. In the pharmaceutical sector, there were sales of Glaxo Wellcome and AstraZeneca prompted by their reduced growth prospects, whilst amongst utilities, the holdings in Anglian Water and British Energy were sold in the light of tighter regulatory controls. Elsewhere there were take-over bids for the holdings in National Westminster and Tarmac, which were completed after the year end.

On a positive footing, the Managers sought to gain advantage, wherever possible, from the upsurge in values of media and telecommunications shares. In the former category, the setback in values in the Autumn allowed an attractive buying opportunity in Carlton Communications, EMI and Reuters. Whilst in telecommunications, there were purchases of Vodafone Airtouch, the Telewest convertible and National Grid; in the latter case the company's key asset is its major stake in

Energis. At the same time the fund purchased a holding in Amvescap, the largest UK quoted fund management group, whose shares had been depressed by the short term weakness on Wall Street. Lastly there were additions to two industrial companies, that is to say FKI and Johnson Matthey, where their business strategies appeared to offer good prospects in a tough environment.

In last year's report, it was noted that the remaining gilt-edged holdings were sold after the 1998/9 year end. As the Chairman stated, it was decided initially to invest the proceeds of the December bond issue in short dated gilt-edged securities. This represented an attractive temporary home for the funds, given the good inflation outlook and the Government's strong financial position.

Future Policy

The weakness in a number of higher yielding blue chip companies since the year end has afforded a good opportunity to invest the new funds raised last December. Nevertheless it seems likely that a number of technology based companies will continue to lead the market forward, given the profound impact on business life that can be expected from harnessing new developments in this sphere. In many cases it is likely that hopes for investment returns have already been pitched too high. However, it is also likely that there will be many opportunities for established companies to benefit, where they can adapt to take full advantage of these changes. The Managers are optimistic that these opportunities, coupled with a sound core portfolio, offer a prosperous outlook for the Trust and the prospect of sustained growth in dividends for shareholders.

Corporate Governance

Internal Financial Control

The Directors have overall responsibility for the Company's system of internal financial controls. Whilst acknowledging their responsibility for the system of internal financial control, the Directors are aware that such a system can provide only reasonable but not absolute assurance against material misstatement or loss.

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

- ▶ Appointment of Dresdner RCM Global Investors (UK) Limited ('Dresdner RCM') as the Managers and Custodian. Dresdner RCM provides all investment management, custodial, accounting and secretarial services to the Company. The Managers and Custodian maintain the internal financial controls associated with the day to day operation of the Company. These responsibilities are included in the Management Agreement between the Company and the Managers (see page 22). The Managers' system of internal financial 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 their internal audit department. Dresdner RCM is regulated by IMRO and its compliance department regularly monitors their compliance with IMRO rules.
- ▶ Regular review and control by the Board of asset allocation and any risk implications. 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.
- ▶ An Audit Committee which reviews the terms of the agreement with the Managers and Custodians, assesses the Managers' and Custodians' systems of controls and approves the appointment of sub-custodians. The Audit Committee also receives reports from the Managers' and Custodian's internal auditors and compliance department.

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

The Board has previously reported on internal financial controls in line with the issued guidelines. New guidelines were issued in September 1999 for the review of internal controls ("the Turnbull guidance"). As permitted by the London Stock Exchange the Company has adopted the transitional approach for reporting on the internal control aspects of the Combined Code.

The Board has undertaken a full review of the aspects covered by the Turnbull guidance and believes that there is an effective framework substantially in place to meet the requirements of the Code, and has agreed a policy necessary to implement the Turnbull guidance in full. It is the Board's intention to be compliant with the guidance by May 2000.

Until full compliance with the Turnbull guidance is achieved the London Stock Exchange has permitted the directors to report on internal financial control in accordance with the existing guidance for directors on internal control and financial reporting which was issued in December 1992.

Exercise of Voting Powers

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

Corporate Governance

United Kingdom Listed Equity Holdings

at 31st January 2000

A senior non-executive Director has not been identified as the Board considers that this is not necessary for a non-executive Board of this size where the positions of Chairman of the Board and Chairman of the Audit Committee are held by different Directors.

The Board has contractually delegated to the Investment Manager the management of the investment portfolio, the custodial services and the day to day accounting and company secretarial requirements. This contract was entered into after due consideration by the Board of the quality and cost of services offered including the financial control systems in operation in so far as they relate to the affairs of the Company. The Board receives and considers reports regularly from the Investment Manager and ad hoc reports and information are supplied to the Board as required.

The Board has established a nominations committee to make recommendations on the appointment and re-appointment of Directors. Due to its size, the Board as a whole considers nominations made in accordance with an agreed procedure. The Audit Committee carries out the functions of a management engagement committee, to review and discuss the terms of the management contract with the Investment Manager. The Audit Committee consisting of the full Board has defined terms of reference and duties. This committee is also responsible for review of the annual accounts and interim report, terms of appointment of the auditors together with their remuneration as well as the non-audit services provided by the auditors. It also meets with representatives of the Investment Manager and receives reports on the effectiveness of the internal financial controls maintained on behalf of the Company and reviews the effectiveness of the Company's internal financial controls.

All non-executive Directors are appointed for an initial term of three years, subject to re-election and Companies Act provisions and, in accordance with the existing Articles of Association, stand for election at the first Annual General Meeting following their appointment.

Environmental Policy

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

Directors' Remuneration

Under the London Stock Exchange's Listing Rule 21.20(i), where an investment trust company has no executive Directors the Code principles relating to Directors' remuneration do not apply.

Relations with Shareholders

The Board strongly believes that the Annual General Meeting should be an event which private shareholders are encouraged to attend and participate in. The Annual General Meeting is attended by the Chairman of the Board and the Chairman of the Audit Committee and the Investment Manager makes a presentation to the meeting.

The Notice of Meeting sets out the business of the meeting and resolutions proposed under special business are explained more fully in the Directors' Report on pages 42 to 44. Separate resolutions are proposed for each substantive issue.

Accountability and Audit

The Directors' statement of responsibilities in respect of the accounts is on page 35 and a statement of going concern is on page 39.

The report of the auditors can be found on page 34.

	Value (£)	Principal Activities
British Telecommunications	33,627,900	Telecommunications
BP Amoco	23,936,000	Oil and gas
Shell Transport	20,950,250	Oil and gas
*National Grid	17,677,181	Electricity and telecommunications
Glaxo Wellcome	15,860,000	Pharmaceuticals
National Westminster	14,256,000	Banking
Scottish & Southern Energy	13,007,250	Electricity
Vodafone Airtouch	10,155,000	Telecommunications
Imperial Tobacco	9,471,000	Tobacco
Tarmac	8,775,000	Building materials
†British Aerospace	8,626,875	Aerospace and defence
Prudential Corporation	8,565,000	Insurance
BG	8,406,665	Gas distribution
Halifax	8,299,200	Banking
BOC	7,968,000	Industrial gases
FKI	7,867,500	Material handling and engineering
Woolwich	7,784,000	Banking
Johnson Matthey	7,695,000	Metal processing
Sainsbury (J)	7,480,000	Food retailing
Abbey National	7,470,000	Banking
Lloyds TSB	7,470,000	Banking
Barclays	7,101,250	Banking
††Telewest	7,083,188	Telecommunications
Tesco	7,019,750	Food retailing
Boots	6,986,000	Retailing
Reed International	6,979,000	Media
Wimpey	6,650,000	Housebuilding
Gallaher	6,534,900	Tobacco
\$\$\$Bell Atlantic	6,261,257	Telecommunications
Reuters	6,084,826	Media
EMI	6,037,222	Media
Scottish & Newcastle	5,955,000	Brewing and leisure
Smith & Nephew	5,923,125	Health care
Anglo American	5,919,400	Mining
Great Portland Estates	5,797,000	Property
Allied Domecq	5,760,000	Spirits and food
United Utilities	5,542,800	Water
Amvescap	5,443,938	Fund management
HSBC Holdings	5,317,725	Banking
Tate and Lyle	5,196,750	Sugar refining
Associated British Food	5,156,000	Food and grocery products
Aggregate Industries	5,121,250	Building materials
Corus	5,053,250	Steel
CGU	4,911,000	Insurance
Thames Water	4,881,500	Water
Royal and Sun Alliance	4,851,000	Insurance

United Kingdom Listed Equity Holdings

at 31st January 2000

	Value (£)	Principal Activities
Hilton	4,837,875	Hotels and betting
SmithKline Beecham	4,803,500	Pharmaceuticals
United Assurance	4,720,000	Insurance
Wilson Connolly	4,707,500	Housebuilding
TI	4,528,125	Engineering
Associated British Ports	4,510,000	Transportation & storage
Norwich Union	4,355,625	Insurance
British Land	4,354,473	Property
††Airtours	4,260,938	Travel and leisure
Bass	4,133,500	Brewing and hotels
Tomkins	4,070,000	Holding company
Beazer	4,026,000	Housebuilding
ICI	3,920,000	Chemicals
Diageo	3,888,750	Spirits and food
Standard Chartered	3,655,149	Banking
Carlton Communications	3,524,573	Media
Kingfisher	3,460,090	Retailer
Land Securities	3,443,643	Property
AstraZeneca	3,180,800	Pharmaceuticals
	<u>£481,295,493</u>	95.55% of Total Assets

†Consists of Convertible Preference Shares

††Consists of Convertible Bonds

*Includes £8,752,181 of Convertible Bonds (priced in US\$)

‡Priced in US\$

United Kingdom Listed Fixed Interest Holdings

at 31st January 2000

	Valuation (£)	Description
Treasury 6¾% stock 2004	9,153,900	Gilt-edged stock
Treasury 6½% stock 2003	9,013,500	Gilt-edged stock
Treasury 5% stock 2004	8,540,100	Gilt-edged stock
	<u>£26,707,500</u>	5.30% of Total Assets

North American Unlisted Holdings

at 31st January 2000

	Value (£)	Principal Activities
Mezzanine Lending Associates	35,359	Leveraged buy-out fund
*J.W. O'Connor	207,885	US property
	<u>£243,244</u>	0.05% of Total Assets

*Investment made through subsidiary company, Surrey Investments Inc.

Statement of Directors' Responsibilities

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the revenue of the Company for that period. In preparing those financial statements, the Directors are required to:

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

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

Corporate Governance

The Board has put in place a framework for corporate governance which it believes is appropriate for an investment trust company and which enables the Company to comply with the Principles of Good Governance and Code of Best Practice ("the Combined Code") prepared by the Committee on Corporate Governance, published in June 1998.

The Board considers that the Company has complied with the provisions contained within Section 1 of the Combined Code throughout the accounting period to 31st January 2000 except where disclosed below and this statement describes how the relevant principles of governance are applied to the Company.

The Board

The Board currently consists of seven Directors, all of whom are non-executive and deemed by the Board to be independent of the Company's investment manager. Their biographies, on page 38, demonstrate a breadth of investment, industrial and commercial experience.

The Board meets at least six times a year and between these meetings there is regular contact with the Investment Manager. Matters specifically reserved for decision by the full Board have been defined and a procedure adopted for Directors, in the furtherance of their duties, to take independent professional advice at the expense of the Company. The Directors have access to the advice and services of the Company Secretary who is responsible to the Board for ensuring that Board procedures are followed and that applicable rules and regulations are complied with.

When a Director is appointed there is an induction process carried out by the Investment Manager. Directors are provided, on a regular basis, with key information on the Company's policies, regulatory and statutory requirements and internal financial controls. Changes affecting Directors' responsibilities are advised to the Board as they arise.

Report of the Auditors

Distribution of Total Assets

at 31st January 2000

Auditors' Report to the Members of The Merchants Trust PLC

We have audited the financial statements on pages 18 to 33 which have been prepared under the historical cost convention as modified by the revaluation of certain fixed assets and the accounting policies set out on page 21.

Respective Responsibilities of Directors and Auditors

The Directors are responsible for preparing the Annual Report. As described on page 35, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange and our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the United Kingdom Companies Act. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding Directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

We review whether the statement on pages 35 to 37 reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the London Stock Exchange, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

Basis of Audit Opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the Company's affairs at 31st January 2000 and of its total return and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers

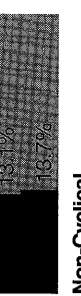
Chartered Accountants
and Registered Auditors

Southwark Towers
32 London Bridge Street
London SE1 9SY

3rd April 2000

Total Assets (less creditors falling due within one year) £503,729,701 (1999: £509,189,128)

	Percentage of Total Assets		
	United Kingdom	North America	1999
Equities (including convertibles)			
Resources			
Mining	1.2	—	0.8
Oil and gas	8.9	—	7.4
	10.1	—	8.2
Basic Industries			
Chemicals	3.9	—	—
Construction & building materials	5.8	—	5.2
Steel & other metals	1.0	—	0.8
	10.7	—	6.0
General Industrials			
Aerospace & defence	1.7	—	1.6
Electronics and electrical equipment	—	—	1.7
Engineering & machinery	3.3	—	1.8
	5.0	—	5.1
Non-Cyclical Consumer Goods			
Beverages	1.9	—	1.1
Food products & process	2.1	—	3.1
Packaging	—	—	0.3
Health	1.2	—	—
Pharmaceuticals	4.7	—	5.0
Tobacco	3.2	—	4.2
	13.1	—	13.7
Cyclical Services			
General retailers	2.1	—	6.0
Leisure, entertainment & hotels	1.8	—	—
Media & photography	4.5	—	3.7
Restaurants, pubs & breweries	2.0	—	2.5
Support services	—	—	0.6
Transport	0.9	—	2.9
	11.3	—	15.7
Non-Cyclical Services			
Food & drug retail	2.9	—	4.5
Telecommunication services	13.0	—	7.2
	15.9	—	11.7
Utilities			
Electricity	4.3	—	4.0
Gas distribution	1.7	—	1.4
Water	2.0	—	2.3
	8.0	—	7.7
Financials			
Banks	12.1	—	14.4
Insurance	1.9	—	3.3
Life assurance	3.5	—	5.9
Real estate	2.7	0.1	3.3
Speciality & other financials	1.1	0.1	—
	21.3	0.2	26.9
Total equities	95.4	0.2	95.0
Fixed interest			
Government securities	5.3	—	4.9
	5.3	—	4.9
Total fixed interest	-0.9	—	0.1
Net Current (Liabilities) Assets	99.8	0.2	100.0
Total Assets			



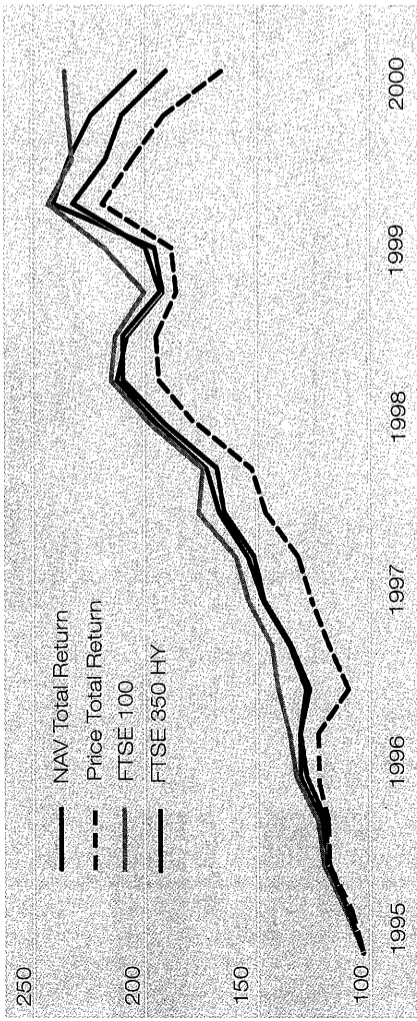
Performance Graphs

5 year record—as at 31st January

Notes to the Accounts

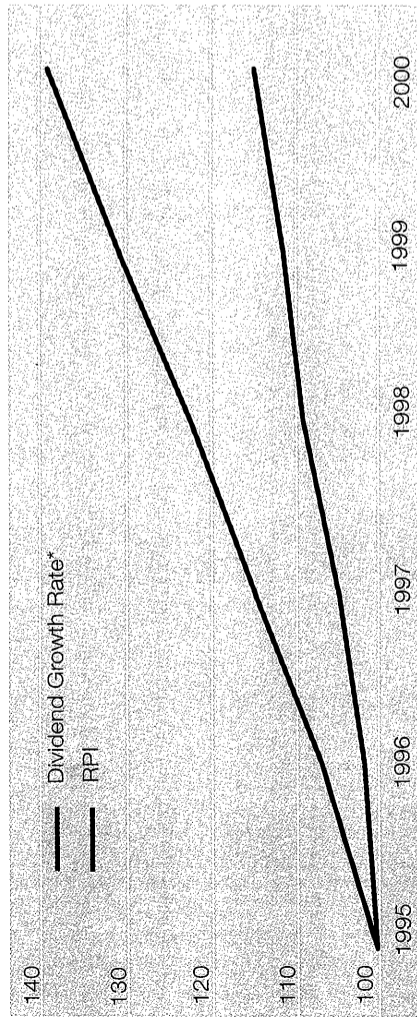
for the year ended 31st January 2000

Merchants Total Return compared to FTSE 100 and FTSE 350 Higher Yield Indices



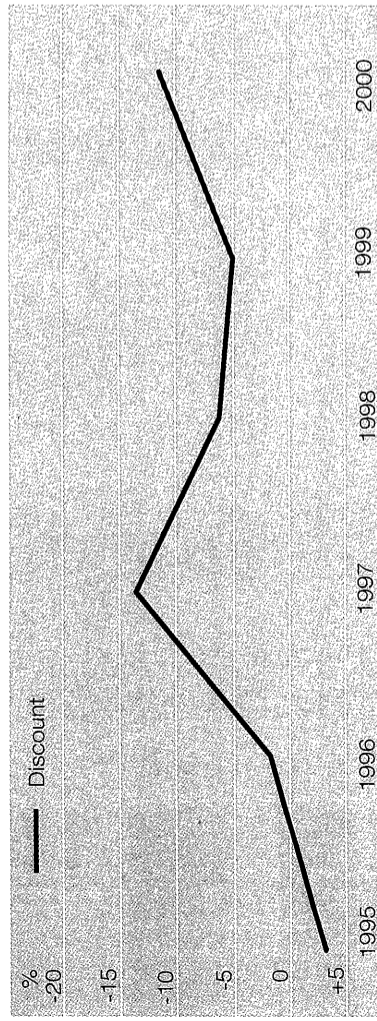
(Rebased to 100, net income reinvested) Source: Datastream

Merchants Net Dividend Growth compared to Inflation



*excluding FID enhancements (see page 9 for details) (Rebased to 100) Source: Dresdner RCM/Datastream

Merchants Share Price Discount/Premium to Net Asset Value



Source: Datastream

19. Financial Reporting Standard 13 – Derivatives and other Financial Instruments: Disclosures (continued)

The fixed rate interest bearing liabilities bear the following coupon and effective rates:

	Maturity date	Amount borrowed	Coupon rate	Effective rate since inception*
First Debenture Finance loan—bonds	2-Jan-18	20,534,079	14.75%	11.28%
First Debenture Finance loan—notes	2-Jan-18	5,133,520	14.75%	11.28%
Fintrust—original loan	20-Nov-23	30,000,000	9.25125%	9.30%
Fintrust—new loan	20-Nov-23	12,000,000	9.25125%	6.00%
5.875% Secured Bond	20-Dec-29	30,000,000	5.875%	6.13%
4% Perpetual Debenture Stock	n/a	1,375,000	4.00%	n/a

*The effective rates are calculated in accordance with FRS 4 as detailed in the Accounting Policies and in Note 10—Current Assets and Creditors.

The weighted average coupon rate of the Company's fixed interest bearing liabilities is 9.58% and the weighted average period to maturity of these liabilities (excluding the 4% perpetual debenture stock) is 290 months.

The weighted average coupon rate of the Company's fixed interest bearing assets is 6.01% and the weighted average period to maturity of those assets is 49 months.

(b) Currency Risk Profile

A portion of the assets and liabilities of the Company are denominated in currencies other than Sterling, with the effect that the total net assets and total return can be affected by currency movements.

	Investments	Current Assets	Creditors	Net currency exposure
	£	£	£	£
Sterling	492,989,555	20,548,876	(137,299,830)	376,238,601
US Dollar	15,256,682	—	—	15,256,682
	<u>508,246,237</u>	<u>20,548,876</u>	<u>(137,299,830)</u>	<u>391,495,283</u>

(c) Fair Values Disclosures

With the exception of the Fintrust and FDF loans shown below, all other financial assets and financial liabilities of the Company are held at fair value.

	2000	2000
	£ million	£ million
First Debenture Finance Loan	34.8	50.6
Fintrust loan	46.9	58.4

(d) Liquidity profile

The maturity profile of the Company's financial liabilities at the 31st January 2000 (being the borrowings from Fintrust, First Debenture Finance, the 5.875% Secured Bond and the 4% Perpetual Debenture stock) is detailed in Note 10—"Current Assets and Creditors" on pages 27 and 28.

(e) Hedging instruments

At the year end the Company had no hedging arrangements in place.

for the year ended 31st January 2000

Risk Review

19. Financial Reporting Standard 13 – Derivatives and other Financial Instruments: Disclosures

The note below should be read in conjunction with the Risk Review of the Company detailed on page 17.

(a) Interest Rate Risk Profile

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

	Currency	Fixed rate interest paid (£)	Floating rate interest paid (£)	Nil interest paid (£)	Total (£)
Financial Assets					
Value affected by changes in interest rates:					
Treasury Stocks	Sterling	26,707,500	—	—	26,707,500
Preference Shares and Bonds	Sterling	19,971,001	—	—	19,971,001
Bonds	US Dollar	15,013,438	—	—	15,013,438
		61,691,939	—	—	61,691,939
Value unaffected by changes in interest rates:					
Equities	Sterling	—	—	446,311,054	446,311,054
Equities	US Dollar	—	—	243,244	243,244
Cash	Sterling	—	—	1,586,682	1,586,682
		—	—	448,140,980	448,140,980
Total Financial Assets		61,691,939	—	448,140,980	509,832,919
Financial Liabilities					
Value affected by changes in interest rates:					
First Debenture Finance loan	Sterling	(34,812,495)	—	—	(34,812,495)
Fintrust loan	Sterling	(46,949,468)	—	—	(46,949,468)
5.875% Secured Bond 2029	Sterling	(29,097,455)	—	—	(29,097,455)
4% Perpetual Debenture Stock	Sterling	(1,375,000)	—	—	(1,375,000)
Total Financial Liabilities		(112,234,418)	—	—	(112,234,418)
Net Financial Assets		(50,542,479)	—	448,140,980	397,598,501
Non financial instruments (consisting of short-term debtors and creditors)					
					(6,103,218)
Net Assets per Balance Sheet					391,495,283

Financial Reporting Standard 13—Derivatives and Other Financial Instruments: Disclosure

Published in September 1998 and applying to accounting periods ending on or after 23rd March 1999, FRS 13 requires entities to disclose narrative and numerical information about the financial instruments they use.

The purpose of these disclosures is to ensure that enough information is provided to investors to enable them to make their own decisions about the risk profile of the entity in which they have invested and to assess for themselves the impact of the use of financial instruments (investments, cash/overdraft and borrowings) on the performance of the entity.

Accordingly, within this year's report are both narrative disclosures discussing risk, and numerical disclosures in Note 19 to the Accounts. These disclosures are in line with the requirements of FRS 13. As an investment trust, the Company invests in securities for the long term. Accordingly it is, and has been throughout the year under review, the Company's policy that no short term trading in investments or other financial instruments shall be undertaken. The main risks arising from the Company's financial instruments are market price risk, liquidity risk and interest rate risk.

Market price risk

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

The Board meets regularly to consider the asset allocation of the portfolio in order to minimise the risk associated with particular industry sectors. A dedicated fund manager has the responsibility for monitoring the existing portfolio selection in accordance with the Company's investment objectives and seeks to ensure that individual stocks meet an acceptable risk reward profile.

Liquidity risk

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

Interest rate risk

The Company invests predominantly in equities, the values of which are not directly affected by changes in prevailing market interest rates.

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

During the year, the Company issued £30 million 5.875% Secured Bonds repayable in 2029. This low cost source of funds is expected to materially enhance the Company's performance, and the cost is expected to be outweighed by the return on equities over the next thirty years.

Foreign currency risk

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

Statement of Total Return

for the year ended 31st January 2000

	2000	2000	2000	1999	1999	1999	1999	1999	1999
	£	Capital	Total	£	Revenue	Capital	Total	£	Total
Net (losses) gains on investments	8	—	(30,408,125)	(30,408,125)	—	10,158,327	10,158,327	—	10,158,327
Exchange rate differences		—	(743)	(743)	—	243	243	—	243
Income	1	22,590,052	—	22,590,052	20,119,042†	—	20,119,042†	—	20,119,042†
Investment management fee	2	(779,436)	(1,447,525)	(2,226,961)	(763,048)	(1,417,089)	(2,180,137)	—	(2,180,137)
Expenses of administration	3	(551,804)	—	(551,804)	(426,891)	—	(426,891)	—	(426,891)
Net return before finance costs and taxation		21,258,812	(31,856,393)	(10,597,581)	18,929,103	8,741,481	27,670,584	—	27,670,584
Finance costs of borrowings	4	(2,650,058)	(4,877,533)	(7,527,591)	(2,385,058)	(4,428,201)	(6,813,259)	—	(6,813,259)
Return on ordinary activities before taxation		18,608,754	(36,733,926)	(18,125,172)	16,544,045	4,313,280	20,857,325	—	20,857,325
Taxation	5	(221,150)	220,411	(739)	(934,134)†	605,508	(328,626)†	—	(328,626)†
Return on ordinary activities after taxation for the financial year		18,387,604	(36,513,515)	(18,125,911)	15,609,911	4,918,788	20,528,699	—	20,528,699
Dividends on Preference Stock		(42,997)	—	(42,997)	(42,997)	—	(42,997)	—	(42,997)
Return attributable to Ordinary Shareholders		18,344,607	(36,513,515)	(18,168,908)	15,566,914	4,918,788	20,485,702	—	20,485,702
Dividends on Ordinary Shares	6	(16,372,630)	—	(16,372,630)	(15,953,081)	—	(15,953,081)	—	(15,953,081)
Transfer to (from) reserves		1,971,977	(36,513,515)	(34,541,538)	(386,167)	4,918,788	4,532,621	—	4,532,621
Return per Ordinary Share	7	17.93p	(35.68)p	(17.75)p	15.21p	4.81p	20.02p	—	20.02p
Net Asset Value	14								
Per Ordinary Share			381.4p				415.2p		415.2p
Per Preference Stock Unit			100.0p				100.0p		100.0p

The revenue column of this statement is the profit and loss account of the Company.

All revenue and capital items in the above statement derive from continuing operations. No operations were acquired or discontinued in the year.

† Restated in accordance with Financial Reporting Standard 16 "Current Taxation" (See Accounting Policy (ii) on page 21)

Notes to the Accounts

for the year ended 31st January 2000

18. Reconciliation of net cash flow to movement in net debt

	2000	1999
	£	£
(Decrease) increase in cash	(6,475,470)	4,558,896
Decrease (increase) in short term loans	497,256	(497,256)
Increase in long-term loans	(29,130,037)	(17,474,520)
Movement in net debt in the period	(35,108,251)	(13,412,880)
Net debt brought forward	(76,684,683)	(63,271,803)
Net debt carried forward	(111,792,934)	(76,684,683)
Represented by:		
Cash at bank and short-term deposits	1,586,682	8,062,152
Stepped and fixed rate loans (including amounts falling due within one year)	(82,853,206)	(82,874,579)
5.875% Secured Bond 2029 (including amounts falling due within one year)	(29,151,410)	—
4% Perpetual Debenture Stock	(1,375,000)	(1,375,000)
Short term loan	—	(497,256)
	(111,792,934)	(76,684,683)

The Notes on pages 21 to 33 form part of these Accounts.

Notes to the Accounts

for the year ended 31st January 2000

Balance Sheet

at 31st January 2000

	2000	2000	2000	1999
	£	£	£	£
Fixed Assets				
Investments		508,246,237		508,503,479
Current Assets				
Debtors	10	18,962,194		14,362,285
Cash at bank	10	1,586,682		8,062,152
		20,548,876		22,424,437
Creditors — Amounts falling due within one year	10	(25,065,412)		(21,738,788)
Net Current (Liabilities) Assets		(4,516,536)		685,649
Total Assets less Current Liabilities		503,729,701		509,189,128
Creditors — Amounts falling due after more than one year	10	(112,234,418)		(83,152,307)
Total Net Assets		391,495,283		426,036,821
Capital and Reserves				
Called up Share Capital:				
Ordinary	11	25,582,234		25,582,234
Preference	11	1,178,000		1,178,000
Share premium account		26,760,234		26,760,234
		39,809		39,809
Capital Reserves: Realised	12	347,584,119		314,035,881
Unrealised	12	6,822,647		76,884,400
Revenue Reserve	13	354,406,766		390,920,281
		10,288,474		8,316,497
Shareholders' Funds	15	391,495,283		426,036,821
Analysis of Shareholders' Funds				
Equity interests	14	390,317,283		424,858,821
Non-equity interests	14	1,178,000		1,178,000
		391,495,283		426,036,821

Approved by the Board of Directors on 3rd April 2000
and signed on its behalf by:

Colin H Black } Directors
Hugh Stevenson }

The Notes on pages 21 to 33 form part of these Accounts

	2000	1999
	£	£
Distributable reserves		
Revenue profit available for distribution	18,387,604	15,609,911
Dividends appropriated in the year	(16,415,627)	(15,996,078)
Transfer to (from) distributable reserves	1,971,977	(386,167)
Other reserves		
Recognised net capital (losses) profits transferred to capital reserves	(36,513,515)	4,918,788
Net (decrease) increase in Shareholders' Funds	(34,541,538)	4,532,621
Opening Shareholders' Funds	426,036,821	421,504,200
Closing Shareholders' Funds	391,495,283	426,036,821

16. Contingent Liabilities and Guarantees

At 31st January 2000 there were no outstanding contingent liabilities (1999 — £nil) in respect of underwriting commitments and calls on partly paid investments.

The Company has guaranteed the repayment of £34,034,112 as detailed in Note 10(i) "Current Assets and Creditors" on page 27. The Company has also agreed to meet its proportionate share of any expenses incurred by FDF, including any tax liability which may accrue to FDF as a result of the redemption or earlier transfer of the Stepped Rate Loan Notes and Bonds held by FDF.

The Company has also guaranteed Halifax Group PLC in respect of an indemnity given by FDF as part of the terms of the Stepped Rate Loan.

17. Reconciliation of Operating Revenue before Taxation to Net Cash Inflow from Operating Activities

	2000	1999
	£	£
Revenue before taxation	18,608,754	16,544,045
Add: Finance costs of borrowings	2,650,058	2,385,058
Less: Management fee charged to capital	(1,447,525)	(1,417,089)
Less: Overseas tax suffered	(739)	(1,033)
Less: UK income tax deducted from unfranked income	(178,299)	(667,960)
	19,632,249	16,843,021
Decrease (increase) in debtors	697,210	(575,362)
Increase in creditors	612,830	114,805
Net cash inflow from operating activities	20,942,289	16,382,464

Cash Flow Statement

Notes to the Accounts

for the year ended 31st January 2000

for the year ended 31st January 2000

	2000	2000	1999
	£	£	£
Net cash inflow from operating activities		20,942,289	16,382,464
Servicing of finance			
Interest paid	(7,340,354)		(6,625,303)
Preference dividends paid	(42,997)		(21,498)
Net cash outflow on servicing of finance		(7,383,351)	(6,646,801)
Taxation			
UK income tax repaid	47,545		335,116
Advance corporation recovered (paid)	142,667		(241,282)
Net tax repaid		190,212	93,834
Investing Activities			
Payments to acquire fixed asset investments	(444,356,135)		(243,493,665)
Proceeds on disposal of fixed asset investments	412,048,368		235,532,762
Net cash outflow from financial investment		(32,307,767)	(7,960,903)
Equity dividends paid		(16,362,397)	(15,093,518)
Net cash outflow before financing		(34,921,014)	(13,224,924)
Financing			
(Decrease) increase in short term loan	(497,256)		497,256
Issue of Secured Bonds	28,942,800		—
Increase in Fintrust loan	—		12,000,000
Premium received thereon	—		5,286,564
Cash inflow from financing		28,445,544	17,783,820
(Decrease) increase in cash		(6,475,470)	4,558,896

18

12. Capital Reserves

	Realised	Unrealised	Total
	£	£	£
Balance at 1st February 1999	314,035,881	76,884,400	390,920,281
Net gain on realisation of investments	8,314,615	—	8,314,615
Decrease in unrealised appreciation	—	(38,722,740)	(38,722,740)
Transfer on disposal of investments	31,339,013	(31,339,013)	—
Exchange rate differences	(743)	—	(743)
Investment management fee charged to capital	(1,447,525)	—	(1,447,525)
Finance costs of borrowings charged to capital	(4,877,533)	—	(4,877,533)
Attributable taxation in respect of management fee and finance costs	220,411	—	220,411
Balance at 31st January 2000	347,584,119	6,822,647	354,406,766

13. Revenue Reserve

Balance at 1st February 1999	8,316,497
Revenue retained for the year	1,971,977
Balance at 31st January 2000	10,288,474

14. Net Asset Value per Share

The Net Asset Value per share (which equals the net asset values attributable to each class of share at the year end calculated in accordance with the Articles of Association) were as follows:

	2000	1999
Ordinary Shares of 25p	381.4p	415.2p
3.65% Cumulative Preference Stock Units of £1	100.0p	100.0p
Net Asset Value per Share attributable		
	£	£
Ordinary Shares of 25p	390,317,283	424,858,821
3.65% Cumulative Preference Stock Units of £1	1,178,000	1,178,000

The movements during the year of the assets attributable to each class of share were as follows:

	Ordinary Shares	Cumulative Preference Stock	Total
	£	£	£
Total net assets attributable at 1st February 1999	424,858,821	1,178,000	426,036,821
Total return on ordinary activities after taxation for the year	(18,168,908)	42,997	(18,125,911)
Dividends appropriated in the year	(16,372,630)	(42,997)	(16,415,627)
Total net assets attributable at 31st January 2000	390,317,283	1,178,000	391,495,283

The Net Asset Value per Ordinary Share is based on 102,328,936 Ordinary Shares in issue at the year end (1999 – 102,328,936).

The Notes on pages 21 to 33 form part of these Accounts.

Notes to the Accounts

for the year ended 31st January 2000

10. Current Assets and Creditors (continued)

(iii) During the year the Company issued £30,000,000 5.875% Secured Bonds 2029 at 97.241%. The consideration received after issue costs amounted to £28,942,800. The Bonds, repayable on 20th December 2029, carry interest at the rate of 5.875% per annum on the principal amount payable in arrears by equal half yearly instalments on 20th June and 20th December in each year. As security for this loan the Company has granted a floating charge over the whole of the present and future undertakings, property, assets and rights of the Company.

The accounting treatment adopted in respect of the Bond is set out in the Statement of Accounting policies.

(iv) The 4% Perpetual Debenture Stock is secured by a floating charge on the assets of the Company, which ranks prior to any other floating charge.

(v) Interest on borrowings consists of interest on the following:

	2000 £	1999 £
Stepped Rate Interest Loan	312,003	313,727
Fixed Rate Interest Loan	779,240	783,545
5.875% Secured Bond 2029	53,955	—
4% Perpetual Debenture Stock	13,750	13,750
	<u>1,158,948</u>	<u>1,111,022</u>

11. Share Capital

	2000 £	1999 £
Authorised		
1,178,000	1,178,000	1,178,000
3.65% Cumulative Preference Stock Units of £1	<u>26,857,812</u>	<u>26,857,812</u>
107,431,248 Ordinary Shares of 25p		
Allotted and fully paid		
1,178,000	1,178,000	1,178,000
102,328,936 Ordinary Shares of 25p	<u>25,582,234</u>	<u>25,582,234</u>
	<u>26,760,234</u>	<u>26,760,234</u>

(i) The Cumulative Preference Stock Units have been classified as non-equity interests in shareholders' funds under the provisions of FRS 4 on Capital Instruments. The rights of the Stock to receive payments are not calculated by reference to the Company's profits and, in the event of a return of capital are limited to a specific amount, being £1,178,000.

Dividends on the Preference Stock are payable half yearly on 1st August and 1st February.

(ii) The Directors are authorised by an ordinary resolution passed on 15th May 1995 to allot relevant securities, in accordance with Section 80 of the Companies Act 1985, up to a maximum aggregate nominal amount of £1,275,578. This authority, if not previously revoked or varied, expires five years from the date of the resolution and a resolution will be proposed at the Annual General Meeting for its renewal.

The Directors are also authorised by a special resolution passed on 10th May 1999 to allot relevant securities for cash, in accordance with Section 95 of the Companies Act 1985, up to a maximum aggregate nominal amount of £1,275,578. This authority, if not previously revoked or renewed expires at the next annual General Meeting and a resolution will be proposed at the Annual General Meeting for its renewal.

Statement of Accounting Policies

for the year ended 31st January 2000

(i) The financial statements have been prepared under the historical cost convention, modified to include the revaluation of investments, and in accordance with applicable accounting standards. The financial statements have been prepared in accordance with the Statement of Recommended Practice – "Financial Statements of Investment Trust Companies".

(ii) Income – Dividends are accounted for on an ex-dividend basis and foreign dividends are stated gross of withholding tax. Following the publication of Financial Reporting Standard (FRS) 16 "Current Taxation", which the Company is adopting early, UK equity dividends are now accounted for net of any tax credit (previously UK dividends were grossed up including the appropriate rate of tax). The 1999 comparative figures have therefore been restated to comply with FRS 16. As a result, both dividends from UK investments and UK taxation have been reduced by £2,333,770 (1999 – £2,941,840). Income from convertible securities, fixed returns on non-equity shares, and deposit interest receivable are accounted for on an accruals basis. Underwriting commission is recognised when the issue underwritten closes.

Where the Company has elected to receive its dividends in the form of additional shares rather than in cash, the amount 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.

(iii) Investment management fee – The investment management fee is calculated on the basis set out in Note 2 and is charged to capital and revenue in the ratio 65:35 to reflect the Company's investment policy and prospective capital and income return.

(iv) Valuation – Investments listed in the United Kingdom have been valued at middle market prices. Those listed abroad have been valued at closing or middle market prices as available. Unlisted investments are valued by the Directors based upon the latest dealing prices, stockbrokers' valuations, net asset values, earnings and other known accounting information. Unrealised differences between the value and book cost of investments at the year end are taken to the Unrealised Capital Reserve.

Net gains or losses arising on realisations of investments are taken directly to the realised Capital Reserve.

(v) Finance costs – In accordance with Financial Reporting Standard 4 "Capital Instruments", long term borrowings are stated at the amount of net proceeds immediately after issue plus the appropriate accrued finance costs at the balance sheet date. The finance costs of such borrowings, being the difference between the net proceeds of a borrowing and the total payments that may be required in respect of that borrowing, are allocated to periods over the term of the debt at a constant rate on the carrying amount. Finance costs on long term borrowings together with related tax relief are charged to the Capital Reserve and Revenue Account in the ratio 65:35 to reflect the Company's investment policy and prospective capital and income return.

(vi) Taxation – Where expenses are allocated between capital and revenue, any tax relief obtained in respect of those expenses is allocated between capital and revenue in the same proportion as the expenses are allocated, using the Company's effective rate of corporation tax for the accounting period.

Deferred taxation, where applicable, is provided for on the liability method on all timing differences which are expected to crystallise in the foreseeable future, calculated at the rate at which it is estimated that the tax liability or asset will accrue.

(vii) Foreign currency – Transactions in foreign currencies are translated into sterling at the rates of exchange ruling on the date of the transaction. Foreign currency assets and liabilities are translated into sterling at the rates of exchange ruling at the balance sheet date. Profits and losses thereon are recognised in capital reserves.

Notes to the Accounts

for the year ended 31st January 2000

Notes to the Accounts

for the year ended 31st January 1999

1. Income

	2000	1999
	£	£
Income from Investments		
Equity income from UK investments	19,408,241	12,223,366†
Special dividends from UK investments	1,335,600	—
Unfranked income:		
Interest from UK fixed income securities	926,532	3,270,501
Dividends from overseas equity securities	70,969	166,927
Interest from overseas fixed income securities	202,100	3,298
Foreign income dividends from UK equity securities	412,540	3,968,618
	1,612,141	7,409,344
	22,355,982	19,632,710
Other income		
Deposit interest	222,707	470,439
Underwriting commission	11,363	15,893
	234,070	486,332
Total income	22,590,052	20,119,042
	22,343,243	19,571,308
	12,739	61,402
	22,355,982	19,632,710

†Restated in accordance with Financial Reporting Standard 16 "Current Taxation" (see Accounting Policy (ii) on page 21).

2. Investment Management Fee

	2000	2000	1999	1999
	£	£	£	£
	Revenue	Capital	Revenue	Capital
Investment management fee	779,436	1,447,525	763,048	1,417,089
	Total	Total	Total	Total
	2,226,961	2,226,961	2,180,137	2,180,137

The management contract with Dresdner RCM Global Investors (UK) Ltd ("Dresdner RCM"), terminable at one year's notice, provides for a management fee based on 0.35% (1999 – 0.35%) per annum of the value of the Company's assets calculated quarterly after deduction of current liabilities, short-term loans under one year and any funds within the portfolio managed by Dresdner RCM. The amounts stated include irrecoverable VAT of £331,675 (1999 – £324,701). Under the contract Dresdner RCM provides the Company with investment management, accounting, secretarial, administration and custodial services.

10. Current Assets and Creditors (continued)

Note

	2000	1999
	£	£
Creditors: Amounts falling due within one year –		
Purchases for future settlement	14,137,445	10,984,554
Short term loan	—	497,256
Other creditors	1,458,876	846,046
Interest on borrowings (see (v) below)	1,158,948	1,111,022
Dividend on Cumulative Preference Stock Units	21,499	21,499
Dividends on Ordinary Shares paid	4,144,322	4,441,076
Dividend on Ordinary Shares (proposed)	4,144,322	3,837,335
	6	
	25,065,412	21,738,788
Creditors: Amounts falling due after more than one year –		
Stepped Rate Interest Loan (see (i) below)	34,812,495	34,733,593
Fixed Rate Interest Loan (see (ii) below)	46,949,468	47,043,714
5.875% Secured Bonds 2029 (see (iii) below)	29,097,455	—
4% Perpetual Debenture Stock (see (iv) below)	1,375,000	1,375,000
	112,234,418	83,152,307

(i) The Stepped Rate Interest Loan comprises adjustable Stepped Rate Interest Loan Notes of £5,133,520 and Stepped Rate Interest Bonds of £20,534,079 issued at 97.4%. £34,034,112 is repayable in 2018 inclusive of a premium of £8,366,513 but exclusive of any redemption expenses. Interest, payable on the Bonds in July and January, was an initial rate of 7.16% per annum increasing annually by 7.5% compound until January 1998, thereafter it became payable at 14.75% per annum until maturity on 2nd January 2018. Interest on the Loan Notes is variable by the lender, First Debenture Finance PLC ("FDF"), in accordance with the terms of the agreement. A floating charge has been granted over all the Company's present and future assets, guaranteeing the repayment of £34,034,112 being its proportionate share (42.52%) of the required amount to enable FDF to meet all of its liabilities to repay principal and interest on its £80 million of 11.125% Severally Guaranteed Debenture Stock 2018. The accounting treatment adopted in respect of the stepped rate interest and redemption premium is set out in the Statement of Accounting Policies.

(ii) The Fixed Rate Interest Loan of £42,000,000 is due to Fintrust Debenture PLC ("Fintrust"). This loan is repayable in 2023 and carries interest at the rate of 9.25125% per annum on the principal amount payable in arrears by equal half yearly instalments on 20th May and 20th November in each year. As security for this loan, the Company has granted a floating charge over all its undertakings, property and assets in favour of the lender. This charge ranks pari passu with the floating charge noted in (i) above.

Following the liquidation of Kleinwort Overseas Investment Trust plc ("KOIT") in March 1998, the Company assumed £12,000,000 of its obligations to Fintrust. Both the interest cost and repayment terms of this additional borrowing are identical to the Company's existing loan. In order that the finance costs on this new borrowing be comparable to existing market rates at that time, the Company also received a premium payment from KOIT of £5,286,564. This premium is being amortised over the remaining life of the loan in accordance with FRS 4, as set out in the Statement of Accounting Policies. At 31st January 2000, the unamortised premium included within the Fixed Rate Interest Loan balance of greater than one year amounted to £5,082,626. The original loan from Fintrust is stated at net proceeds (being the principal amount of £30,000,000 less issue costs of £141,053) plus accrued finance costs.

Notes to the Accounts

for the year ended 31st January 2000

9. Investments in Subsidiary and Other Companies

Surrey Investments Inc. is a wholly owned subsidiary registered in the State of Delaware, U.S.A. with an issued share capital of US\$300,000. It was formed to act as a Limited Partner in JW O'Connor Associates LP and a shareholder in JW O'Connor & Co Inc., both of which are engaged in property development in the US and the aggregate of which has been included in the Company's unlisted holdings. It has no other material assets or liabilities. There were no balances outstanding between the Company and Surrey Investments Inc. at 31st January 2000 nor have there been any transactions between them during the year ended at that date.

The Company has not produced consolidated accounts in view of the immaterial amounts involved.

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

Company	Class of Shares Held	% of Class held	% Equity
First Debenture Finance PLC ('FDF')	'B' Shares	41.0	20.4
Fintrust Debenture PLC ('Fintrust')	Ordinary	49.5	49.5

In the opinion of the Directors, the Company is not in a position to exert significant influence over these companies. The aggregate share capital, reserves and results are immaterial and they have been accounted for as investments at nil value. FDF and Fintrust are the lenders of the Company's Stepped Rate Loan and Fixed Rate Interest Loan, as detailed in notes 10(i) and (ii), respectively. The finance costs of these borrowings and outstanding balances at the year end are shown in notes 4 and 10 respectively. Apart from the finance costs there were no other transactions between FDF, Fintrust and the Company during the year.

10. Current Assets and Creditors

	2000	1999
	£	£
Debtors—		
Sales for future settlement	16,289,342	10,980,310
Accrued income	2,476,885	3,203,845
Other debtors	53,152	23,402
Taxation recoverable	142,815	154,728
	<u>18,962,194</u>	<u>14,362,285</u>
Cash at bank—		
Sterling bank balances—		
Current account	125,724	109,994
Deposit accounts		
Barclays Bank plc	342,044	2,156,344
Kleinwort Benson Investment Management Ltd	1,118,914	5,795,814
	<u>1,586,682</u>	<u>8,062,152</u>

Notes to the Accounts

for the year ended 31st January 2000

3. Expenses of Administration

	2000	1999
	£	£
Directors' fees	76,915	75,000
Auditors' remuneration for audit services	11,860	10,677
Marketing expenses	167,630	89,917
"its" campaign costs	99,168	—
Other administrative expenses	196,231	251,297
	<u>551,804</u>	<u>426,891</u>

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

(ii) Included in other administrative expenses is £2,408 payable to the Auditors in respect of non-audit services (1999 – £74,947).

(iii) Directors' fees are paid at the rate of £10,000 (1999 – £10,000) per annum with an additional sum of £3,000 (1999 – £3,000) with effect from 10th May 1999) per annum paid to the Chairman of the Audit Committee and an additional sum of £5,000 (1999 – £5,000) increased from £2,000 on 10th May 1999) per annum paid to the Chairman.

4. Finance Costs of Borrowings

	2000	2000	1999	1999
	Revenue	Capital	Revenue	Capital
	£	£	£	£
On Stepped Rate Interest Loan repayable after more than five years	1,205,200	2,238,229	1,084,798	2,014,624
On Fixed Rate Interest Loan repayable after more than five years	1,328,899	2,467,957	1,280,368	2,377,827
On 4% Perpetual Debenture Stock repayable after more than five years	19,250	35,750	19,250	35,750
On 5.875% Secured Bonds repayable after more than 5 years	73,014	135,597	—	—
On sterling overdraft	23,695	—	642	—
	<u>2,650,058</u>	<u>4,877,533</u>	<u>2,385,058</u>	<u>4,428,201</u>
		<u>7,527,591</u>		<u>6,813,259</u>

5. Taxation

	2000	2000	1999	1999
	Revenue	Capital	Revenue	Capital
	£	£	£	£
Credit for expenses allocated to capital	220,411	(220,411)	719,997	(719,997)
Overseas taxation	739	—	1,033	—
Advance corporation tax written off	—	—	98,615	—
Under provision of tax for previous year	—	—	114,489	114,489
	<u>221,150</u>	<u>(220,411)</u>	<u>934,134</u>	<u>(605,508)</u>
		<u>739</u>		<u>328,626</u>

Notes to the Accounts

for the year ended 31st January 2000

6. Dividends on Ordinary Shares

	2000	2000	1999
	£	£	£
Dividends on Ordinary Shares of 25p—			
First interim 3.95p paid 24th August 1999 (1998 – 3.75p)	4,041,993	3,837,335	3,837,335
Second interim 3.95p paid 10th November 1999 (1998 – 3.75p)	4,041,993	3,837,335	
Third interim – ordinary dividend – 4.05p paid 22nd February 2000 (1999 – 1.36p) – foreign income dividend – nil (1999 – 2.98p)	4,144,322	1,391,674 3,049,402	4,441,076
Final proposed – ordinary dividend 4.05p payable 18th May 2000 (1999 – 3.75p)	4,144,322	3,837,335	
	16,372,630	15,953,081	

Ordinary dividends paid by the Company carry a tax credit of 10%. The credit discharges the tax liability of shareholders subject to income tax at less than the higher rate. Shareholders liable to pay tax at the higher rate will have further tax to pay. PEP and ISA holders may be able to reclaim this tax credit and charities are subject to transitional provisions.

7. Return per Ordinary Share

	2000	2000	1999	1999
	£	£	£	£
Return after taxation	18,387,604	(36,513,515)	15,609,911	20,528,699
Attributable to Preference Stockholders	(42,997)	—	(42,997)	(42,997)
Attributable to Ordinary Shareholders	18,344,607	(36,513,515)	15,566,914	20,485,702
Return per Ordinary Share	17.93p	(35.68)p	15.21p	20.02p

The return per Ordinary Share is based on 102,328,936 Ordinary Shares of 25p in issue (1999 – 102,328,936).

Notes to the Accounts

for the year ended 31st January 2000

8. Fixed Asset Investments

	2000	1999
	£	£
Listed at market valuation on recognised Stock Exchanges—		
United Kingdom	501,741,736	505,428,621
Abroad	6,261,257	2,352,492
	508,002,993	507,781,113
Unlisted at Directors' valuation—		
Abroad	35,359	517,253
Subsidiary at Directors' valuation	207,885	205,113
	243,244	722,366
Total fixed asset investments	508,246,237	508,503,479
Market value of investments brought forward	508,503,479	488,598,653
Unrealised gains brought forward	(76,884,400)	(130,606,995)
Cost of investments held brought forward	431,619,079	357,991,658
Additions at cost	447,509,026	251,939,839
Disposals at cost	(377,704,515)	(178,312,418)
Cost of investments held at 31st January	501,423,590	431,619,079
Unrealised gains at 31st January	6,822,647	76,884,400
Market value of investments held at 31st January	508,246,237	508,503,479
Gains on investments		
Net realised gains based on historical costs	39,653,628	63,880,922
Less: Net unrealised gains recognised on these investments at the previous balance sheet date	(31,339,013)	(48,857,237)
Net realised gains based on carrying value at previous balance sheet date	8,314,615	15,023,685
Net unrealised losses arising in the year	(38,722,740)	(4,865,358)
Net (losses) gains on investments	(30,408,125)	10,158,327

The Board considers that none of the Company's unquoted investments were individually material (or in aggregate) to the financial statements. In addition, no material disposals of unquoted investments took place during the year.