Report and Accounts for the year ended 31st January 2002

Dresdner RCM Global Investors | Investment Trusts

The Merchants Trust PLC

www.merchantstrust.co.uk

its investment trusts
the easy way to invest in the stock market

Dresdner RCM Global Investors

Contents

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 Growth and Income 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	**2002**	**2001**	**% change**
Revenue	£21,595,671	£21,546,258	+0.2
Available for Ordinary Dividend	£17,051,644	£16,714,573	+2.0
Earnings per Ordinary Share	16.70p	16.35p	+2.1
Dividend per Ordinary Share	16.80p	16.40p	+2.4
Key Data as at 31st January			
Total Net Assets	£422,160,624	£474,906,733	–11.1
Net Asset Value per Ordinary Share	412.3p	463.5p	–11.0
Ordinary Share Price	392.0p	411.3p	–4.7
Discount of Net Asset Value to Ordinary Share Price	4.9%	11.3%	n/a

Investor Information

Results

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

Ordinary Dividends

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

Preference Dividends

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

Dividend Payment Schedule for the years ended:

		Dividend	Payment Date
31 January 1998	First Interim	2.35p	09.06.97
	Second Interim	4.65p	18.11.97
	Third Interim	3.50p	26.02.98
	Final	3.75p	20.05.98
31 January 1999	First Interim	3.75p	21.08.98
	Second Interim	3.75p	18.11.98
	Third Interim	4.34p‡	22.02.99
	Final	3.75p	19.05.99
31 January 2000	First Interim	3.95p	24.08.99
	Second Interim	3.95p	10.11.99
	Third Interim	4.05p	22.02.00
	Final	4.05p	18.05.00
31 January 2001	First Interim	4.10p	24.08.00
	Second Interim	4.10p	10.11.00
	Third Interim	4.10p	16.02.01
	Final	4.10p	17.05.01
31 January 2002	First Interim	4.20p	10.08.01
	Second Interim	4.20p	09.11.01
	Third Interim	4.20p	16.02.02
	Final (proposed)	4.20p	14.05.02

‡See page 8 “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 weekly and published on the London Stock Exchange Primark Service. The geographical spread of investments and ten largest holdings are published monthly on the London Stock Exchange Primark Service. They are also available to any enquirer from the Dresdner RCM Investment Trust Helpline or the Dresdner RCM website: www.dresdnerrcm-its.co.uk.

Share Prices

The share prices quoted in London Stock Exchange Daily Official List for 31st January 2002 were 387p-397p.

For CGT indexation purposes at 31st March 1982 the share price, after adjustment for bonus issues, was 48.75p.

Savings Scheme

The Dresdner RCM Global Investors Investment Trusts Savings Scheme 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 Dresdner RCM 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. It manages eleven listed investment trusts, including The Merchants Trust PLC, with total assets under management of some £1.65 billion as at 31st January 2002.

Dresdner RCM Global Investors provides a full range of global, regional and country investment capabilities and asset allocation expertise, assisted by the 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. Following the merger of Dresdner Bank AG and Allianz AG the ultimate parent company of Dresdner RCM Global Investors (UK) Ltd is Allianz AG.

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 Capita 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 Growth and Income

Contact Details

Shareholder Enquiries

Capita 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 0870 1623100 or, if telephoning from overseas, 0044 20 8639 2157. 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 AUKSIP ACIS
Director European Equities, Dresdner RCM Global Investors (UK) Ltd.

Secretary and Registered Office
Nicola Schrager von Altishofen ACIS
10 Fenchurch Street, London EC3M 3LB
Telephone: 020 7475 2700

Deputy Secretary
Kirsten Salt BA (Hons) ACIS

Registered Number 28276

Registrars and Transfer Office
Capita IRG plc
Bourne House, 34 Beckenham Road,
Beckenham, Kent BR3 4TU
Telephone: 0870 1623100 or, if telephoning from overseas, 0044 20 8639 2157

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

Bankers
HSBC Bank PLC
Lloyds TSB Bank plc
Kleinwort Benson Private Bank Limited

Stockbroker
Cazenove & Co. Ltd

The Merchants Trust PLC website
www.merchantstrust.co.uk

Dresdner RCM Investment Trust Helpline
020 7475 5832

Dresdner RCM website
www.dresdnerrcm-its.co.uk

Chairman's Statement

Results

The year ended 31st January 2002 was dominated by difficult and volatile equity markets. A stream of bad news relating to the world economy, to the level of corporate profitability and to individual companies produced a loss of confidence among investors. The tragic events in New York and Washington on 11th September 2001 also led to market declines.

During the year the FTSE 100 Index – the principal benchmark for the Trust – fell by 18%. The Trust's other benchmark, the FTSE 350 Higher Yield Index, fell by 6%. (As I have stated previously, the latter index needs to be treated with caution, since it has a greatly overweight and underweight position in oils and telecoms respectively.)

Against this background there was also a decline in the value of the assets attributable to ordinary shareholders in the Trust – a decline which was increased by the effect of the Trust's gearing in a falling market. I am able to report, however, that, as in the previous year, the Trust's portfolio performed relatively well; the Trust's capital returns were some 6% above the average for the UK Growth and Income investment trust sub-sector as calculated by Datastream. Moreover there was a modest increase in earnings per share, reflecting the underlying quality of the companies in which the Trust invests.

Return on Shareholders' Funds

The net asset value per share fell by 11% from 463.5p to 412.3p. Adjusting for the effect of the Trust's gearing, the underlying fall in net asset value was 7.2%. After taking credit for the Trust's revenues, there was a negative total return on shareholders' funds of 7.4%. The share price fell by 4.7% from 411.25p to 392p.

Net Earnings Per Share

Net earnings per share rose by 2.1% from 16.35p to 16.70p. Shareholders may recall that last year's earnings included 1.21p per share of special dividends. In 2001/02 the equivalent figure was 0.21p per share and, after adjusting for these payments, the underlying growth in earnings per share was 8.9%. This represents a robust performance at a time when dividend payments by companies are under scrutiny and when BT, one of the Trust's major investments, passed its dividend.

Dividends

The Board is recommending a final dividend of 4.2p per share, giving a total of 16.8p for the full year, an increase of just under 2.5% over the dividends for the previous year. The proposed total dividends, costing £17.2m, includes £104,000 transferred from the Trust's revenue reserves. This is in accordance with the policy established by the Board two years ago. The Trust's revenue reserves now stand at £10.1m.

This is the twentieth consecutive year of dividend increases recorded by the Trust. The latest increase in the total dividend payments is broadly in line with the underlying 2.6% increase in the retail prices index over the same twelve months. As at 8th April 2002 the net yield on the Trust's shares at 420p is 4.0%, which compares with the net yield of 2.7% on the FTSE 100 Index.

Repurchase of Shares

As at the date of this report the company has repurchased and cancelled a total of 225,000 shares, including 100,000 during the year under review. This is pursuant to the authorisation renewed by shareholders at last year's Annual General Meeting. The Board is proposing that this authority is renewed again at the forthcoming AGM on 13th May 2002.

The Board

Anthony Forbes will retire from the Board at the conclusion of the forthcoming AGM after nearly eight years as a director. He has had a most distinguished career in the City and we will miss his long experience and wise advice. We wish him every happiness in his retirement.

Prospects

When I wrote to shareholders at the time of the interim results, I stated that the market's volatility was likely to be much greater and persist for much longer than we had expected. This has indeed proved to be the case.

Looking ahead, leading indicators in the US, Europe and the Far East, but not in Japan, are suggesting that the worst has now been seen for this economic cycle. Whilst this suggests that easier monetary policies have in general been successfully implemented, there is considerable doubt as to how rapid any recovery may be. Nevertheless the likelihood is that in 2002 there should be a recovery in earnings and that inflation should remain subdued.

Here in the UK, due to the strength of the service sector and to the continued buoyancy of consumer spending prompted by falling interest rates, we appear to have avoided the severe slowdown in activity seen elsewhere. There remain questions as to the sustainability of the UK's "two-speed" economy, but growth is nevertheless forecast at about 2% for the coming year. In the main, UK listed companies are modestly rated by comparison with equivalent companies overseas and there should be useful opportunities to purchase good quality higher yielding shares in the coming months.

Hugh Stevenson
Chairman
9th April 2002

Historical Record

Years ended 31st January

Revenue and Capital	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
Revenue (£000s)	13,563†*◊	15,514◊	17,466◊	17,351◊	18,769◊	20,399◊	20,119◊	22,590	21,546	21,596
Earnings per share (net)	10.20p†*	11.04p	12.12p	12.41p	13.66p	14.88p	15.21p	17.93p	16.35p	16.70p
Paid net per Share	10.60p	11.00p	11.50p	12.25p	13.65pø	14.25p	15.59p‡	16.00p	16.40p	16.80p
Tax Credit per Share	3.31p	2.75p	2.88p	3.06p	3.41p#	3.56p	3.90p§	1.78p	1.82p	1.87p
Gross Ordinary Dividend	13.91p	13.75p	14.38p	15.31p	17.06p	17.81p	19.49p	17.78p	18.22p	18.67p
Total Net Assets (£000s)	242,331†*	311,127	253,604	303,934◊	335,212	421,504	426,037	391,495	474,907	422,161
Net Assets attributable to Ordinary Capital (£000s)	241,153†*	309,949	252,426	302,756◊	334,034	420,326	424,859	390,317	473,729	420,983
Net Asset Value per Ordinary Share	235.7p†*	302.9p	246.7p	295.9◊	326.4p	410.8p	415.2p	381.4p	463.5p	412.3p
NAV Total Return (%)ˣ	+15.1	+33.2	–14.8	+24.9	+14.9	+30.2	+4.9	–4.3	+25.8	–7.4
Retail Price Index Increase (%)δ	+3.2	+2.8	+2.8	+2.8	+3.1	+2.5	+2.6	+2.1	+1.8	+2.6

Notes

◊ Restated in accordance with Financial Reporting Standard 16 "Current Taxation".

† 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.

ˣ 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.

ø 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.

δ RPIX – excludes the effect of mortgage rates.

Geographical Distribution

	Percentage of Portfolio Investments									
	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
United Kingdom	99.1	99.5	99.5	99.6	99.6	99.8	99.8	99.9	100.0	100.0
North America	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

Thirty Largest Holdings

at 31st January 2002

	Valuation £'000s	%	Unrealised Gain (Loss) over Book Cost £'000s
BP Amoco	34,798	6.36	3,043
HSBC	32,989	6.03	(2,072)
GlaxoSmithkline	28,713	5.25	3,700
HBOS	21,844	4.00	4,746
Shell	19,220	3.52	3,822
Royal Bank of Scotland	16,827	3.08	8,579
Lloyds TSB	14,005	2.56	1,522
Abbey National	13,384	2.45	192
Vodafone	11,723	2.14	(11,758)
Alliance & Leicester	11,686	2.14	4,241
Scottish & Newcastle	10,152	1.86	(2,337)
Imperial Tobacco	10,010	1.83	3,580
British Telecommunications	9,205	1.68	(8,976)
Gallaher	9,031	1.65	3,302
Prudential	8,777	1.61	2,602
CGNU	8,714	1.59	1,373
Sainsbury(J)	8,624	1.58	962
Six Continents	8,257	1.51	656
BOC	8,176	1.50	139
Legal & General	7,888	1.44	(125)
BPB	7,836	1.43	2,083
United Utilities	7,706	1.41	(1,627)
Rio Tinto	7,645	1.40	1,993
Bradford & Bingley	7,340	1.34	700
Royal & Sun Alliance	7,009	1.28	(4,659)
Lattice	6,950	1.27	401
Wolseley	6,934	1.27	1,982
George Wimpey	6,840	1.25	2,879
Rank	6,797	1.24	900
Allied Domecq	6,682	1.22	2,578
	365,762	66.89	% of Total Invested Funds

Investment Managers' Review

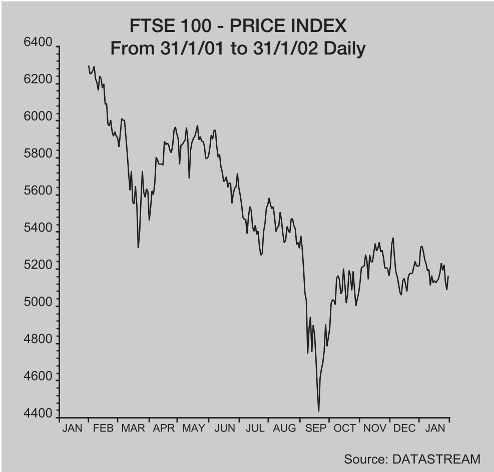
Economic Background

The unusual aspect of the UK economy in the last year has been the predictability of the key economic indicators. Despite the contrast between the buoyant consumer sector and tough conditions for manufacturing, both growth and inflation have been in line with most expectations at about 2%. Much of the credit for this state of affairs must go to the actions of the Monetary Policy Committee, which cut interest rates sharply from 6% to 4% in the face of the slowdown in overseas economies and the terrorist atrocities in the US in September. The easing of monetary policy was in line with, but much less extreme than, the rate cuts seen in the US where Fed Funds were cut from 6% to 1¾% during 2001.

The trends in the UK are all the more remarkable given the extent of the slowdown in growth seen elsewhere. Inevitably this has been at the expense of the UK's overseas trade current account, where the rise in the deficit, coupled with the 6% growth in UK retail sales, has led fixed interest markets to expect a rise in UK base rates later in 2002. In this climate, overall profit growth for UK companies has been dull, but there have been extremes of performance depending on the nature of individual companies and also their market positions. Defensive companies in general have done well. The foreign exchanges have influenced corporate profits, with US revenues and profits gaining from the strength in the dollar, but with interests elsewhere suffering from weakness in the Euro and most Far Eastern currencies.

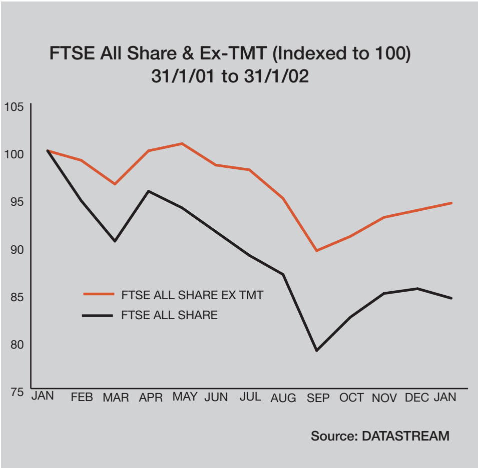
Market Trends

Despite some recovery towards the end of the financial year, the last twelve months has been disappointing overall for investors. As the first chart on this page shows, the FTSE 100 Index drifted off in the first half. This was in response to adverse trends in overseas economies and markets. A rally in April did not prove to be sustainable, and the Index fell back to its March low, at just above 5200, in July. The terrorist attacks in September led to a further rapid fall in values with the FTSE 100 Index closing at just above 4400 on the 21st of that month.



The following two months saw a very sharp recovery in values, largely prompted by an aggressive easing of monetary policy in all Western economies. Central Banks were intent on sustaining growth rather than containing inflation. The year ended in a quiet fashion with the FTSE 100 index in a trading range just above the 5000 level.

Looking at sector performances, the impact of the further decline in the "new economy" components can be seen in the second graph on page 11, which shows the market excluding Telecoms, Media and Technology (TMT). For this latter index the total return, including dividends, was of the order of –5.6%, compared with –15.6% for the FTSE All Share Index. Of note were returns recorded by Information Technology (–70.1%), Telecoms (–48.4%) and Media (–38.3%). In contrast the market leaders included Tobacco (+35.2%), Beverages (+21.9%) and Retailers (+21.5%). As in the past, the portfolio has put greater emphasis on the latter grouping, thus protecting shareholders from the worst of the market decline.



Portfolio Changes

The fundamental structure of the portfolio has meant that, in broad terms, it was well placed to show defensive qualities in the above market environment. Nevertheless it was necessary to review a number of investments, where it appeared that the companies concerned were vulnerable to these trends. Accordingly it was decided to dispose of all the holdings in Amvescap, Carlton Communications, ICI, Reuters and WPP. Additionally there was a complete disposal of the holding in Man Group, the specialist fund management group, following its substantial appreciation. Lastly in terms of significant disposals, the holding in mm02, which incorporates BT's mobile telephone interests, was sold following its de-merger from its parent.

In the last year there have been a number of opportunities to add to existing holdings, particularly in the banking sector, on attractive yields. Such purchases included Halifax (now HBOS), Lloyds TSB and Royal Bank of Scotland as well as additions to Gallaher and Lattice. The latter two additions can be categorised by the defensiveness of their earnings at a time of economic uncertainty. Other new investments of a defensive nature included AstraZeneca, the leading pharmaceutical group, and Northern Foods, a key supplier to the UK's major supermarket chains. There were purchases of two recovery situations in the cases of BPB and Rank, where new management and changed market circumstances are exerting a positive influence. The Trust also invested in Woolworths, following its de-merger from the Kingfisher Group.

Regarding corporate activity, the take-over of Beazer by Persimmon benefited the portfolio, along with the latter's appreciation following completion. In addition the merger of Bank of Scotland and Halifax had a similar advantageous impact. Lastly the Trust crystallised useful gains during the year through shorter-term holdings in Misys and the London Stock Exchange.

Future Policy

Although established UK company shares have out-performed the market as a whole, the fall in their value means that many such shares are now lowly rated by recent standards. Clearly there is a need to be very conscious of their balance sheet and cashflow characteristics, especially in the light of the current debate over accounting and auditing standards.

Given the likely persistence of low inflation, and therefore lower nominal returns from equities, yield is becoming a more important factor for investors. Although there have been some high-profile reductions in individual dividend payments, the overall trend has remained reasonably robust, largely through payments by the financial sector. There are grounds for a little more optimism overall and an improved economic environment should follow through to increased dividend payments from the quoted sector as a whole.

United Kingdom Listed Holdings

at 31st January 2002

	Value (£)	Principal Activities
BP Amoco	34,798,000	Oil exploration and production
HSBC	32,988,800	Banking
GlaxoSmithkline	28,713,000	Pharmaceuticals
HBOS	21,843,597	Banking
Shell	19,220,000	Oil and gas
Royal Bank of Scotland	16,826,552	Banking
Lloyds TSB	14,004,500	Banking
Abbey National	13,384,051	Banking
Vodafone	11,723,250	Telecommunications
Alliance & Leicester	11,686,100	Banking
Scottish & Newcastle	10,152,000	Brewing and leisure
Imperial Tobacco	10,010,000	Tobacco
British Telecommunications	9,204,500	Telecommunications
Gallaher	9,031,050	Tobacco
Prudential	8,777,250	Life and general insurance
CGNU	8,714,300	Life and general insurance
Sainsbury(J)	8,624,000	Food retailing
Six Continents	8,257,000	Leisure and hotels
BOC	8,176,000	Industrial gases
Legal & General	7,887,500	Life and general insurance
BPB	7,835,520	Building materials
United Utilities	7,705,600	Water
Rio Tinto	7,645,000	Mining
Bradford & Bingley	7,339,846	Banking
Royal & Sun Alliance	7,008,750	Life and general insurance
Lattice	6,950,125	Gas distribution
Wolseley	6,934,200	Building materials distribution
Wimpey	6,840,000	Housebuilding
Rank	6,797,250	Leisure and gaming
Allied Domecq	6,681,575	Spirits and food
Wilson Connolly	6,629,970	Housebuilding
Tate & Lyle	6,396,000	Sugar
Anglo American	6,349,250	Mining
Land Securities	6,326,250	Property
BAA	6,315,000	Airports and retailing
Hilton	6,141,750	Betting and hotels
AstraZeneca	5,687,500	Pharmaceuticals
Standard Chartered	5,572,095	Banking
Boots	5,542,000	Retailing
Associated British Ports	5,310,500	Transport and storage
General Universal Stores	5,292,000	Retailing
Safeway	5,285,000	Food retailing
Scottish Power	5,255,250	Electricity
Northern Foods	5,253,000	Food
Tomkins	5,023,500	Engineering
RMC	4,826,250	Building materials
Next	4,821,421	Retailing

United Kingdom Listed Holdings

at 31st January 2002

	Value (£)	Principal Activities
FKI	4,800,000	Engineering
3i Group	4,596,000	Investment company
Kingfisher	4,528,125	Retailing
Scottish & Southern Energy	4,354,000	Electricity
BBA	4,352,000	Engineering
Britannic	4,312,500	Life insurance
*Airtours	4,197,155	Travel
United Business Media	4,188,502	Media
Rexam	4,173,000	Consumer packaging
Pennon	4,148,000	Water
Persimmon	3,948,768	Housebuilding
Slough Estates	3,914,431	Property
Close Bros	3,901,125	Banking
Morgan Crucible	3,580,000	Engineering
EMI	3,360,000	Media
Lonmin	3,181,500	Mining
Woolworths	3,143,374	Retailing
Provident	3,118,800	Consumer lending
Schroders	3,024,600	Fund management
National Grid	2,806,250	Electricity
Exel	2,772,000	Logistics
Severn Trent	2,639,997	Water
Johnson Matthey	1,642,428	Chemicals
Marconi	285,843	Telecommunications equipment
	£546,754,450	

*Consists of Convertible Bonds

Performance Attribution Analysis

For the year ended 31st January 2002

	%	%
Capital return on FTSE 100 Index		(18.0)
Relative return from Portfolio		10.8
Change in total assets		(7.2)
Impact of gearing		(2.3)
Expenses charged to capital		(1.5)
Impact of repurchases of shares		0.0*
Change in Net Asset Value per Ordinary Share		(11.0)

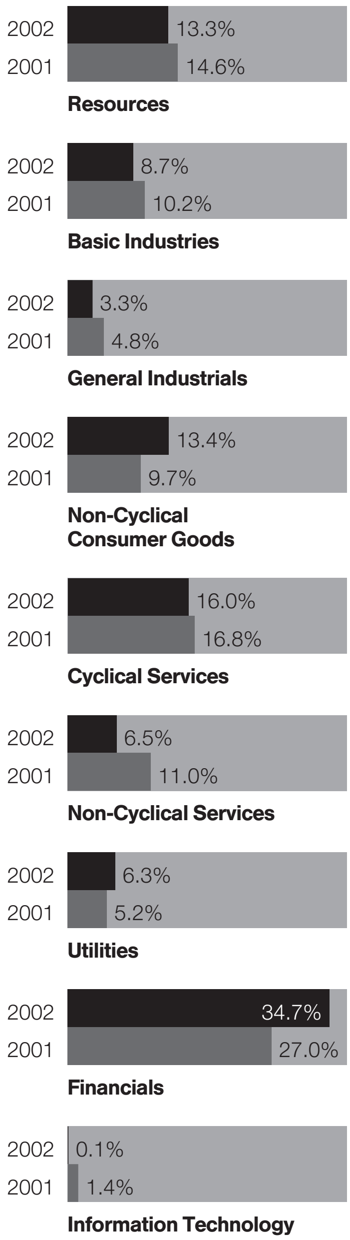
*Share repurchases had a minimal impact in 2001/2002

Distribution of Total Assets

at 31st January 2002

Total Assets (less creditors falling due within one year) £534,248,098 (2001: £586,989,188)

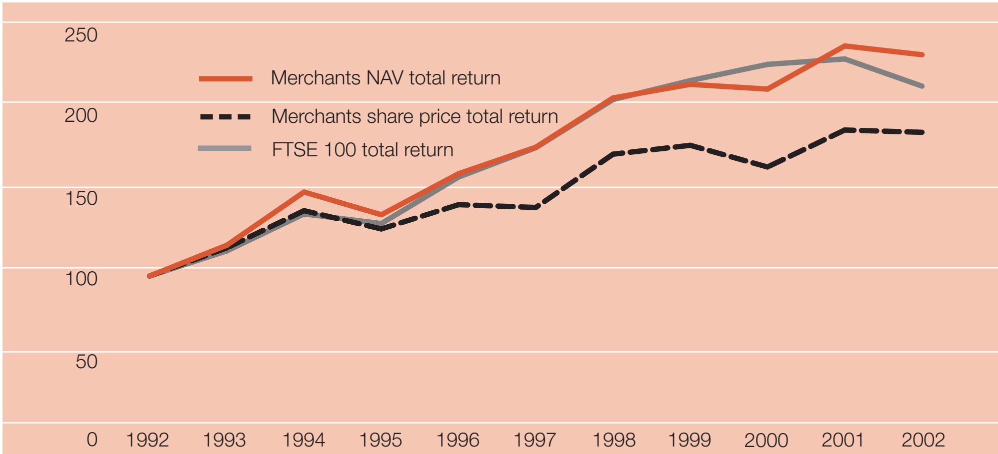
	Percentage of Total Assets 2002	2001
Equities (including convertibles)		
Resources		
Mining	3.2	3.5
Oil and gas	10.1	11.1
	13.3	14.6
Basic Industries		
Chemicals	1.8	3.0
Construction & building materials	6.9	6.7
Steel & other metals	0.0	0.5
	8.7	10.2
General Industrials		
Aerospace & defence	0.0	1.0
Engineering & machinery	3.3	3.8
	3.3	4.8
Non-Cyclical Consumer Goods		
Beverages	1.3	1.2
Food products & process	2.2	1.5
Pharmaceuticals	6.4	4.0
Tobacco	3.5	3.0
	13.4	9.7
Cyclical Services		
General retailers	4.4	4.6
Leisure, entertainment & hotels	6.7	4.0
Media & photography	1.4	4.2
Support services	0.8	0.0
Transport	2.7	4.0
	16.0	16.8
Non-Cyclical Services		
Food & drug retail	2.6	1.9
Telecommunication services	3.9	9.1
	6.5	11.0
Utilities		
Electricity	2.3	2.7
Gas distribution	1.3	0.8
Water	2.7	1.7
	6.3	5.2
Financials		
Banks	23.1	17.2
Insurance	1.3	1.9
Life assurance	5.6	4.2
Investment companies	0.9	0.0
Real estate	1.9	2.1
Speciality & other financials	1.9	1.6
	34.7	27.0
Information Technology		
Information technology hardware	0.1	1.4
	0.1	1.4
Total Equities	102.3	100.7
Net Current Liabilities	(2.3)	(0.7)
Total Assets	100.0	100.0



Performance Graphs

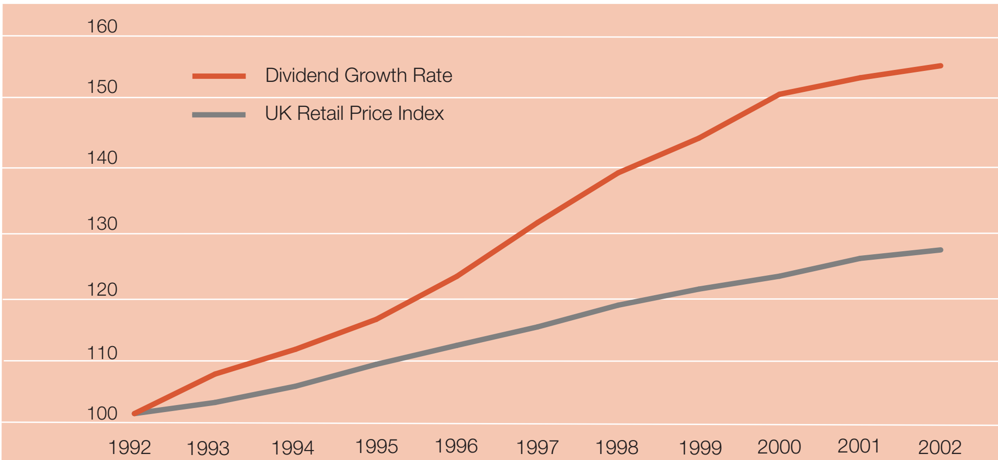
10 year record—as at 31st January

Merchants Total Return compared to FTSE 100 Total Return



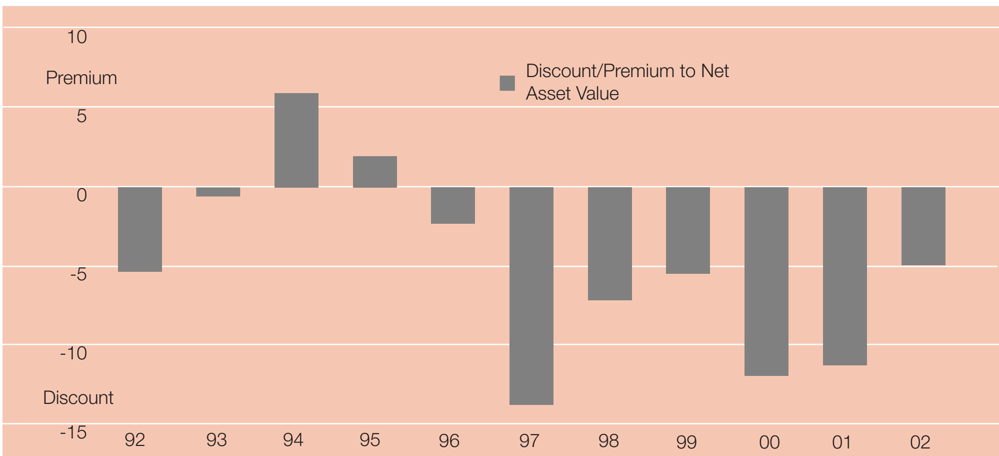
(Rebased to 100, net income reinvested) Source: Datastream

Merchants Net Dividend Growth compared to Inflation*



***excluding FID enhancements (see page 8 for details)**
(Rebased to 100) Source: Dresdner RCM/Datastream

Merchants Share Price Discount/Premium to Net Asset Value



Risk Review

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

FRS 13 requires entities to disclose narrative and numerical information about the financial instruments that they use.

This information is given so that investors in the Company can decide for themselves whether their investment is high or low risk. It also allows them to assess what kind of impact the use of financial instruments (investments, cash/overdraft and borrowings) will have on the performance of the entity. Short term debtors and creditors are not considered to be financial instruments. They have been included at the bottom of the numerical disclosure in Note 20(a) merely to enable users of the accounts to reconcile the summary provided to total net assets per the balance sheet.

The narrative below explains the different types of risks the Company may face. Numerical disclosures are listed in Note 20 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. The risk profile and the policies adopted to manage risk did not change materially during either the current or the previous period.

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 evaluate 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 can be achieved through the use of overdraft facilities where necessary.

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.

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.

Credit risk

In February 2000 the Trust commenced stock lending in order to generate additional income. The risk of default is managed by holding collateral, in the form of sterling letters of credit and FTSE 100 equities amounting to 105% of the mid value of the stock on loan. The level of collateral required is recalculated on a daily basis.

Statement of Total Return

for the year ended 31st January 2002

	Note	2002 £ Revenue	2002 £ Capital	2002 £ Total	2001 £ Revenue	2001 £ Capital	2001 £ Total
Net (losses) gains on investments	8	—	(45,049,190)	(45,049,190)	—	89,852,702	89,852,702
Exchange rate differences		—	(47,836)	(47,836)	—	1,158,076	1,158,076
Income	1	21,595,671	—	21,595,671	21,546,258	—	21,546,258
Investment management fee	2	(805,463)	(1,495,860)	(2,301,323)	(826,964)	(1,535,791)	(2,362,755)
Expenses of administration	3	(588,430)	—	(588,430)	(642,557)	—	(642,557)
Net return before finance costs and taxation		20,201,778	(46,592,886)	(26,391,108)	20,076,737	89,474,987	109,551,724
Finance costs of borrowings	4	(3,068,058)	(5,682,815)	(8,750,873)	(3,134,815)	(5,723,936)	(8,858,751)
Return on ordinary activities before taxation		17,133,720	(52,275,701)	(35,141,981)	16,941,922	83,751,051	100,692,973
Taxation	5	(39,079)	39,079	—	(184,352)	184,352	—
Return on ordinary activities after taxation for the financial year		17,094,641	(52,236,622)	(35,141,981)	16,757,570	83,935,403	100,692,973
Dividends on Preference Stock		(42,997)	—	(42,997)	(42,997)	—	(42,997)
Return attributable to Ordinary Shareholders		17,051,644	(52,236,622)	(35,184,978)	16,714,573	83,935,403	100,649,976
Dividends on Ordinary Shares	6	(17,155,611)	—	(17,155,611)	(16,769,646)	—	(16,769,646)
Transfer (from) to reserves		(103,967)	(52,236,622)	(52,340,589)	(55,073)	83,935,403	83,880,330
Return per Ordinary Share	7	16.70p	(51.15p)	(34.45p)	16.35p	82.09p	98.44p
Net Asset Value	15						
Per Ordinary Share				412.3p			463.5p
Per Preference Stock Unit				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.

The Notes on pages 20 to 33 form part of these Accounts.

Balance Sheet

at 31st January 2002

	Note	2002 £	2002 £	2001 £
Fixed Assets				
Investments	8		546,771,665	591,210,681
Current Assets				
Debtors	10	2,628,868		7,771,150
Cash at bank	10	—		1,044,517
				8,815,667
Creditors—Amounts falling due within one year	10	(15,152,435)		(13,037,160)
Net Current Liabilities			(12,523,567)	(4,221,493)
Total Assets less Current Liabilities			534,248,098	586,989,188
Creditors—Amounts falling due after more than one year	10		(112,087,474)	(112,082,455)
Total Net Assets			422,160,624	474,906,733
Capital and Reserves				
Called up Share Capital: Ordinary	11	25,525,984		25,550,984
Preference	11	1,178,000		1,178,000
			26,703,984	26,728,984
Capital Redemption Reserve	12		56,250	31,250
Share Premium Account			39,809	39,809
Capital Reserves: Realised	13	385,653,373		384,849,145
Unrealised	13	(422,226)		53,024,144
			385,231,147	437,873,289
Revenue Reserve	14		10,129,434	10,233,401
Shareholders' Funds	16		422,160,624	474,906,733
Analysis of Shareholders' Funds				
Equity interests	15		420,982,624	473,728,733
Non-equity interests	15		1,178,000	1,178,000
			422,160,624	474,906,733

Approved by the Board of Directors on 9th April 2002
and signed on its behalf by:

Hugh Stevenson
Joe Scott Plummer
Directors

The Notes on pages 20 to 33 form part of these Accounts.

Cash Flow Statement

for the year ended 31st January 2002

	Note	2002 £	2002 £	2001 £
Net cash inflow from operating activities	18		19,433,017	17,748,009
Servicing of finance				
Interest paid		(8,745,854)		(8,850,396)
Preference dividends paid		(42,997)		(42,997)
Net cash outflow on servicing of finance			(8,788,851)	(8,893,393)
Taxation				
UK income tax (paid) repaid			(660,987)	865,492
Investing Activities				
Payments to acquire fixed asset investments		(221,291,887)		(334,875,548)
Proceeds on disposal of fixed asset investments		227,689,157		340,271,533
Net cash inflow from financial investment			6,397,270	5,395,985
Equity dividends paid			(16,959,605)	(16,677,567)
Net cash outflow before financing			(579,156)	(1,561,474)
Financing				
(Decrease) increase in short term loan		(802,368)		1,488,189
Purchase of Ordinary Shares for cancellation		(405,520)		(468,880)
Cash (outflow) inflow from financing			(1,207,888)	1,019,309
Decrease in cash	19		(1,787,044)	(542,165)

The Notes on pages 20 to 33 form part of these Accounts.

Statement of Accounting Policies

for the year ended 31st January 2002

(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 including the Statement of Recommended Practice – "Financial Statements of Investment Trust Companies" issued by the Association of Investment Trust Companies.

(ii) Revenue – Dividends on equity shares are accounted for on an ex-dividend basis. UK dividends are shown net of tax credits. Income from convertible securities having an element of equity is recognised on an accruals basis. Fixed returns on non-equity shares are recognised on an accruals basis.

Where the Company has elected to receive its dividends in the form of additional shares rather than in cash, the equivalent of the cash dividend is recognised as income. Any excess in the value of the shares received over the amount of the cash dividend is recognised in capital reserves.

Deposit interest receivable and stock lending fees are accounted for on an accruals basis. Underwriting commission is recognised when the issue underwritten closes.

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

(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 in accordance with the principles set out by the British Venture Capital Association. An unrealised Capital Reserve has been established to reflect differences between value and book cost.

Net gains or losses arising on realisations of investments are taken directly to a 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 are charged to capital and revenue in the ratio 65:35 to reflect the Company's prospective split of capital and income returns.

(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, using the Company's effective rate of corporation tax for the accounting period.

Full provision is made for deferred taxation except to the extent that deferred tax assets are likely to be considered irrecoverable.

(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.

(viii) No Statement of Recognised Gains and Losses as required by Financial Reporting Standard 3 has been prepared. The Managers consider that the additional information provided would not add materially to the information disclosed in the Statement of Total Return from which recognised gains and losses can be derived.

Notes to the Accounts

for the year ended 31st January 2002

1. Income

	2002 £	2002 £	2001 £
Income from Investments			
Equity income from UK investments		20,905,128	18,956,896
Special dividends from UK investments		212,750	1,240,814
Unfranked income:			
Interest from UK fixed income securities	199,287		957,769
Interest from overseas fixed income securities	—		63,139
		199,287	1,020,908
		21,317,165	21,218,618
Other income			
Deposit interest	256,202		310,266
Underwriting commission	11,321		6,527
Stocklending fees	10,983		10,847
		278,506	327,640
Total income		21,595,671	21,546,258
Income from Investments			
Listed		21,317,165	21,218,618
Unlisted		—	—
		21,317,165	21,218,618

2. Investment Management Fee

	2002 £ Revenue	2002 £ Capital	2002 £ Total	2001 £ Revenue	2001 £ Capital	2001 £ Total
Investment management fee	805,463	1,495,860	2,301,323	826,964	1,535,791	2,362,755

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% (2001 – 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 £342,750 (2001 – £351,900). Under the contract Dresdner RCM provides the Company with investment management, accounting, secretarial, administration and custodial services.

Notes to the Accounts

for the year ended 31st January 2002

3. Expenses of Administration

	2002 £	2001 £
Directors' fees	68,053	70,637
Auditors' remuneration for audit services	15,891	13,548
Marketing costs of Savings Scheme	281,994	302,472
Other promotional activity	34,561	56,558
Other administrative expenses	187,931	199,342
	588,430	642,557

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

(ii) There were no payments to the Auditors in respect of non-audit services included in other administrative expenses (2001 – £nil).

(iii) Directors' fees are paid at the rate of £10,000 (2001 – £10,000) per annum with an additional sum of £3,000 (2001 – £3,000) per annum paid to the Chairman of the Audit Committee and an additional sum of £5,000 (2001 – £5,000) per annum paid to the Chairman.

4. Finance Costs of Borrowings

	2002 £ Revenue	2002 £ Capital	2002 £ Total	2001 £ Revenue	2001 £ Capital	2001 £ Total
On Stepped Rate Interest Loan repayable after more than five years	1,094,179	2,032,046	3,126,225	1,091,316	2,026,728	3,118,044
On Fixed Rate Interest Loan repayable after more than five years	1,324,943	2,460,609	3,785,552	1,326,416	2,463,344	3,789,760
On 4% Perpetual Debenture Stock repayable after more than five years	19,250	35,750	55,000	19,250	35,750	55,000
On 5.875% Secured Bonds repayable after more than five years	621,605	1,154,410	1,776,015	645,138	1,198,114	1,843,252
On sterling overdraft	8,081	—	8,081	52,695	—	52,695
	3,068,058	5,682,815	8,750,873	3,134,815	5,723,936	8,858,751

5. Taxation

Reconciliation of current charge

	2002 £ Revenue	2002 £ Capital	2002 £ Total	2001 £ Revenue	2001 £ Capital	2001 £ Total
Return on ordinary activities before taxation	17,133,720	(52,275,701)	(35,141,981)	16,941,922	83,751,051	100,692,973
Tax on return on ordinary activities at 30% (2001—30%)	5,140,116	(15,682,710)	(10,542,594)	5,082,577	25,125,315	30,207,892
Reconciling factors:						
Non taxable income	(6,335,363)	—	(6,335,363)	(6,059,313)	—	(6,059,313)
Non taxable capital gains	—	13,529,108	13,529,108	—	(27,303,233)	(27,303,233)
Disallowable expenses	106,184	19,405	125,589	136,090	17,443	153,533
Excess of allowable expenses over taxable income	1,128,142	2,095,118	3,223,260	1,024,998	1,976,123	3,001,121
Current year tax charge	39,079	(39,079)	—	184,352	(184,352)	—

The Company's taxable income is exceeded by its tax allowable expenses, which include both the capital and revenue elements of the management fee and finance costs of borrowings. The Company has surplus expenses carried forward of £45m (2001: £34m). Given the Company's current investment strategy, it is unlikely to generate sufficient UK taxable profits to relieve these expenses.

As at 31st January 2002 there is an unrecognised deferred tax asset, measured at the standard rate of 30%, of £13.5m (2001: £10.3m). This deferred tax asset relates to the current and prior year unutilised expenses. It is considered uncertain that there will be taxable profits in the future against which the deferred tax asset can be offset. Therefore the asset has not been recognised.

Notes to the Accounts

for the year ended 31st January 2002

6. Dividends on Ordinary Shares

	2002 £	2001 £
Dividends on Ordinary Shares of 25p—		
First interim 4.2p paid 10th August 2001 (2000 – 4.10p)	4,290,465	4,195,486
Second interim 4.2p paid 9th November 2001 (2000 – 4.10p)	4,290,465	4,193,436
Third interim 4.2p paid 16th February 2002 (2001 – 4.10p)	4,288,365	4,190,362
Final proposed – 4.2p payable 14th May 2002 (2001 – 4.10p)	4,288,365	4,190,362
Prior year over accrual	(2,049)	—
	17,155,611	16,769,646

The proposed final dividend accrued is based on the number of shares in issue at the year end. However, the dividend payable will be based on the number of shares in issue on the record date and will reflect any purchases and cancellation of shares by the Company settled subsequent to the year end.

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 all or part of this tax credit and charities are subject to transitional provisions.

7. Return per Ordinary Share

	2002 £ Revenue	2002 £ Capital	2002 £ Total	2001 £ Revenue	2001 £ Capital	2001 £ Total
Return after taxation	17,094,641	(52,236,622)	(35,141,981)	16,757,570	83,935,403	100,692,973
Attributable to Preference Stockholders	(42,997)	—	(42,997)	(42,997)	—	(42,997)
Attributable to Ordinary Shareholders	17,051,644	(52,236,622)	(35,184,978)	16,714,573	83,935,403	100,649,976
Return per Ordinary Share	16.70p	(51.15p)	(34.45p)	16.35p	82.09p	98.44p

The return per Ordinary Share is based on a weighted average of 102,131,744 Ordinary Shares of 25p in issue throughout the period (2001 – 102,250,726).

for the year ended 31st January 2002

8. Fixed Asset Investments

	Note	2002 £	2001 £
Listed at market valuation on recognised Stock Exchanges—			
United Kingdom		546,754,450	591,159,223
Unlisted at Directors' valuation—			
Abroad		17,215	51,458
Subsidiary at Directors' valuation	9	—	—
		17,215	51,458
Total fixed asset investments		546,771,665	591,210,681
Market value of investments brought forward		591,210,681	508,246,237
Unrealised gains brought forward		(53,024,144)	(6,822,647)
Cost of investments held brought forward		538,186,537	501,423,590
Additions at cost		224,015,391	320,738,103
Disposals at cost		(215,008,037)	(283,975,156)
Cost of investments held at 31st January		547,193,891	538,186,537
Unrealised (losses) gains at 31st January		(422,226)	53,024,144
Market value of investments held at 31st January		546,771,665	591,210,681
Gains on investments			
Net realised gains based on historical costs		8,397,180	43,651,205
Less: Net unrealised gains recognised on these investments at the previous balance sheet date		(1,889,072)	(44,810,715)
Net realised gains (losses) based on carrying value at previous balance sheet date		6,508,108	(1,159,510)
Net unrealised (losses) gains arising in the year		(51,557,298)	91,012,212
Net (losses) gains on investments		(45,049,190)	89,852,702

The Board considers that the Company's remaining unquoted investment is not material to the financial statements.

Stock Lending	£	£
Aggregate value of securities on loan at year-end	15.2m	6.8m
Maximum aggregate value of securities on loan during the year	41.6m	32.7m
Fee income from stock lending during the year	10,983	10,847

In respect of securities on loan at the year-end, the Company held £16.0m (2001 – £7.2m) as collateral, the value of which exceeded the value of the loan securities by £0.8m (2001 – £0.4m).

In respect of the maximum aggregate value of securities on loan during the year, the Company held £43.7m (2001 – £34.4m) as collateral, the value of which exceeded the value of the securities on loan by £2.1m (2001 – £1.7m).

Notes to the Accounts

for the year ended 31st January 2002

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. This company is now in the process of liquidation following the disposal of the interest in O'Connor.

The Company has not produced consolidated accounts in view of the immaterial amounts involved. This subsidiary is deemed not material for the purposes of giving a true and fair view.

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	**Total Net Assets* £**	**Class of Shares Held**	**% of Class held**	**% Equity**
First Debenture Finance PLC ('FDF')	(863,650)	'B' Shares	41.0	20.4
Fintrust Debenture PLC ('Fintrust')	5,690	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 to the Trust's accounts. 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 and the provision of a short term loan by FDF, there were no other transactions between FDF, Fintrust and the Company during the year.

*At the date of the latest published financial statements

10. Current Assets and Creditors

	2002 £	**2001 £**
Debtors—		
Sales for future settlement	470,470	4,802,246
Accrued income	2,129,245	2,940,209
Other debtors	19,484	28,695
Taxation recoverable	9,669	—
	2,628,868	7,771,150
Cash at bank—		
Sterling bank balances—		
Current account	—	404,517
Deposit account	—	640,000
	—	1,044,517

10. Current Assets and Creditors (continued)

	Note	2002 £	2001 £
Creditors: Amounts falling due within one year—			
Bank overdraft		742,527	—
Taxation payable		—	650,578
Purchases for future settlement		2,723,504	—
Short term loan (see (v) below)		685,821	1,488,189
Other creditors		1,083,088	1,176,904
Interest on borrowings (see (vi) below)		1,319,266	1,319,266
Dividend on Cumulative Preference Stock Units		21,499	21,499
Dividend on Ordinary Shares (declared)	6	4,288,365	4,190,362
Dividend on Ordinary Shares (proposed)	6	4,288,365	4,190,362
		15,152,435	13,037,160
Creditors: Amounts falling due after more than one year—			
Stepped Rate Interest Loan (see (i) below)		34,998,003	34,900,297
Fixed Rate Interest Loan (see (ii) below)		46,743,496	46,849,398
5.875% Secured Bonds 2029 (see (iii) below)		28,970,975	28,957,760
4% Perpetual Debenture Stock (see (iv) below)		1,375,000	1,375,000
		112,087,474	112,082,455

(i) The effective interest rate of the Stepped Rate Interest Loan over its term is 11.28% per annum.

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%. These amounts are repayable on 2nd January 2018 exclusive of any redemption expenses, together with a premium of £8,366,513.

The initial interest rate in 1987 on the Loan Notes and Bonds was 7.16% per annum. This increased annually by 7.5% compound until January 1998 when it reached its current rate of 14.75%. However, the combined effect of this interest charge and the accrual of the premium referred to above results in an effective interest rate of 11.28% per annum. Interest is payable in January and July each year.

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

The Company has guaranteed the repayment of £34,012,852, 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. There is a floating charge on all the Company's present and future assets to secure this obligation. The Company has also agreed to meet its proportionate share of any expenses incurred by FDF, including any tax liability 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 accounting treatment adopted in respect of the stepped rate interest and redemption premiums 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 in May and 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 KOIT's 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 2001, the unamortised premium included within the Fixed Rate Interest Loan balance of greater than one year amounted to £4,873,202 (2001 – £4,980,907).

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 2002

10. Current Assets and Creditors (continued)

(iii) The £30,000,000 5.875% Secured 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 in June and December in each year. As security for this loan the Company has granted a floating charge ranking pari passu with the floating charges referred to in note (i) and (ii) above over the whole of the present and future undertakings, property, assets and rights of the Company.

The accounting treatment adopted in respect of the Bonds 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. Interest is payable in arrears by equal half yearly instalments in May and November.

(v) The short term loan from FDF is interest free and repayable on demand.

(vi) Interest on borrowings consists of:

	2002 £	2001 £
Stepped Rate Interest Loan	313,728	313,728
Fixed Rate Interest Loan	783,545	783,545
5.875% Secured Bonds 2029	208,243	208,243
4% Perpetual Debenture Stock	13,750	13,750
	1,319,266	1,319,266

11. Share Capital

		2002 £	2001 £
Authorised			
1,178,000	3.65% Cumulative Preference Stock Units of £1	1,178,000	1,178,000
107,431,248	Ordinary Shares of 25p	26,857,812	26,857,812
Allotted and fully paid			
1,178,000	3.65% Cumulative Preference Stock Units of £1	1,178,000	1,178,000
102,103,936	Ordinary Shares of 25p (2001 – 102,203,936)	25,525,984	25,550,984
		26,703,984	26,728,984

(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 14th May 2001 to allot relevant securities, in accordance with Section 80 of the Companies Act 1985, up to a maximum aggregate nominal amount of £1,319,328. This authority, if not previously revoked or varied, expires five years from the date of the resolution.
The Directors are also authorised by a special resolution passed on 14th May 2001 to allot relevant securities for cash, in accordance with Section 95 of the Companies Act 1995, up to a maximum aggregate nominal amount of £1,274,703. 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.

(iii) During the year the Company repurchased 100,000 Ordinary Shares for cancellation at a cost of £405,520.

12. Capital Redemption Reserve

	£
Balance at 1st February 2001	31,250
Movement in the year	25,000
Balance at 31st January 2002	56,250

The balance of this reserve was increased by the transfer of £25,000 relating to the repurchase for cancellation by the Company of 100,000 Ordinary Shares of 25p.

13. Capital Reserve

	Realised £	Unrealised £	Total £
Balance at 1st February 2001	384,849,145	53,024,144	437,873,289
Net gain on realisation of investments	6,508,108	—	6,508,108
Decrease in unrealised appreciation	—	(51,557,298)	(51,557,298)
Transfer on disposal of investments	1,889,072	(1,889,072)	—
Exchange rate differences	(47,836)	—	(47,836)
Investment management fee	(1,495,860)	—	(1,495,860)
Finance costs of borrowings	(5,682,815)	—	(5,682,815)
Attributable taxation in respect of management fee and finance costs	39,079	—	39,079
Purchase of Ordinary Shares for cancellation	(405,520)	—	(405,520)
Balance at 31st January 2002	385,653,373	(422,226)	385,231,147

14. Revenue Reserve

	£
Balance at 1st February 2001	10,233,401
Deficit for the year	(103,967)
Balance at 31st January 2002	10,129,434

Notes to the Accounts

for the year ended 31st January 2002

15. 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:

	Net Asset Value per Share attributable 2002	2001
Ordinary Shares of 25p	412.3p	463.5p
3.65% Cumulative Preference Stock Units of £1	100.0p	100.0p

	Net Asset Values attributable 2002 £	2001 £
Ordinary Shares of 25p	420,982,624	473,728,733
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 2001	473,728,733	1,178,000	474,906,733
Total return on ordinary activities after taxation for the year	(35,184,978)	42,997	(35,141,981)
Purchase of Ordinary Shares for cancellation	(405,520)	—	(405,520)
Dividends appropriated in the year	(17,155,611)	(42,997)	(17,198,608)
Total net assets attributable at 31st January 2002	420,982,624	1,178,000	422,160,624

The Net Asset Value per Ordinary Share is based on 102,103,936 Ordinary Shares in issue at the year end (2001 – 102,203,936).

16. Reconciliation of Movements in Shareholders' Funds

	2002 £	2001 £
Revenue reserves		
Revenue profit available for distribution	17,094,641	16,757,570
Dividends appropriated in the year	(17,198,608)	(16,812,643)
Transfer from distributable reserves	(103,967)	(55,073)
Other reserves		
Recognised net capital (losses) profits transferred to capital reserves	(52,236,622)	83,935,403
Purchase of Ordinary Shares for cancellation	(405,520)	(468,880)
Net (decrease) increase in Shareholders' Funds	(52,746,109)	83,411,450
Opening Shareholders' Funds	474,906,733	391,495,283
Closing Shareholders' Funds	422,160,624	474,906,733

17. Contingent Liabilities and Guarantees

At 31st January 2002 there were no outstanding contingent liabilities (2001 – £nil) in respect of underwriting commitments and calls on partly paid investments.

Details of the guarantee provided by the Company as part of the terms of its Stepped Rate Loan are provided in Note 10(i) "Current Assets and Creditors" on page 26.

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

	2002	2001
	£	£
Revenue before taxation	17,133,720	16,941,922
Add: Finance costs of borrowings	3,068,058	3,134,815
Less: Management fee charged to capital	(1,495,860)	(1,535,791)
UK income tax deducted from unfranked income	740	(72,098)
	18,706,658	18,468,848
Decrease (increase) in debtors	820,175	(438,867)
Decrease in creditors	(93,816)	(281,972)
Net cash inflow from operating activities	19,433,017	17,748,009

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

(i) Analysis of Net Debt

	Overdraft	Cash	Short term loan	Stepped and Fixed Rate loans	5.875% Secured Bonds 2029	4% Perpetual Debenture Stock	Net Debt
	£	£	£	£	£	£	£
At 1st February 2001	—	1,044,517	(1,488,189)	(81,749,695)	(28,957,760)	(1,375,000)	(112,526,127)
Movement in year	(742,527)	(1,044,517)	802,368	8,196	(13,215)	—	(989,695)
At 31st January 2002	(742,527)	—	(685,821)	(81,741,499)	(28,970,975)	(1,375,000)	(113,515,822)

(ii) Reconciliation of net cash flow to movement in net debt

	2002	2001
	£	£
Net cash outflow	(1,787,044)	(542,165)
Decrease (increase) in short term loan	802,368	(1,488,189)
(Increase) decrease in long term loans	(5,019)	151,963
Movement in net funds	(989,695)	(1,878,391)
Net debt brought forward	(112,526,127)	(110,647,736)
Net debt carried forward	(113,515,822)	(112,526,127)

Notes to the Accounts

for the year ended 31st January 2002

20. 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 16.

(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	2002 Fixed rate interest paid £000s	2002 Floating rate interest paid £000s	2002 Nil interest paid £000s	2002 Total £000s	2001 Fixed rate interest paid £000s	2001 Floating rate interest paid £000s	2001 Nil interest paid £000s	2001 Total £000s
Financial Assets									
Values directly affected by changes in interest rates:									
Bonds	Sterling	—	—	—	—	—	—	—	—
		—	—	—	—	—	—	—	—
Values not directly affected by changes in interest rates:									
Equities	Sterling	—	—	478,428	478,428	—	—	491,858	491,858
Equities	US Dollar	—	—	64,147	64,147	—	—	86,868	86,868
Preference Shares and Bonds	Sterling	4,197	—	—	4,197	12,484	—	—	12,484
Cash	Sterling	—	—	—	—	—	1,045	—	1,045
		4,197	—	542,575	546,772	12,484	1,045	578,726	592,255
Total Financial Assets		4,197	—	542,575	546,772	12,484	1,045	578,726	592,255
Financial Liabilities									
Values affected by changes in interest rates:									
First Debenture Finance loan	Sterling	(46,743)	—	—	(46,743)	(46,849)	—	—	(46,849)
Fintrust loan	Sterling	(34,998)	—	—	(34,998)	(34,900)	—	—	(34,900)
5.875% Secured Bonds 2029	Sterling	(28,971)	—	—	(28,971)	(28,958)	—	—	(28,958)
4% Perpetual Debenture Stock	Sterling	(1,375)	—	—	(1,375)	(1,375)	—	—	(1,375)
		(112,087)	—	—	(112,087)	(112,082)	—	—	(112,082)
Values not directly affected by changes in interest rates:									
Cash	Sterling	—	(743)	—	(743)	—	—	—	—
		—	(743)	—	(743)	—	—	—	—
Total Financial Liabilities		(112,087)	(743)	—	(112,830)	(112,082)	—	—	(112,082)
Net Financial Assets (Liabilities)		(107,890)	(743)	542,575	433,942	(99,598)	1,045	578,726	480,173
Short term debtors and creditors					(11,781)				(5,266)
Net Assets per Balance Sheet					**422,161**				**474,907**

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

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

	Maturity date	Amount borrowed £	Coupon rate	Effective rate since inception*
First Debenture Finance loan—bonds	2/1/2018	20,534,079	14.75%	11.28%
First Debenture Finance loan—notes	2/1/2018	5,133,520	14.75%	11.28%
Fintrust—original loan	20/11/2023	30,000,000	9.25125%	9.30%
Fintrust—new loan	20/11/2023	12,000,000	9.25125%	6.00%
5.875% Secured Bonds	20/12/2029	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.

The weighted average coupon rate of the Company's fixed interest bearing liabilities is 9.58% (2001 – 9.58%) and the weighted average period to maturity of these liabilities (excluding the 4% perpetual debenture stock) is 22.2 years (2001 – 23.2) years.

The Company's only fixed interest asset has a coupon rate of 5.75% (2001 – 6.41%). It matures in 2.2 years.

(b) Currency Risk Profile

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

	2002 Investments £000s	2002 Current Assets £000s	2002 Creditors £000s	2002 Net currency exposure £000s	2001 Investments £000s	2001 Current Assets £000s	2001 Creditors £000s	2001 Net currency exposure £000s
Sterling	488,196	2,629	(127,240)	363,585	591,160	8,816	(125,120)	474,856
US Dollar	58,576	—	—	58,576	51	—	—	51
	546,772	2,629	(127,240)	422,161	591,211	8,816	(125,120)	474,907

(c) Fair Values Disclosures

The assets and liabilities of the Company are held at fair value with the exception of the liabilities shown below:

	2002 £ million Book value	2002 £ million Fair value	2001 £ million Book value	2001 £ million Fair value
First Debenture Finance Loan	35.0	51.9	34.9	50.9
Fintrust Loan	46.7	55.8	46.8	57.8
5.875% Secured Bonds	29.0	26.2	29.0	27.2
4% Perpetual Debenture Stock	1.4	1.0	1.4	1.1

(d) Liquidity profile

The maturity profile of the Company's financial liabilities at the 31st January 2002 (being the borrowings from Fintrust, First Debenture Finance, the 5.875% Secured Bonds and the 4% Perpetual Debenture stock) is detailed in Note 10—"Current Assets and Creditors" on pages 26 to 28. The undrawn committed borrowing facilities available to the Company at 31st January 2002 were £9,257,473.

(e) Hedging instruments

At the year end the Company had no hedging arrangements in place. (2001 – Nil)

Independent Report of the Auditors

Independent auditors' report to the members of The Merchants Trust PLC

We have audited the financial statements which comprise the statement of total return, the balance sheet and the cash flow statement and notes 1 to 20, which have been prepared under the historical cost convention (as modified by the revaluation of certain fixed assets) and the accounting policies set out in the statement of accounting policies.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards issued by the Auditing Practices Board and the Listing Rules of the Financial Services Authority.

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 Companies Act 1985. 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. The other information comprises only the directors' report, the chairman's statement, the investment manager's report and the corporate governance statement.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, 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 2002 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

9th April 2002

Southwark Towers
32 London Bridge Street
London SE1 9SY

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 Combined Code on Corporate Governance ("the Combined Code") issued by the Financial Services Authority.

The Board considers that the Company has complied with the provisions contained within Section 1 of the Combined Code throughout the year ended 31st January 2002 and with the Internal Control Guidance for Directors in the Combined Code published in September 1999 ("the Turnbull guidance") except that, as detailed below, the Board has not identified a senior non-executive Director. This statement describes how the relevant principles of governance are applied to the Company.

The Board

The Board currently consists of six 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.

Corporate Governance

When a new 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 controls. Changes affecting Directors' responsibilities are advised to the Board as they arise.

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 internal 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.

All non-executive Directors are appointed for an initial term of three years, subject to re-election and Companies Act provisions. In accordance with the Articles of Association, new Directors stand for election at the first Annual General Meeting following their appointment and every Director stands for re-election at intervals of not more than three years.

Board Committees

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 controls maintained on behalf of the Company and reviews the effectiveness of the Company's internal controls.

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 Financial Services Authority'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 and accordingly the financial statements do not include a Directors' Remuneration Report.

Relations with Shareholders

The Board strongly believes that the Annual General Meeting should be an event which private shareholders are encouraged to attend and in which they are invited to participate. 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 43. 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.

Internal Control

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

The Board has established an ongoing process for identifying, evaluating and managing the significant risks faced by the Company. This process is subject to review by the Board and accords with the Turnbull guidance.

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

▶ The Board, assisted by the Managers, undertook a full review of the Company's business risks and these are analysed and recorded in a risk matrix. The Board receives every six months from the Managers a formal report which details any known internal controls failures, including those that are not directly the responsibility of the Managers. Steps have been taken to continue to ensure that the system of internal control and risk management is embedded in the operations and culture of the Company and its key suppliers.

▶ The 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 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 Note 2 on page 21). The Managers' system of internal control includes organisation arrangements with clearly defined lines of responsibility and delegated authority as well as control procedures and systems which are regularly evaluated by management and monitored by their internal audit department. Dresdner RCM is regulated by the FSA and its compliance department regularly monitors their compliance with FSA rules. The effectiveness of the internal controls is assessed by the Managers' compliance and risk management department on an ongoing basis.

▶ The regular review and control by the Board of asset allocation and any risk implications. The regular and comprehensive review by the Board of management of 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 Custodians' internal auditors and compliance department.

By means of the process above, the Board has reviewed the effectiveness of internal controls for the period under review and up to the date of the signing of this Report and Accounts.

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. The Managers use a proxy voting service which casts votes in accordance with the guidelines of the National Association of Pension Funds (NAPF) research material, unless its clients request a very specific policy to be voted by its fund managers.

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

Directors and Management

Directors

Hugh Stevenson* (Chairman)

(Born September 1942) joined the board in September 1999. Formerly Chairman of Mercury Asset Management Group plc, he is Chairman of Equitas Limited, a Director of Standard Life Assurance Company and a member of the Investment Committee of the Wellcome Trust.

Sir John Banham*

(Born August 1940) joined the Board in August 1992. Formerly Controller of the Audit Commission and Director General of the Confederation of British Industry, he is Chairman of Whitbread PLC and ECI Ventures Ltd. He is also the Senior Non-Executive Director of Amvescap Plc.

Dick Barfield*

(Born April 1947) joined the board in May 1999. Formerly Chief Investment Manager of Standard Life Assurance Company, he is a Director of Equitas Limited, Baillie Gifford Japan Trust PLC, The Fleming Overseas Investment Trust PLC, The Edinburgh Investment Trust PLC, Marshalls PLC, New Look Group PLC 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.

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.

Directors' Report

Status

The Company was last approved by the Inland Revenue as an investment trust for the year ended 31st January 2001. Approval for the year ended 31st January 2002 is subject to there being no subsequent enquiry under Corporate Tax Self Assessment. In the opinion of the Directors the Company has subsequently conducted its affairs so as to enable it to continue to obtain S.842 approval.

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

During the year under review a total of 100,000 ordinary shares were repurchased and cancelled as part of the share buyback programme that was approved last year. The consideration paid, excluding buyback expenses, amounted to £405,520.

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.

Commission

The Managers had arrangements in place whereby some stockbrokers paid for the use by the Managers of specific investment services in return for business placed with these stockbrokers. With effect from 12th March 2002 these arrangements ceased to apply to any business carried out for the Company.

Invested Funds

Sales of investments during the year resulted in net gains based on historical costs of £8,397,180 (2001 – £43,651,205). Provisions contained in the Finance Act 1980 exempt approved Investment Trusts from corporation tax on their chargeable gains. Invested funds at 31st January 2002 had a value of £546,754,450 before deducting net liabilities of £124,611,041 (2001 – £591,210,681 and £116,303,948).

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 412.3p as compared with a value of 463.5p at 31st January 2001.

Donations and Subscriptions

Aggregate charitable donations and subscriptions in respect of the year amounted to £2,564 (2001 – £Nil). No political donations were made during the year.

Historical Record

There is included on page 9 a schedule of the Company's thirty largest holdings. The distribution of total assets is shown on page 14, and the historical record of the Company's revenue, capital and invested funds over the past ten years is shown on page 8. Graphs are included on page 15 showing the performance on a total return basis over the past ten years of the net asset value of the Company's Ordinary Shares against the Company's benchmark indices, the growth in net ordinary distributions made by the Company against the Retail Price Index, and the Company's discount to net asset value over the same period.

Directors' Report

Business Review

A review of the Company's activities is given in the Chairman's Statement on pages 6 and 7 and in the Investment Managers' Review on pages 10 and 11.

Revenue

	£
Revenue for the year after deducting management and general expenses and finance costs of borrowings amounted to	17,133,720
Taxation	(39,079)
and there remained a balance of	17,094,641
from which has been deducted the dividend on £1,178,000 of Preference Stock	(42,997)
leaving available for distribution to the Ordinary Shareholders	17,051,644

Dividends

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

	£	
1st Interim 4.2p per Share paid 10th August 2001	4,290,465	
2nd Interim 4.2p per Share paid 9th November 2001	4,290,465	
3rd Interim 4.2p per Share paid 16th February 2002	4,288,365	
Final 4.2p per Share proposed payable on 14th May 2002	4,288,365	
Prior year over accrual	(2,049)	
		(17,155,611)
leaving a deficit to be transferred from the Revenue Reserve of		(103,967)

Subject to the final dividend being approved payment will be made on 14th May 2002 to shareholders on the Register of Members at the close of business on 12th April 2002 at the rate of 4.2p 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:

The Prudential Corporation PLC–176,000 (14.9%); Ecclesiastical Insurance Office PLC–134,690 (11.4%); Zurich Financial Services Group–90,000 (7.6%); Royal Insurance PLC–60,000 (5.0%).

Ordinary Shares of 25p:

Barclays PLC and its subsidiaries–4,209,758 (4.1%).

Directors and Management

All Directors listed below served throughout the financial year under review.

Sir John Banham and Mr A. D. W. Forbes retire by rotation in accordance with the Articles of Association. Mr Forbes is not seeking re-election and will retire from the Board with effect from the conclusion of the Annual General Meeting. Sir John Banham being eligible offers himself for re-election.

The present Board and their interests in the share capital of the Company as at 31st January 2002 and 2001 (or date of appointment if later) are listed below:

	Ordinary Shares of 25p			
	2002		2001	
	Beneficial	Non-Beneficial	Beneficial	Non-Beneficial
R. A. Barfield	1,930	—	1,872	—
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	—	25,000	—

Between the end of the period under review and the date of this report Mr R. A. Barfield has acquired a further 17 ordinary share of 25p each through the Dresdner RCM Investment Trust ISA bringing his total holding in the Trust to 1,947 shares.

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 (2001 – 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 years' notice (2001 – 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 31st January 2003 will be £272,140 excluding VAT (2002 – £265,806 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

Analysis of Share Register

	Shareholder Accounts				Ordinary Shareholding			
	Number		%		000's		%	
Shareholder Type	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**
Private holders*	10,212	10,084	64.2	65.1	26,829	27,145	26.3	26.6
Nominees	4,844	4,476	30.4	28.9	66,015	64,387	64.7	63.0
Insurance Companies	43	57	0.3	0.4	1,784	2,266	1.7	2.2
Other holders	559	546	3.5	3.5	3,796	4,076	3.7	4.0
Pension Funds	9	8	0.1	0.1	91	74	0.1	0.1
Investment Trusts and Funds	240	312	1.5	2.0	3,588	4,208	3.5	4.1
	15,907	15,483	100.0	100.0	102,103	102,156	100.0	100.0

*Including PEP, ISA and Saving Plan Nominees.
Based on an analysis of the Ordinary Share register at 25th March 2002 (28th March 2001).

Directors' and Officers' Liability Insurance

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

Purchase of own shares

As referred to in the Chairman's statement, the Board is proposing that the Company should be given renewed authority to purchase Ordinary Shares in the market for cancellation. The Board believes that such purchases in the market at appropriate times and prices 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 £395 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.

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 15,305,380 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 2003 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 £1,331,828. This authority 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 14th May 2001 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 £1,273,746 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 2002. 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.

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 — 9th April 2002

Kirsten Salt

Deputy Secretary

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, 13th May 2002 at 12 noon 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 2002 together with the Auditors' Report thereon.

2 To declare a final ordinary dividend of 4.2p per Ordinary Share.

3 To re-elect Sir John Banham as a Director.

4 To re-appoint PricewaterhouseCoopers as Auditors of the Company.

5 To authorise the Directors to determine the remuneration of the Auditors.

Special Business

Resolution 7 will be proposed as an Ordinary Resolution and resolutions 6 and 8 as Special Resolutions:

6 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 15,305,380;

(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 2003 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.

7 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 £1,331,828 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.

8 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 £1,273,746 (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 pursuant of such offer or agreement as if that power had not expired.

10 Fenchurch Street,
London EC3M 3LB
9th April 2002

By Order of the Board
Kirsten Salt
Deputy 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. Duly completed forms of proxy 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 noon on 11th May 2002 ("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.

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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.

Ⓐ 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.

Ⓑ 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.

Ⓒ 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

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

SURNAME/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 13th May 2002 at 12 noon and at any adjournment thereof.

	Ⓑ **Routine Business**	**For**	**Against**
1	To receive the Report and Accounts	☐	☐
2	To declare a final dividend of 4.2p	☐	☐
3	To re-elect Sir John Banham as a Director	☐	☐
4	To re-appoint PricewaterhouseCoopers as Auditors	☐	☐
5	To authorise the Directors to determine the remuneration of the Auditors	☐	☐
	Special Business		
6	To authorise the Company to make market purchases of its own shares	☐	☐
7	To renew the Directors' authority to allot shares	☐	☐
8	To renew the Directors' authority to allot shares for cash	☐	☐

Ⓒ Shareholders Details

SURNAME/TITLE

FORENAMES

ADDRESS

POSTCODE

SIGNATURE DATE

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Capita IRG plc
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F I R S T F O L D

Second Fold