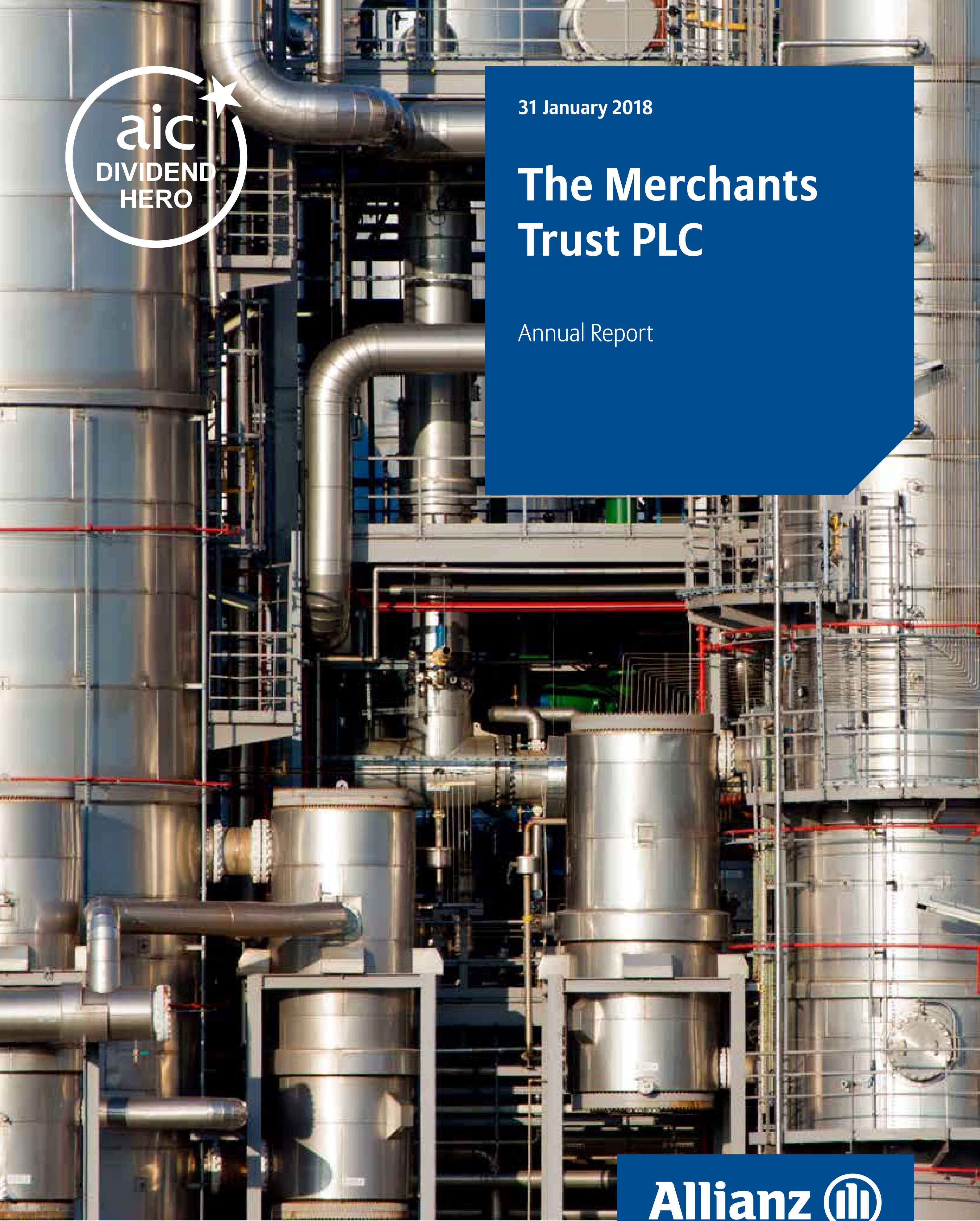

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DIVIDEND HERO

31 January 2018

The Merchants Trust PLC

Annual Report

Allianz
Global Investors

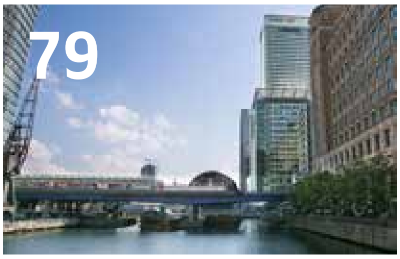
www.merchantstrust.co.uk

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

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

Cover
Close-up of pipelines and distillation tanks within an oil-refinery plant.

Contents



Financial Highlights

As at 31 January 2018

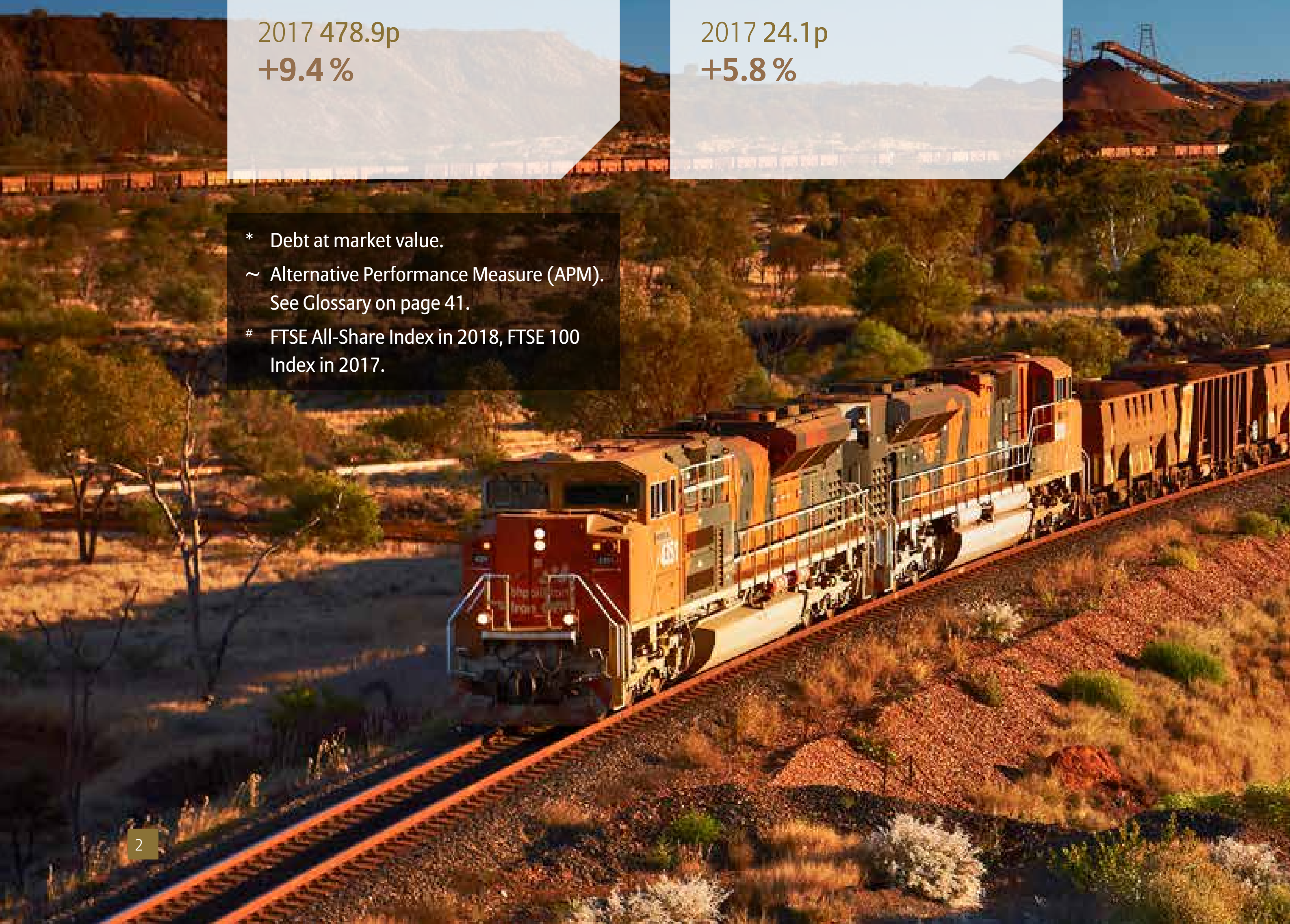
Dividend	Yield
24.8p	**5.2%**
2017 **24.2p**	2017 **5.3%**
+2.5%	

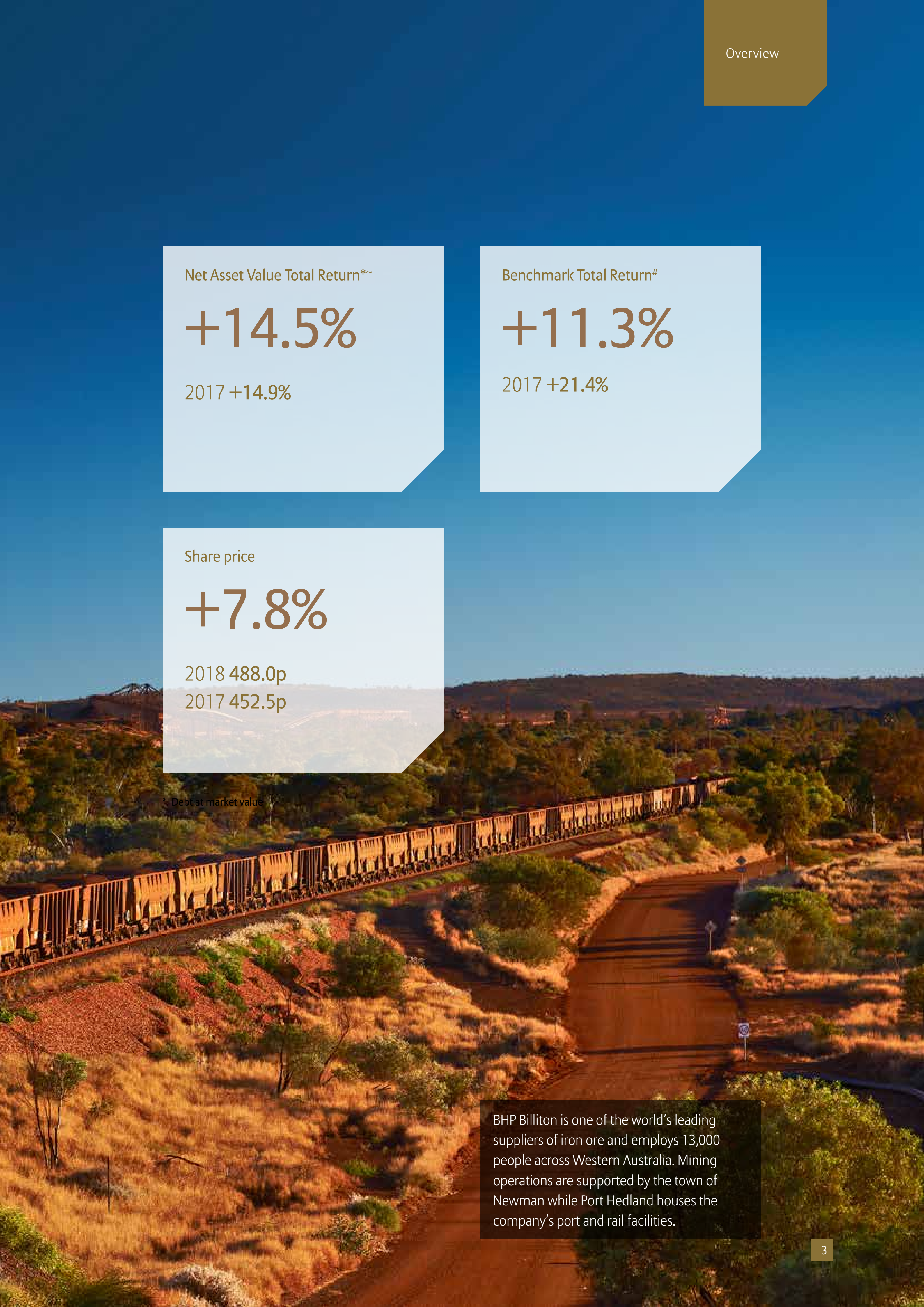
Net Asset Value per ordinary share*	Revenue earnings per ordinary share
523.9p	**25.5p**
2017 **478.9p**	2017 **24.1p**
+9.4 %	**+5.8 %**

* Debt at market value.

~ Alternative Performance Measure (APM). See Glossary on page 41.

\# FTSE All-Share Index in 2018, FTSE 100 Index in 2017.





Net Asset Value Total Return*~

+14.5%

2017 **+14.9%**

Benchmark Total Return#

+11.3%

2017 **+21.4%**

Share price

+7.8%

2018 **488.0p**
2017 **452.5p**

* Debt at market value

BHP Billiton is one of the world's leading suppliers of iron ore and employs 13,000 people across Western Australia. Mining operations are supported by the town of Newman while Port Hedland houses the company's port and rail facilities.

Chairman's Statement

Dear Shareholder

Your board is delighted to announce that, with shareholder approval at our Annual General Meeting, your company will have achieved 36 consecutive years of dividend growth. We are proud of this progressive dividend policy and the company's continued recognition as one of the Association of Investment Companies' 'Dividend Heroes'.

Highlights of the year

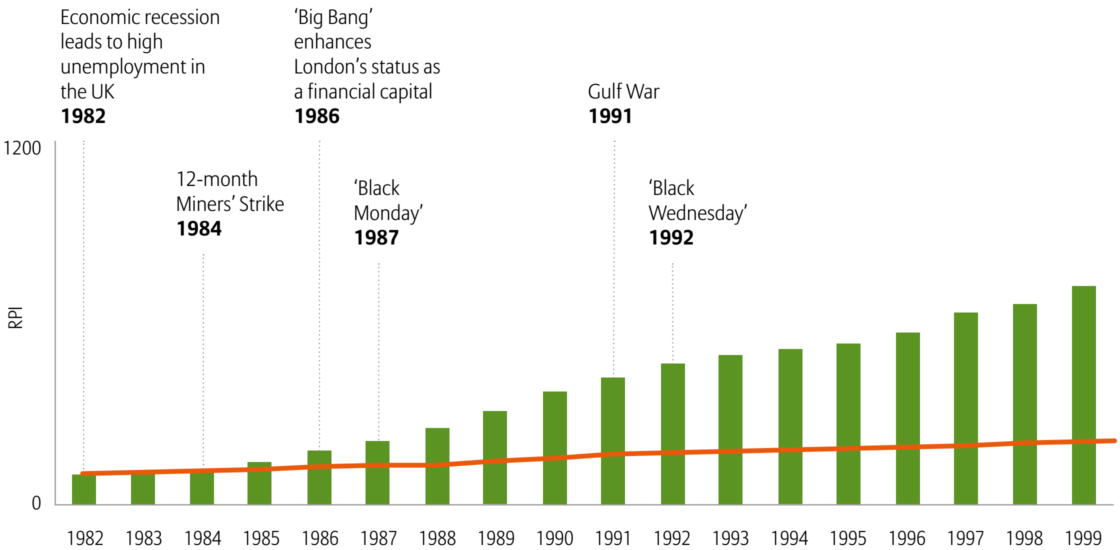
- A rising dividend for 36 consecutive years
- Second highest yield in its sector
- Investment performance ahead of benchmark
- New borrowing secured at much lower interest rate

In a key development during the year, the company announced the refinancing of the first tranche of its long-term borrowings, replacing it with new borrowings at a much lower interest rate. This has many potential benefits for shareholders, such as enhancing earnings per share and the flexibility to grow the dividend faster.

A year of positive asset returns for shareholders

This has been a strong year for Merchants in both absolute and relative terms. In a buoyant year overall for global stock markets, Merchants outperformed the FTSE All-Share, its benchmark index. Our Net Asset Value (NAV) total return was +14.5% with debt at market value, outperforming the benchmark total return of +11.3%. This investment return placed the company 6 out of 25 funds in its peer group. The board would like to thank our fund manager, Allianz Global Investors, on a very good year for Merchants.

Gearing helped the NAV performance for the year, adding a net 2% to total return, after taking account of the cost of finance and movements in the value of debt. A full table of attribution is shown on page 10.



Total dividend: from 2.1p to 24.8p over the period, representing growth of 12x over 36 years

UK RPI growth of 3x over 36 years

*Final dividend for approval at the 2018 AGM.

Source: AllianzGI.

Chairman's Statement *(continued)*

You will find more information on the performance of the investment portfolio, including stock selections and portfolio changes, in the Investment Manager's Review on page 18. In a year in which the only certainty was uncertainty, with various geopolitical challenges at play, global economic growth nevertheless steadily improved whilst interest rates have risen, albeit from historical lows.

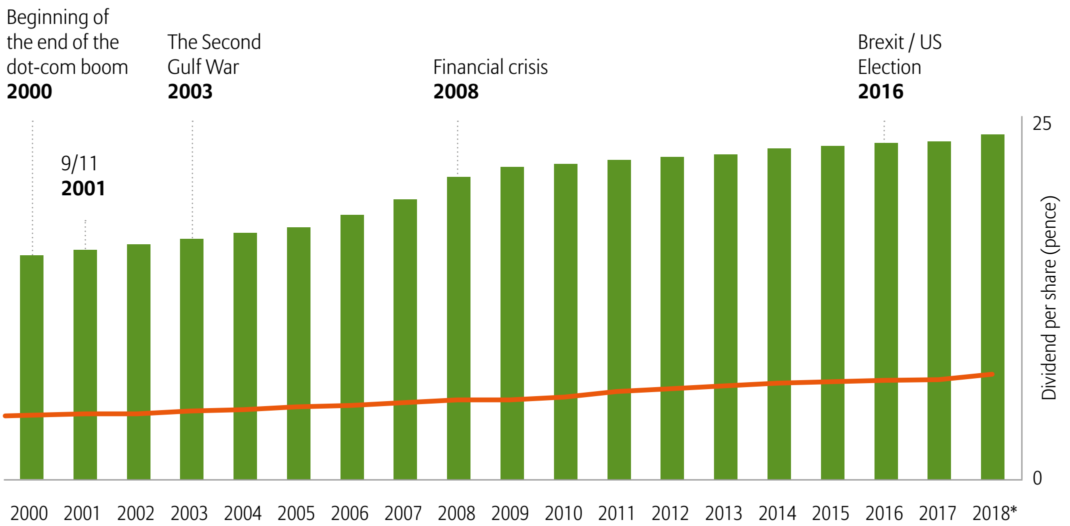
While the board is pleased to see the outperformance over the last year, longer term trends are important. On a cumulative basis, over 5 years, the NAV total return was 49.1%, which was once again ahead of the benchmark (+45.9%).#

The company's share price rose by 7.8% over the year, from 452.5p to 488.0p. On a total return basis (which includes net dividends) the value of the shares increased by 13.3%.

A genuine high yield UK equity fund: 36 consecutive years of dividend growth

The board is recommending a final dividend of 6.3p (2017: 6.1p) which will increase the total dividend for the year to 24.8p (2017: 24.2p), a rise of 2.5%. Significantly, this will be the 36th consecutive year in which we have grown the dividend and we are proud to be recognised as an AIC 'Dividend Hero'; this is an elite group of investment trust companies that have increased their dividends each year for 20 years or more.

The board monitors the company's yield relative to other investment trusts in the UK Equity Income sector. At 31 January 2018, the company's yield of 5.2% ranked Merchants second highest in the sector – and well above the sector average of 3.5%. The company has consistently offered its shareholders a high yield and dividends have grown ahead of inflation over the long term. This period under review was generally a good year for the level of dividend receipts generated by Merchants' portfolio holdings. In addition, the weakness of sterling against the US dollar early in the year (which has now reversed) helped, since almost a third of income comes from dividends paid in foreign currencies. The improved level of income generation, and the benefits of debt refinancing, have allowed the directors to raise the dividend by a greater amount than in recent years.



The benchmark for the year ended 31 January 2018 was FTSE All-Share Index and prior to that it was FTSE 100 Index.

Chairman's Statement *(continued)*

It remains the board's aim to continue Merchants' distinguished dividend track record. We are confident that the manager's policy of identifying individual stocks with strong franchises and sound finances, and ones that it believes can deliver a high level of income and good overall return, will facilitate that. The board believes that, by investing in a portfolio of such stocks, Merchants can continue to create security and growth of income over the medium to long term.

The final dividend of 6.3p will be paid on 30 May 2018 to shareholders on the register on 20 April 2018. The dividend is fully covered by the revenue generated by the company's portfolio and there are significant reserves.

Stewardship and engagement

The manager devotes considerable resources to stewardship responsibilities on behalf of shareholders. Allianz Global Investors engages on matters including governance, capital management, remuneration, strategy, sustainability and other issues. The manager votes at all general meetings of portfolio companies and also engages regularly with executives and boards. A new section in the Investment Manager's Review on page 27 has been included for shareholders, giving some background to the twenty three corporate engagements that have taken place during the year. Further detail on environmental, social and governance issues, and stewardship is shown in the Strategic Report on page 51. It also sets out where shareholders can see the voting decisions that Allianz Global Investors have made on their behalf.

New borrowing at much lower interest rates

Investment trusts like Merchants aim to enhance their investment returns by borrowing money to buy more assets (known as 'gearing'). The company has gearing in the form of long term debt amounting to £112 million, all deployed in the market for investment purposes. Our gearing averaged 19.7% throughout the year, compared to 22.7% last year. At the end of the year, our gearing level was 18.1% compared to 19.0% at 31 January 2017.

Towards the end of the financial year we refinanced a debenture taken out in 1987 (when the Bank of England base rate stood at 8.375%) with new borrowing at a much lower interest rate (2.96%). This replacement of the expensive debenture with lower cost borrowing is significant for the company. Not only does it reduce interest payment costs significantly (the

Debt refinancing secures long term, low cost finance

Financial year ending 31 January	2017	2018
Gross debt	£111m	£112m
Average interest rate*	8.5%	6.1%

* Effective interest rate - Excludes perpetual debt. See note 11 on pages 93 and 94.

- £35m private placement to refinance £34m Jan 2018 debenture
- 2.96% fixed rate on the new notes
- Secures long term financing
- Significant reduction in interest cost
- Enhances earnings per share

Chairman's Statement *(continued)*

weighted average cost of debt decreased from 8.5% to 6.1%), enhancing the revenue earnings per share, but it also reduces capital costs and presents the possibility of growing the dividend faster in the future.

The debt refinancing allows the investment manager to invest with a long-term view. Having secured the new borrowing for the next 35 years at an interest rate of just under 3%, the investment manager is able to invest in a selection of higher yielding stocks listed on the FTSE All-Share Index, whose average dividend yield is 4% at the time of writing.

This year's annual report

We regularly review the content and layout of Merchants' annual report to ensure that, as well as providing statutory information, the report is informative, interesting and visually compelling. The board is mindful of the ever-increasing numbers of private individuals who have chosen to buy Merchants' shares in recent years, so this year's report carries new case studies as well as expanded profiles on the company's largest holdings. There is also a new Investment Process section, where the manager explains its long-term value focus, underpinned by fundamental analysis, and how this informs stock selection. In addition, there is more information on stewardship and engagement activities as described above.

We hope that these enhancements will provide insight into our investment management process. As always, we welcome feedback from all shareholders, as well as suggestions that we can consider for future years.

The Board

There have been no changes to the composition of the board during the year. Details of the directors are set out on page 54.

Strategy and Strategic Report

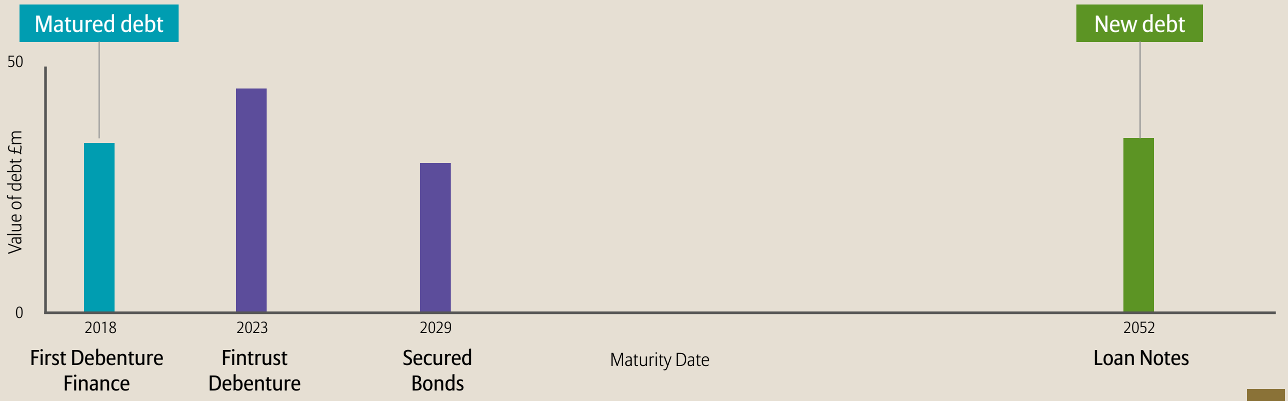
The Strategic Report is on page 42. At our annual strategy day last year, we took a more in-depth look at the matters we consider at each board meeting, including our position relative to our peer group and benchmark, borrowing strategy and a review of marketing strategy.

Increasing demand for Merchants' shares

1. Marketing communications

As a board, we are keen to grow the number of individual shareholders that hold Merchants' shares and we carefully consider the level of marketing expenditure that should be allocated to targeted marketing activity. The Merchants'

Maturity dates for long-term debt



Source: AllianzGI/JP Morgan Cazenove.

Chairman's Statement *(continued)*

marketing programme includes electronic communications with existing and potential investors and substantial liaison with national and industry journalists, since positive press coverage can be highly influential.

Targeted online and print advertising is also undertaken on a very selective basis, where the potential benefits are judged to merit the cost. The most recent campaign has focused on the company's 'Dividend Hero' status, with the following headline: 'Experienced. Disciplined. Determined. All you want from a hero.'

Online trading platforms have largely replaced the traditional stockbroker as the destination for investors wishing to buy shares in recent years and our communication programme targets

Targeted press advertising by Merchants.

both platform providers and investors. Marketing activity has been instrumental in creating sustained and ongoing demand for Merchants' shares through these platforms. Approximately 42.2% (2017: 38.4%) of the company's shares are now held by investors on these platforms, an increase of 3.8% (or an extra 4.1 million shares) in just one year.

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

2. Meeting shareholders

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

Enhanced online access for Merchants' investors

The Merchants Trust website (www.merchantstrust.co.uk) is the company's 'shop window' and is at the heart of our marketing communications strategy. As well as the very latest performance statistics, visitors to the site can also access a wealth of information, including: 'Video Hub' face to face interviews with the investment manager; useful information on platform investing; educational content; and a complete literature library of current and historical documents.

During the period under review, the website was redesigned in a 'responsive' format that provides an optimal viewing experience for visitors using all forms of devices – mobile phones, tablets and desktop computers. As well as a much cleaner 'look and feel', the redesign has added substantial new content that the board believes

Chairman's Statement *(continued)*

shareholders will appreciate. Via the site, visitors can also sign up to receive monthly Merchants' fact sheets by email, as well as other useful information.

Key Investor Information Document (KIID)

Key Investor Information Documents (KIIDs) were published in January 2018 for investment trusts and many other investment products. The KIID is a standardised pan-European document containing product, risk, charges and other information. It is a regulatory requirement that investors are provided with a KIID before they invest and your chosen platform provider or stockbroker should provide you with a copy before accepting your investment instructions. The KIID's standardised format is intended to allow potential investors to compare funds easily. However, there are concerns in the industry that differing interpretations of the requirements may have resulted in KIIDs that prove to be unhelpful for investors. We take the view that any prospective investor should not rely solely on the KIID when making their investment decision.

There is more information about the KIID on page 106.

Annual General Meeting

We strongly encourage shareholders on the register or with letters of representation from their nominee on the register to attend the annual general meeting of the company. This will be held on Wednesday, 16 May 2018 at 12 noon at Grocers' Hall, Princes Street, London EC4Y 0JP. For those shareholders unable to attend, filmed AGM video content will be added to the Merchants' dedicated website as soon as it becomes available.

Outlook

When I wrote to shareholders at the end of September, in the Half-yearly Report, I noted the rising risk profile for the UK economy and these concerns remain as valid now as they were six months ago. There remain further 'speed bumps' in the form of geopolitical and economic risks that will create short-term volatility along the way. High levels of consumer debt and the impact of inflation on real earnings, as well as uncertainty in the corporate sector caused by Brexit are all concerns. However, interest rates, although nudging upwards, remain very low by historic standards. Add to this the weak pound (which helps exporters), historically high employment levels and the fact that the UK stock market is predominantly exposed to economies outside the UK, and one can begin to understand why markets have remained near to all-time highs since September.

In uncertain times, it is useful to remember that The Merchants Trust will celebrate its 130th anniversary in 2019 and that the company has a long and distinguished history of delivering income and capital returns through many uncertain periods over the years. The investment manager continues to invest in a portfolio comprising solid businesses with good prospects for growth and attractive dividends that are priced at a level from which they can deliver good total returns for shareholders.

Looking ahead we think it's vital to continue doing what we've always done at The Merchants Trust. We leverage Allianz Global Investors' investment expertise to ensure The Merchants Trust always has a portfolio of attractive UK stocks. Above all, we believe that the company is well positioned to continue meeting its objectives of paying a high and growing dividend yield and delivering attractive total returns, for both existing and new investors, for many years to come.

Simon Fraser
Chairman
28 March 2018

Performance – Review of the Year

Financial Summary

Revenue	For the year ended 31 January 2018	For the year ended 31 January 2017	% change	
Income	£32,633,321	£31,123,179	+4.9	
Revenue earnings attributable to ordinary shareholders	£27,732,007	£26,160,643	+6.0	
Revenue earnings per ordinary share	25.5p	24.1p	+5.8	
Dividends per ordinary share	24.8p	24.2p	+2.5	
Assets	**2018**	**2017**	**Capital Earnings % change**	**Total Return % change**
Total assets less current liabilities	£703,921,177	£621,339,256[2]	+13.3	-
Total net assets with debt at par	£593,477,860	£545,317,550	+8.8	-
Total net assets with debt at market value (capital)	£569,629,606	£520,728,742	+9.4	-
Net asset value per ordinary share with debt at par	545.8p	501.5p	+8.8	+13.7[1]
Net asset value per ordinary share with debt at market value (capital)	523.9p	478.9p	+9.4	+14.5[1]
Ordinary share price	488.0p	452.5p	+7.8	+13.3
FTSE All-Share	4,137.7	3,858.3	+7.2	+11.3
Discount of ordinary share price to net asset value (debt at par)	-10.6%	-9.8%	n/a	n/a
Discount of ordinary share price to net asset value (debt at market value)	-6.9%	-5.5%	n/a	n/a
Ongoing charges[3]	0.6%	0.6%	n/a	n/a

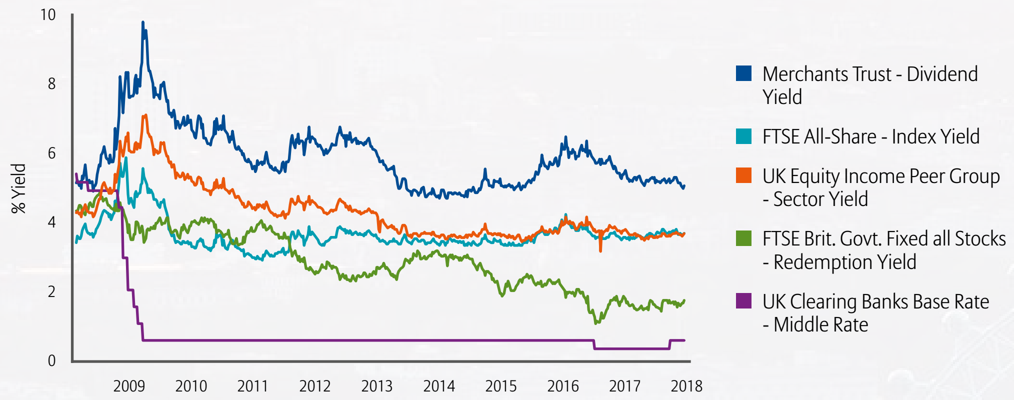
[1] NAV total return reflects both the change in net asset value per ordinary share and the net ordinary dividends paid.
[2] The 2017 total assets less current liabilities figure was net of £34m owed to First Debenture Finance PLC within short term creditors.
[3] The ongoing charges percentage is calculated in accordance with the explanation given on page 46.

Performance Attribution Analysis against the FTSE All-Share Index	Capital Return %	Revenue Return %	Total Return %
Return of Index	7.2%	4.1%	11.3%
Relative return on portfolio	1.0%	1.3%	2.3%
Return of portfolio	8.2%	5.4%	13.6%
Impact of gearing on portfolio	2.4%	1.3%	3.7%
Movement in market value of debt	0.1%	0.0%	0.1%
Finance costs	-1.1%	-0.7%	-1.8%
Management fee	-0.3%	-0.2%	-0.5%
Administration expenses	0.0%	-0.2%	-0.2%
Other	0.1%	-0.5%	-0.4%
Change in net asset value per ordinary share (debt at market value)	**9.4%**	**5.1%**	**14.5%**

A Glossary of Alternative Performance Measures (APMs) can be found on page 41.

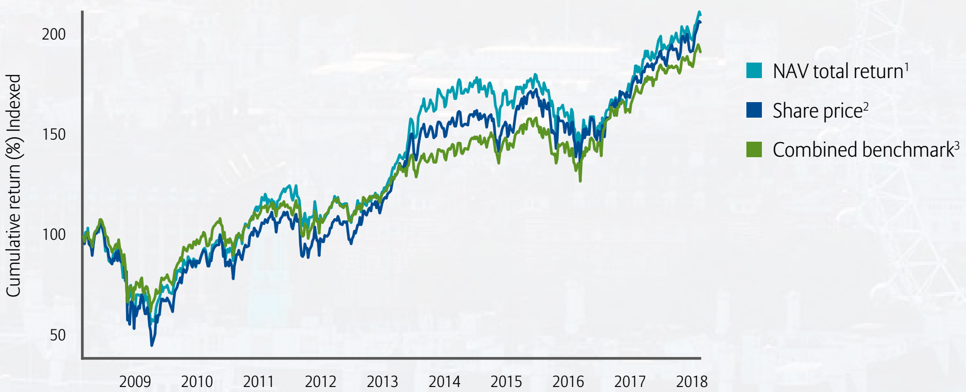
Performance Graphs

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



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

The Merchants Trust 10 Year Cumulative Total Return compared to the benchmark



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

Source: AllianzGI / Datastream in GBP.

The Merchants Trust PLC

Investment Manager's Review

UBM is the second largest exhibition management company in the world and was a significant contributor to portfolio performance.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Investment Philosophy and Stock Selection Process

Inefficient markets

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

Income bias

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

Income Bias

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

Research intensive, focus on cash flow.

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

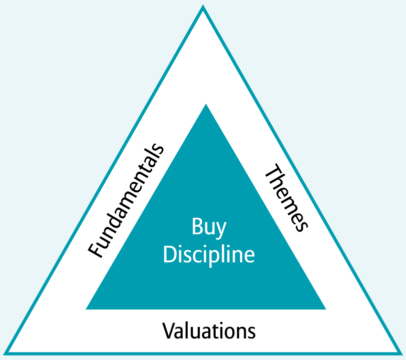
Stock Selection blends fundamentals, valuation and themes

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

Buy Discipline

Fundamentals

Industry dynamics
Competitive position
Financials
Environmental, social & governance



Themes

Macroeconomic outlook
Business cycle
Industry/secular themes

Valuation

Absolute
Relative to history
Relative to market
Dividend yield

Investment Philosophy and Stock Selection Process *(continued)*

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

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

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

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

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

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

Sell Discipline:

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

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

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

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

Sell Discipline

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

Portfolio Construction

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

Investment Manager's Review

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

Economic and Market Background

The stock market made steady progress throughout the year. A year ago, we said that the political environment was uncertain, but even so, we did not envisage another general election in the UK. Mrs May called for a vote to cement her position as prime minister, and to strengthen her hand whilst negotiating Brexit, but she ended up losing the Conservative parliamentary majority, and having to depend upon the support of the Democratic Unionist Party (of Northern Ireland) to form a government. In the process, she gave a big boost to the Labour opposition party with a more left wing agenda, under Jeremy Corbyn's leadership, than in the recent past. However, these events were not enough to derail the stock market. In France, the election of Emmanuel Macron as President was generally welcomed by investors, but the German elections left Angela Merkel struggling for months to form a coalition government. In the USA, the first year of the Trump presidency was marked by political division, but he did manage to pass a large tax cutting bill towards the end of 2017.

The first stage of the Brexit negotiation was slow and complex. However, in early December, there was agreement on key issues such as citizens' rights of residence and the UK's financial obligations, enabling the process to move on to the second stage of talks. This involves discussing a transition period, and possibly future trading arrangements, as well as other issues. A transition period is important as it will allow companies and other organisations to plan for Brexit in an orderly manner, rather than making precautionary changes to their operations, which could impact the economy via job losses or constrained investment.

The overriding feature of the year for financial markets was, arguably, the steady improvement in economic growth around the world and the gradual tightening of monetary policy, indicating that the major Western economies might finally be emerging from a prolonged period of low growth in the aftermath of the great financial crisis. The Bank of England raised interest rates for the first time in 10 years, whilst, in the USA,

The Bank of England raised interest rates in November 2017 for the first time in a decade.

Investment Manager's Review *(continued)*

the Federal Reserve raised interest rates by a cumulative 0.75%. The strong economy, interest rate rises and the US tax stimulus started to impact government bond yields, which increased towards the end of the year. The US dollar also weakened throughout the year, closing at $1.42 to the pound, close to the level just before the Brexit referendum.

The FTSE All-Share Index produced a total return of 11.3% for the year, even after a retreat in the last few weeks. There were some clear sector trends, although the market was not as polarised as in the prior couple of years. In general, cyclical, financial and commodity sectors as well as overseas earners performed well, with strong gains in engineering, life insurance, financial services, oil producers and mining. Conversely, many defensive sectors and domestically exposed industries underperformed, such as utilities, tobacco, pharmaceuticals, general retailers and construction.

FTSE All-Share 31.1.17-31.1.18
Source: AllianzGI/Datastream

Mining was among the sectors showing strong gains during the year.

Investment Manager's Review *(continued)*

Investment Performance

A full attribution of performance is given on page 10. In this section, we discuss the performance of the investment portfolio and compare it to the performance of the FTSE All-Share Index benchmark. The portfolio total return was 13.6%, 2.3% above the benchmark return of 11.3%. The table below shows the top ten positive and negative contributors to the performance relative to the benchmark.

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

Positive Contribution	%	Over/under weight	Negative Contribution	%	Over/under weight
UBM	0.7	+	Centrica	-0.9	+
Ladbrokes Coral	0.6	+	GlaxoSmithKline	-0.8	+
Shire	0.6	-	Kier	-0.7	+
Equiniti	0.5	+	Greene King	-0.7	+
Man Group	0.5	+	SSE	-0.4	+
Standard Life Aberdeen	0.5	+	Inmarsat	-0.3	+
IG Group	0.5	+	Unilever	-0.3	-
BHP Billiton	0.5	+	AstraZeneca	-0.3	-
British American Tobacco	0.5	-	Pennon	-0.3	+
Hansteen	0.5	+	Vodafone	-0.3	-

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

Three financial services companies were among the top ten contributors.

Investment Manager's Review *(continued)*

Stock selection was the prime driver of outperformance, although having a minimal exposure to the tobacco sector was beneficial, as tobacco shares were weak. Several medium sized companies made positive contributions. UBM and Ladbrokes Coral had the biggest impact as they both received takeover offers from peers within their sectors. Three financial services companies were among the top ten contributors. IG Group, the spread-betting market leader, saw its shares return over 50%, as the company reassured investors about the limited potential impact of new regulations on its client base, as well as continuing to report strong trading results. Fund manager Man Group also reported strong results, which boosted its shares materially. Standard Life announced a merger with Aberdeen Asset Management, with significant cost saving potential in the two complementary businesses. The shares performed well, after an initial period of market scepticism.

Elsewhere, Equiniti was re-rated, as Capita sold a competing share registration business for a high valuation, and Equiniti also announced a well-received US acquisition. BHP Billiton underperformed in the spring, giving us the opportunity to significantly increase the shareholding at an attractive price. A subsequent strong rally, as commodity prices firmed, meant that the stock made a good contribution to overall performance. The industrial real estate company Hansteen also performed well, as the management sold its large German and Dutch portfolio, for a good price, and returned capital to shareholders. The remaining top ten performers were stocks that were not owned (or underweight) in the portfolio. As they underperformed, they held back the index return. Pharmaceutical company Shire fell by over 20% during the year and British American Tobacco also underperformed.

Among the main negative contributors to performance, there were a couple of themes

IG Group, which provides trading in derivatives and spread betting, saw its shares return over 50%.

Investment Manager's Review *(continued)*

as well as stock specific issues. Utilities were affected by difficult trading conditions and government plans to cap energy prices, as well as the rising chance of a Labour government, which has a stated intention of renationalising the water industry. Domestic stocks were also under pressure, on concerns over potential risks to the economy from the Brexit process.

Centrica was the worst performer among the utilities, in response to a significant profit warning, but SSE and Pennon also underperformed, despite more resilient trading. Greene King shares pulled back, as the company saw subdued trading in their pubs, and faced rising cost inflation. Construction company Kier performed reasonably well as a business, but the shares were heavily de-rated in response to high profile troubles at some of their peers in the sector, despite Kier's strategy of avoiding large, fixed priced contracts which have caused competitors difficulties.

GlaxoSmithKline was the most disappointing large holding in the portfolio. The company's third quarter results call was used by management to downgrade profits forecasts for next year, and a lack of commitment to a progressive dividend policy was taken badly by the stock market. This caused the shares to underperform and trade at an unusually depressed valuation, given the quality and diversity of the business. Inmarsat also suffered from downgraded earnings and cash flow guidance. Ironically, the company's success in winning new contracts in their aviation division, in particular, has led to rising costs and investment needs, accounting for much of the downgrade.

The last three negative contributors were all stocks that we did not own, but which rallied and helped the benchmark performance. Unilever received an unsuccessful bid approach early in the year and unveiled a major cost cutting strategy in response. Vodafone and Astrazeneca shares performed well, after underperforming in the previous year.

Portfolio Changes

Although the overall stock market has shown limited volatility in the last two years, there

Largest Net Purchases		Largest Net Sales	
Company	£m	Company	£m
WPP	13.5	Centrica	13.9
Meggit	12.5	Carnival	12.6
National Express	11.3	Hansteen	11.2
BHP Billiton	9.3	Aviva	10.5
Bovis Homes	9.0	HSBC	10.3
Morgan Advanced	8.9	Hostelworld	5.5
Barclays	7.9	British American Tobacco	4.9
SSE	5.1	Equiniti	3.6
Greene King	4.9	UBM	3.2
BAE Systems	4.7	Mothercare	3.1

Source: Allianz Global Investors

The underperformance of many domestically exposed companies made this a fertile investment area. We also added several recovery situations, where the stock market was undervaluing longer term business franchises, as well as other companies that offered particularly good value.

Investment Manager's Review *(continued)*

have been some dramatic individual sector and stock moves. With our disciplined valuation framework, this has given us opportunities to invest in new companies at attractive prices, as well as the chance to sell out of other businesses at full valuations. Overall, we added seven new positions to the portfolio and sold out of six completely, leaving 45 holdings at the year end.

There were a few common features among the new holdings. The underperformance of many domestically exposed companies made this a fertile investment area. We also added several recovery situations, where the stock market was undervaluing longer term business franchises, as well as other companies that offered particularly good value.

In the first half of the year, as described in the interim report, we bought the engineering businesses Morgan Advanced Materials and Meggitt, as well as the housebuilder, Bovis Homes, which were all recovery situations. We also bought National Express and WPP, as we believed the stock market undervalued their potential. In the second half we added two domestically exposed businesses, Barclays and Landsecs.

Barclays has a UK retail and commercial bank, as well as domestic and international credit card and investment banking operations. The company is finally emerging from a long period of restructuring following the financial crisis. The sale of most of its African business has strengthened the balance sheet and Barclays has a clear plan to improve returns. This should lead to a re-rating from a low level of 0.7x book value, at the time of purchase, and it should allow for higher dividend payments as has recently been indicated with the company's 2017 annual results.

Landsec is a leading London Office and UK retail real estate company. There was an unusually wide disconnect between the value of the company's assets and its share price, with the shares trading at a discount of over 30% to asset value. Investors have been nervous about the outlook for City offices since the Brexit referendum, despite many transactions at prices in line with current valuations. There has also been growing nervousness about the

Commercial property developer Landsec's Piccadilly Lights in Piccadilly Circus, upgraded to a single 783.5m² screen, is now the largest advertising display in Europe.

Case Study

Bovis Homes

Household Goods & Home Constructions 10,188,150 1.5

The housebuilding industry in the UK benefits from some appealing structural factors. There is a growing population, strong demand for housing and a shortage of supply, which has historically led to rising house prices. Land, materials and key skills can be limited, creating barriers to competition, which are further supported by complex regulations and planning requirements.

Because of these issues, and favourable shorter term factors like the Help-to-Buy scheme and low interest rates, most house builders are highly profitable and are worth considerably more than the value of their assets (book value).

Like many of its large competitors, Bovis Homes builds mostly 3-4 bedroom, detached houses in southern England. However, unlike its peers, the company got into trouble when it tried to grow output too quickly. This ended in disaster, as build quality and customer service suffered. Eventually, Bovis had to abandon its objective of building 4000 homes a year and cut its profit forecasts significantly. In the process the company's shares fell heavily, giving us the opportunity to buy them at just above their asset value in the summer.

We are confident that a new management team can turn the business around and continue paying an attractive ordinary dividend yield, as well as extra returns of surplus capital. In time, we expect Bovis to trade at a significant premium to its asset value again, as profitability recovers.

Bovis is a good example of our investment process in action. It is a business with sound fundamental qualities; land, expertise, a supply chain, strong balance sheet etc., in a structurally attractive industry, that was trading at an unusually cheap valuation, for a specific reason that could be rectified.

Investment Manager's Review *(continued)*

outlook for retail property, as online shopping grows. However, prime shopping centres, such as Landsecs' Bluewater in Kent or Westgate in Oxford, should benefit from trade concentrating in the best venues. The company has positioned itself defensively, with a modest level of gearing and a stable income stream, backed by long term leases. This underpins a growing dividend and a yield of over 4% at time of purchase.

Apart from completely new holdings, we also added to a number of existing portfolio positions. As described on page 19, we added to BHP Billiton at a low level. We also took advantage of relatively poor performance to add to BAE Systems, Tyman, SSE and Greene King, among others, at attractive prices.

Sales typically fell into two distinct groups. Those companies that had performed well and reached a full valuation, and those where we changed our investment view. As described in the interim report, we sold Aviva, British American Tobacco and Hostelworld as they were fully valued, and we sold Mothercare on a change of view. In the second half, we sold the last holding in Carnival for a considerable profit (see separate comment). We also sold Centrica, following a profit warning, where the company cited competitive pressures and lower margins in both its UK retail and its US businesses. Although the company committed to pay the year's dividend, the cover was running quite thin. More fundamentally, we reassessed our level of conviction in the investment case. There should be significant scale advantages in energy supply, coming from operational efficiencies and the use of a strong balance sheet to hedge commodity costs. However, a combination of government policy that favours smaller suppliers, intense media coverage encouraging switching, and political pressure for price caps, have undermined the competitive advantages of scale. We therefore sold the position, despite a low headline valuation.

As well as these total disposals, we took profits elsewhere. Three of the largest holdings in the portfolio, HSBC, Royal Dutch Shell and BP have been extremely strong performers over the last two years, as confidence in their profits

One of the largest net purchases was Meggitt, an engineering group specialising in aerospace, military and energy markets.

Case Study

Carnival

Hotels, Resorts & Cruise Lines n/a n/a

Carnival, the cruise company, highlights the distinction between a great company and a great investment. Carrying 11.5m guests per annum, it is the world's largest cruising business, with approximately a 50% global market share.[1] Demand is structurally growing, with an increasing cohort of wealthy older people. With the largest ships carrying over 5,000 passengers and costing well over $500m, there are substantial advantages to scale. Only the biggest companies can market and operate these huge vessels, and reposition itineraries in response to geo-political events.

Carnival is a great business, and back in 2011, Carnival was also a great investment opportunity. An oversupply of new ships, ordered in the boom years of 2006 and 2007, was delivered into a soft market in the aftermath of the great financial crisis. This depressed ticket prices, whilst rising oil prices put a further squeeze on profitability. Carnival's earnings halved from 2008 to 2013. However, by 2011, the seeds of the recovery had been sown. The number of new ship orders had fallen significantly, which would, in due course, lead to a recovery in pricing power. Any oil price decline would also boost profits.

The recovery in Carnival's share price took some time, as a number of operational incidents, and the tragic Costa Concordia capsizing in 2012, impacted the business. But the recovery came through gradually, helped by a restructuring under a new Chief Executive appointed in 2013.

The company's earnings per share are forecast to have trebled by November 2018 from the low point, with dividends up around 75%. The shares gained over 150%, excluding dividends, between our initial purchases and the final sale. Whilst Carnival remains a great business, at the current valuation it no longer represents a compelling investment opportunity.

[1] Carnival plc, December 2017.

Case Study

Royal Dutch Shell

Oil & Gas Producers £ 52,123,968 7.6

Royal Dutch Shell is the biggest holding in the portfolio. Our investment case in Shell has been based upon its ability to generate substantial cash flows over the oil price cycle, which allows the company to pay a high and progressive dividend to shareholders.

Shell has been one of the best investments in the portfolio over the last two years, with a total return of around 90%. Shell's shares were depressed in early 2016, on concerns over dividend sustainability, as the collapse in the oil price had a severe impact on the company's profitability.

We thought the market's reaction then was far too pessimistic, and the shares were exceptionally cheap, for three primary reasons. First, the long term value of any business should not be determined by one year's profitability, especially in a cyclical industry like oil and gas. Shell's true value is related to its enormous hydrocarbon resources, chemical refineries and other assets, and its ability to generate cash and profits over the cycle.

Second, during downturns, oil companies are able to significantly reduce their huge capital spending budgets, which typically far exceed dividend costs. As in previous cycles, the cost of equipment and labour has fallen materially and companies have become far more efficient. Shell can now generate enough cash to cover all costs, including dividends, at a far lower oil price than in 2014.

Third, we believed that a combination of higher oil demand, boosted by the low oil price, and tightening supply across the industry, due to reduced capital spending, would balance the oil market over time. This has happened, assisted by OPEC, and the higher resulting oil price is helping the oil industry to rebuild profits.

Investment Manager's Review *(continued)*

outlook has improved. All three recovered from being deeply out of favour, with some analysts questioning the sustainability of their dividends. We still see good value in all three companies, but we reduced Merchants' exposure as the discount to fair value narrowed. We also took profits on UBM and Ladbrokes Coral, which received takeover approaches, and from a number of mid-caps which performed well and moved closer to fair value, such as Man Group, Equiniti, IG Group, Balfour Beatty and NEX Group.

Derivatives

Option activity continued at a moderate pace through the year, with only limited opportunities for writing options that met our specific criteria. The option strategy once again delivered its primary objective of income generation, with approximately £0.7m of option premiums accrued. The strategy was also profitable overall, with a profit of £0.4m, after the opportunity costs of all exercised options.

Further information about Merchants' derivatives strategy is in the Glossary on page 41.

Stewardship

As investors in businesses, we pay close attention to issues that can affect the longer term prospects for individual companies and industries. We carry out research into environmental, social and governance (ESG) issues and we take stewardship responsibilities seriously. Allianz Global Investors is a founder member of the Investor Forum. Further details of our approach are shown in the Strategic Report. We set out below the numerous engagements that we have had with companies, in addition to our normal meetings with executive directors to discuss trading and other strategic issues. In total, during 2017 we engaged 23 times with 14 different companies, approximately 30% of the portfolio, on specific issues. The majority of these engagements were led by either portfolio managers or industry analysts, who work closely with our ESG specialists.

For engagement to be effective, an element of discretion and confidentiality is important, so we cannot provide too many details on specific engagements. However we can give

Bookmaking and gaming company Ladbrokes Coral was another holding to receive a takeover approach.

Investment Manager's Review *(continued)*

a few examples of the types of issues we have engaged on. With one financial services company, we had discussions with the chairman about the returns the company could achieve from allocating capital, and the strength of board oversight and challenge of the executive directors. With a natural resources company, we focused on environmental policies and how the company dealt with social and environmental issues around a specific incident. In a third situation, we engaged on a new proposed remuneration structure in a turnaround situation. We made specific recommendations about the range of targets for executives, that were sufficiently challenging, yet provided a fair linkage between potential executive rewards and shareholder returns. We believe our recommendations were influential in the eventual targets that were set.

Economic and market outlook

I have been working in investment markets for thirty years and, in all that time, there has been a bull market in government bonds. Inflation, interest rates and bond yields have fallen relentlessly, at least until recently. We may now, finally, be at a turning point. A decade after the great financial crisis, interest rates in the U.K. have been increased to 0.5%, from their lowest ever level of 0.25%, reached in the wake of the Brexit referendum. In the USA, interest rates have been rising for over a year. Even in Europe, the end of quantitative easing seems to be in sight and the era of negative interest rates may be drawing to a close. Unemployment in the US and the UK are at low levels and inflation is accelerating, albeit from a low base. European economic growth is also picking up. All this points to a change in the long term trend.

Company Engagement Activities in the year – by Global Industry Classification sector

	Topics and engagements by sector						
GICS Sector	Strategy / business model	Capital management	Operational performance	Corporate governance	Environmental risks / impacts	Business conduct and culture	Transparency and disclosure
Materials		2		1	1		
Technology				1			
Health		1					
Real Estate				1			
Financials				2		1	
Telecoms				1			
Industrials	1	1	1	3			1
Utilities				1			
Consumer Staples				1			
Consumer Discretionary	1			1		1	

Source: AllianzGI

Investment Manager's Review *(continued)*

If so, it could mark a major challenge for financial markets. Cheap money has pushed up the price of many assets, including real estate, infrastructure, bonds and, of most relevance for Merchants' portfolio, equities. There is a reasonable argument that an end to cheap money could put pressure on equity valuations. And we have already seen heightened volatility in early 2018.

Of course, the bond bull market may not be over quite yet. There have been plenty of false dawns (or sunsets) before. Western governments and consumers are highly indebted. So, interest rate increases will put pressure on public and private spending, which could in turn slow down the economy and reduce inflationary pressures. In that scenario, the equity bull market could potentially continue, although it would be that much harder for central banks to stimulate economies again, starting from this point.

But it is worth considering what the implications are for equities, from a period of rising bond yields. In theory the lower the interest rate that is used to discount future cashflows, the greater the present value of a company. Higher growth companies, with more of their value far into the future, should theoretically benefit more from lower interest rates than more mature businesses, generating high cash flows today. Indeed, if we look at the value of high growth technology stocks, they are extremely highly rated, as is the tech-heavy US stock market overall. The UK has fewer technology businesses, and the stock market is far more reasonably valued. However, even in the UK, companies exhibiting steady growth, like those in the consumer staples sectors, are generally very highly rated compared to their past.

There is a chance that the valuations of these growth companies come under pressure, with rising interest rates, and indeed, this seems to have been a feature of recent market trends. But, there are also many very reasonably priced companies in the UK market. Partly, this reflects fears about the implications of Brexit and political risk. But it also reflects the composition of the British stock market, with a high weighting in the natural resources and financial sectors, among others, which have not benefited from cheap money as much as many higher growth sectors.

Our value investment style means that we have avoided investing in most of the highly rated companies for some time. The portfolio has a high exposure to modestly rated companies in sectors such as oil producers, construction, aerospace & defence, financial services and travel & leisure.

Although we take account of macro-economic trends, our investment approach, as set out in detail earlier in the report, is very much driven by individual stock considerations. We look to buy sound companies, trading on sensible valuations which have a supportive environment for their business. Even under a scenario of higher interest rates, we can find many such businesses that should be able to deliver both a high yield and attractive total returns to investors.

With the company recently taking out 35 year debt, we have been considering the UK stock market from a genuinely long term investment viewpoint. Merchants has been able to borrow money at an interest cost of under 3%, to invest in a portfolio of leading British businesses, paying a current dividend yield of over 4%. We believe this leaves the company well positioned to deliver healthy medium and long term returns to shareholders, even if there is a period of higher volatility in the short term.

Simon Gergel
Allianz Global Investors

Top 20 Holdings

Sector Value of holding Percentage of portfolio

1 Royal Dutch Shell

Oil & Gas Producers
52,123,968
7.6

Royal Dutch Shell is one of the leading global integrated oil and gas companies, with activities throughout the petroleum value chain from exploration and production to refining and retailing. The company has natural resources that should enable it to maintain production of energy at today's levels for around 25 years. The business is roughly evenly split three ways, between oil, gas and economic growth related activities such as power and chemicals.

The takeover of BG in 2016 has transformed Shell and benefits the company in several ways. It increases the exposure to gas, including LNG (liquid natural gas) where demand is likely to continue growing for decades to come, even if crude oil demand peaks at some point. It brings Shell some high growth, low cost assets, most notably deep water oil and gas in Brazil. BG also improves Shell's cash flow, as the purchase was made close to the peak of a large investment programme. Shell's valuation is modest and we have explained our investment rationale in a separate case study.

2 GlaxoSmithKline

Pharmaceuticals & Biotechnology
43,160,213
6.3

GSK is a science-led healthcare company with particularly strong global positions in pharmaceuticals for respiratory diseases and HIV, vaccines and consumer health.

The shares are lowly valued, with one of the highest dividend yields in the stock market. This rating reflects challenges the business has faced in recent years, especially when blockbuster drugs faced patent expiries. However, looking forward, we believe GSK is a far stronger business. A transformational deal with Novartis in 2015 built GSK into one of the world leaders in both vaccines and consumer health. Vaccines is a highly profitable business, with significant technological barriers to competition and good growth prospects from innovative drugs in shingles and meningitis, in particular. Consumer health is another quality business, with growing brands like Sensodyne toothpaste and Voltarol in pain relief. We believe the pharmaceuticals division has reached a turning point, with new products growing fast, offsetting the pressure on Advair, their last remaining significant drug facing potential generic competition before the middle of the next decade.

Top 20 Holdings *(continued)*

Sector Value of holding Percentage of portfolio

3 BP

Oil & Gas Producers
36,317,057
5.3

BP is another major global integrated oil and petrochemical company. Operating in 70 countries, BP finds and extracts oil and gas on land and offshore, refines products and distributes and sells fuel and energy around the world.

The BP investment case has been hampered by ongoing Deepwater Horizon litigation costs, which has meant that the improvements in operating efficiency made by the company have not been fully reflected in the share price. With materially lower payments expected going forwards, BP will be able to de-gear its balance sheet, allowing for greater shareholder returns and the removal of the scrip dividend. Following a protracted period of volume declines post the Deepwater Horizon event, several new major projects are driving strong upstream volume growth and improved cash flow. BP also has significant value in its downstream operations which include Castrol, (the market-leading lubricants brand), a significant petrochemical franchise and a network of 18,000 retail sites globally. Like Royal Dutch Shell, BP is modestly valued, with a high dividend yield and a huge asset base.

4 HSBC Holdings

Banks
34,037,343
5.0

HSBC is one of the largest banking groups in the world with more than 38 million customers across 67 countries, providing retail, commercial, private and investment banking services. HSBC is more geographically diversified than most UK-listed banks, with developing markets, most notably Hong Kong and China, accounting for a large proportion of revenues.

HSBC has undergone a significant restructuring programme which strengthened the balance sheet and focussed the business on areas where it can generate satisfactory returns on equity. In addition, the whole banking industry is more tightly regulated today than before the financial crisis, with banks holding higher levels of capital and being subject to regular stress tests. This improved supervision should improve the resilience of banks' earnings. HSBC's cost reduction initiatives have been well executed and are supporting improving earnings growth. Although the stock is more highly rated than some UK peers (having performed strongly over the last 18 months) it has a more attractive growth profile, due to its broad geographical exposure to fast growing emerging markets.

Top 20 Holdings *(continued)*

Sector · Value of holding · Percentage of portfolio

5 UBM

Media
28,581,749
4.2

UBM is a media business, focused on managing exhibitions and events, where UBM is the second largest provider globally. Large exhibitions are attractive businesses, capable of generating high returns and strong cash flow. There are considerable scale advantages, with the largest exhibitions often becoming the "must-attend" event in an industry. UBM's strong market position and reasonable valuation, attracted a takeover approach from Informa in January.

6 Lloyds Banking Group

Banks
28,245,800
4.1

Lloyds Banking Group, including Bank of Scotland, Halifax and Scottish Widows, has strong market positions in UK mortgages, credit cards, savings and business banking. Lloyds is emerging from a long post-financial crisis restructuring, with a better capital position and solid underlying profitability. We anticipate improving cash generation and dividend payments which should drive a re-rating of the shares from the current modest valuation.

7 BHP Billiton

Mining
26,614,322
3.9

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

8 Standard Life Aberdeen

Financial Services
23,499,203
3.4

One of the largest asset management companies in Europe, Standard Life Aberdeen is a leading life insurer and asset manager formed by a merger of two complementary businesses in 2017. The merger should generate significant cost saving synergies and longer term cross-selling opportunities supporting the company's high and growing dividend yield. The company has recently announced the proposed sale of its life assurance assets to Phoenix.

Top 20 Holdings *(continued)*

Sector Value of holding Percentage of portfolio

9 BAE Systems

Aerospace & Defence
21,317,052
3.1

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

10 Prudential

Life Insurance
21,055,775
3.1

Prudential is a global insurance, savings and investment management company. It has proposed a separation of the recently-merged UK savings and life insurance business from its international operations, comprising a strong Asian insurance and savings business and a large US annuity franchise. Prudential's leading emerging market presence and growing US market share result in one of the best growth track records in the sector.

11 Legal & General

Life Insurance
20,287,500
3.0

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

12 SSE

Electricity
20,162,250
2.9

SSE is an integrated energy firm, with a balance of regulated distribution assets, electricity generation and energy supply businesses. It has a financial objective of increasing its dividend by at least RPI inflation, and has grown its dividend for over 20 consecutive years. SSE announced in November 2017 plans to merge its energy supply business with Npower, to drive efficiency gains, and to float it separately on the stock market.

Top 20 Holdings *(continued)*

Sector Value of holding Percentage of portfolio

13 Tate & Lyle

Food Producers
15,489,810
2.3

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

14 Greene King

Travel & Leisure
15,216,300
2.2

Greene King is a leading pub company and brewery, running over 3,000 pubs, restaurants and hotels across the UK. It has a well invested, largely freehold pub estate, with several category leading brands. The Spirit pub chain acquisition provides opportunities to optimise the estate, whilst strong cash flow has enabled Greene King to invest in the business and maintain a progressive dividend policy for over 40 years.

15 SThree

Support Services
12,700,093
1.8

SThree is an international specialist recruitment company focussed on providing companies in "STEM" sectors with highly skilled permanent and contract staff. The company is well positioned in technically complex sectors such as IT, Life Sciences and Engineering, and benefits from the structural shift to outsourcing of recruitment. Several markets, such as the US and Germany, are relatively immature and have high growth potential.

16 Kier Group

Construction & Materials
12,505,154
1.8

Kier is a diversified UK property, construction, residential and services company, operating across a number of different sectors including housing, transport, government and infrastructure. Kier has a strong emphasis on risk management and a focus on lower risk framework contracts. Services account for half of profits and are underpinned by long term contracts. Kier has an attractive valuation and exposure to growing infrastructure and housing markets.

Top 20 Holdings *(continued)*

Sector Value of holding Percentage of portfolio

17 J Sainsbury

Food & Drug Retailers
12,463,620
1.8

Sainsbury is the UK's second-largest food retailer with over 600 supermarkets and 800 convenience stores. The acquisition of Argos in 2016, brought excellent logistics and home delivery capabilities, as well as the Habitat brand. Growth in convenience stores, online shopping, clothing and financial services is offsetting pressure in the traditional food business. The valuation is modest, with strong cash flow and scope for synergy savings from the Argos integration.

18 Pennon Group

Gas, Water & Multiutilities
12,432,134
1.8

Pennon Group is a UK environmental infrastructure group, focussing on water, recycling and energy from waste services. Pennon's South West Water division generates best-in-sector returns on regulatory equity, whilst their £1.5bn investment in energy-from-waste, within their Viridor business, is nearly complete and will drive medium term earnings growth. The shares are lowly valued, with political and regulatory risk mitigated by the growing waste business.

19 Diageo

Beverages
12,409,250
1.8

Diageo is a global leader in the alcoholic beverage market with a collection of over 200 brands such as Johnnie Walker and Guinness. It has strong market positions in the attractive US market and across higher growth emerging markets. Diageo is one of Merchants' few consumer staples holdings, as improving cash flow generation and revenue growth, along with high financial returns, justify a premium valuation.

20 Barclays

Banks
12,195,120
1.8

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

Portfolio Holdings

at 31 January 2018

Listed Equity Holdings

Name	Value (£)	% of listed holdings	Principal Activities
Royal Dutch Shell B	52,123,968	7.6	Oil & Gas Producers
GlaxoSmithKline	43,160,213	6.3	Pharmaceuticals & Biotechnology
BP	36,317,057	5.3	Oil & Gas Producers
HSBC Holdings	34,037,343	5.0	Banks
UBM	28,581,749	4.2	Media
Lloyds Banking Group	28,245,800	4.1	Banks
BHP Billiton	26,614,322	3.9	Mining
Standard Life Aberdeen	23,499,203	3.4	Financial Services
BAE Systems	21,317,052	3.1	Aerospace & Defence
Prudential	21,055,775	3.1	Life Insurance
Top Ten Holdings	314,952,482	46	
Legal & General Group	20,287,500	3.0	Life Insurance
SSE	20,162,250	2.9	Electricity
Tate & Lyle	15,489,810	2.3	Food Producers
Greene King	15,216,300	2.2	Travel & Leisure
SThree	12,700,093	1.8	Support Services
Kier Group	12,505,154	1.8	Construction & Materials
Sainsbury (J)	12,463,620	1.8	Food & Drug Retailers
Pennon Group	12,432,134	1.8	Gas, Water & Multiutilities
Diageo	12,409,250	1.8	Beverages
Barclays	12,195,120	1.8	Banks
Meggitt	12,138,830	1.8	Aerospace & Defence
National Express Group	11,409,410	1.7	Travel & Leisure
Inmarsat	11,295,355	1.6	Mobile Telecommunications
Land Securities Group	10,969,200	1.6	Real Estate Investment Trusts
Tyman	10,650,000	1.6	Construction & Materials
Senior	10,540,239	1.5	Aerospace & Defence
Ashmore Group	10,490,181	1.5	Financial Services
National Grid	10,411,664	1.5	Gas, Water & Multiutilities
WPP	10,220,000	1.5	Media
Ladbrokes Coral Group	10,200,000	1.5	Travel & Leisure
Bovis Homes Group	10,188,150	1.5	Household Goods & Home Constructions
IG Group Holdings	10,171,152	1.5	Financial Services
Morgan Advanced Materials	10,143,530	1.5	Electronic & Electrical Equipments
Marks & Spencer Group	10,048,355	1.5	General Retailers
Antofagasta	10,001,800	1.5	Mining
Balfour Beatty	9,260,297	1.3	Construction & Materials
TP ICAP	7,748,820	1.1	Financial Services

Portfolio Holdings *(continued)*

at 31 January 2018

Listed Equity Holdings *(continued)*

Name	Value (£)	% of listed holdings	Principal Activities
Equiniti Group	7,555,729	1.1	Support Services
Man Group	7,480,230	1.1	Financial Services
Hansteen Holdings	7,003,107	1.0	Real Estate Investment Trusts
NEX Group	6,480,179	0.9	Financial Services
FirstGroup	5,371,650	0.8	Travel & Leisure
Sirius Real Estate Ltd	5,364,000	0.8	Real Estate Investment & Services
CRH	5,354,600	0.8	Construction & Materials
St. Ives	4,011,363	0.6	Support Services
Total Listed Equities	**685,321,554**	**100**	

Unlisted Equity Holdings

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

* These companies are the lenders of the company's Stepped Rate Loan and Fixed Rate Interest Loan; more details are available in Note 9 on page 92.
# In liquidation

Written Call Options

As at 31 January 2018, the market value of the open option positions was £(51,450) (2017: £(85,100)), resulting in an underlying exposure to 2.5% of the portfolio (valued at strike price).

Distribution of Total Assets

at 31 January 2018

	Percentage of Total Assets* at 31 January 2018	Percentage of Total Assets* at 31 January 2017
Oil & Gas		
Oil & Gas Producers	12.6	14.7
	12.6	**14.7**
Basic Materials		
Mining	5.2	3.7
	5.2	**3.7**
Industrials		
Aerospace & Defence	6.2	4.0
Construction & Materials	5.4	6.4
Electronic and Electrical Equipment	1.4	-
Support Services	3.5	4.0
	16.5	**14.4**
Consumer Goods		
Beverages	1.8	1.7
Food & Drug Retailers	1.8	2.0
Food Producers	2.2	2.9
Household Goods & Home Construction	1.4	-
Tobacco	-	0.7
	7.2	**7.3**
Health Care		
Pharmaceuticals & Biotechnology	6.1	7.8
	6.1	**7.8**
Consumer Services		
General Retailers	1.4	2.5
Media	5.5	4.1
Travel & Leisure	6.0	7.0
	12.9	**13.6**

Distribution of Total Assets *(continued)*

at 31 January 2018

	Percentage of Total Assets* at 31 January 2018	Percentage of Total Assets* at 31 January 2017
Telecommunications		
Mobile Telecommunications	1.6	2.6
	1.6	**2.6**
Utilities		
Electricity	2.9	2.8
Gas, Water & Multiutilities	3.3	7.3
	6.2	**10.1**
Financials		
Banks	10.5	10.7
Financial Services	9.3	6.4
Life Insurance	5.9	9.2
Real Estate Investment & Services	0.8	0.8
Real Estate Investment Trusts	2.6	2.3
	29.1	**29.4**
Total Investments	**97.4**	**103.6**
Net Current Assets (Liabilities)	**2.6**	**(3.6)**
Total Assets	**100.0**	**100.0**

*Total Assets (less creditors due within one year) £703,921,177 (2017: £621,339,256).

Historical Record

years ended 31 January 2018

Revenue and Capital	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Income (£'000s)	31,730	23,687	25,741	27,305	28,313	29,827	29,958	30,985	31,123	32,633
Earnings per ordinary share	27.25p	18.91p	21.22p	22.00p	22.90p	24.22p	23.56p	24.05p	24.06p	25.50p
Dividend per share	22.80p	22.50p	22.80p	23.00p	23.20p	23.60p	23.80p	24.00p	24.20p	24.80p
Ordinary dividend per share	22.30p	22.50p	22.80p	23.00p	23.20p	23.60p	23.80p	24.00p	24.20p	24.80p
Special dividend per share	0.50p	-	-	-	-	-	-	-	-	-
Tax credit per share	2.53p	2.50p	2.53p	2.56p	2.58p	2.62p	2.64p	2.67p	n/a	n/a
Gross dividend per share	25.33p	25.00p	25.33p	25.56p	25.78p	26.22p	26.44p	26.67p	24.20p	24.80p
Total net assets attributable to ordinary capital (£'000s)	314,804	384,747	440,846	415,025	481,464	529,478	562,009	498,108	545,318	593,478
Net asset value per ordinary share (debt at par)	306.2p	372.8p	427.1p	402.1p	466.5p	510.8p	516.9p	458.1p	501.5p	545.8p
Net asset value per ordinary share (debt at market value) ~#	278.5p	356.4p	407.3p	366.2p	434.1p	486.8p	486.1p	437.7p	478.9p	523.9p
NAV total return (debt at par) % *	-33.4	29.2	20.7	-0.5	21.8	14.5	5.8	-6.7	14.7	13.7
NAV total return (debt at market value) % *~#	-	36.2	20.7	-4.5	24.9	17.5	4.7	-5.0	14.9	14.5
Ordinary share price	282.0p	329.1p	406.9p	363.0p	412.7p	491.5p	484.0p	414.0p	452.5p	488.0p
Share price total return % #	-29.1	25.8	31.4	-5.4	20.8	25.2	3.4	-9.8	15.6	13.3
Discount/premium (debt at par) % #	-7.9	-11.7	-4.7	-9.7	-11.5	-3.8	-6.4	-9.6	-9.8	-10.6
Discount/premium (debt at market value) % ~#	1.3	-7.7	-0.1	-0.9	-4.9	+1.0	-0.4	-5.4	-5.5	-6.9

Notes

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

~ NAV debt at market value has been reported since 2009.

APMs - refer to the Glossary on page 41.

Glossary

UK GAAP performance measures

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

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

Derivatives

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

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

Alternative Performance Measures (APMs)

Net Asset Value, debt at market value, is the value of total assets less all liabilities, with the company's debt measured at the market value at the time of calculation. The Net Asset Value, or NAV, per ordinary share with debt at market value is calculated by dividing this amount by the total number of ordinary shares in issue (see page 102).

Net Asset Value per ordinary share, total return represents the theoretical return on NAV per ordinary share, assuming that dividends paid to shareholders were reinvested at the NAV per ordinary share at the close of business on the day the shares were quoted ex dividend (see page 40).

Share Price Total Return represents the theoretical return to a shareholder, on a closing market price basis, assuming that all dividends received were reinvested, without transaction costs, into the ordinary shares of the company at the close of business on the day the shares were quoted ex dividend (see page 40).

Benchmark Total Return is the return on the benchmark, on a closing market price basis, assuming that all dividends received were reinvested into the shares of the underlying companies at the time their shares were quoted ex dividend. Further information on the company's benchmark, which was changed at the beginning of the financial year, can be found on page 46.

Discount is the amount by which the stock market price per ordinary share is lower than the Net Asset Value, or NAV, with either debt at par or debt at market value, per ordinary share. The discount is normally expressed as a percentage of the NAV per ordinary share. The opposite of a discount is a premium (see page 40).

Ongoing Charges are operating expenses incurred in the running of the company, whether charged to revenue or capital, but excluding financing costs. These are expressed as a percentage of the average net asset value during the year and this is calculated in accordance with guidance issued by the Association of Investment Companies (see page 46).

The Merchants Trust PLC

Strategic Report

The first of twelve Eurofighter Typhoon combat jets was delivered to the Royal Air Force of Oman in June following an official roll-out event at BAE Systems in the UK in May.

Strategic Report

Strategy Review

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

- The company's market position compared with its peer group, including an analysis of objectives, yields, gearing and benchmarks;
- Gearing, and the future for our debt structure and the investment implications;
- An in-depth examination of the commitment of the manager and the value added by the management company; and
- Marketing and communications strategy.

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

- Issue new loan notes to repay the debentures that matured in January 2018 and maintain our structural gearing at a lower cost;
- Consider marketing strategy and confirm that expenditure provides value; and
- Noted the impact of less expensive borrowing on our future ability to pay dividends and maintain our high yield.

Strategic Aims

The company's aims continue to be to:

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

Objectives

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

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

A review of the company's business, activities and prospects is given in the Chairman's Statement starting on page 4, and in the Investment Manager's Review on pages 12 to 41.

Investment Strategy

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

More detail on the investment philosophy and stock selection process is set out in the investment manager's review on pages 14 and 15 which will help shareholders understand how and why the manager invests the way he does, and sets the background for individual investment decisions

Investment Policy

Objective

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

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

Strategic Report *(continued)*

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

The company's authorised borrowing powers set out in the Articles state that the company's borrowings may not exceed its called up share capital and reserves. The board's policy is to maintain gearing (borrowings as a percentage of net assets) in the range of 10-25% (at the time of drawdown). Gearing averaged 19.7% in the year to 31 January 2018 (2017: 22.7%).

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

Benchmark

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

The board monitors the company's NAV total return against several comparators, including the FTSE All-Share Index which is the benchmark for the year to 31 January 2018, and the company's peer group, which is the UK equity income sector.

Marketing

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

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

Dividend

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

Discount/premium

The discount/premium of the share price to net asset value is closely monitored. When shares are trading at a premium, the policy is to be prepared to issue shares to meet natural demand in the market. Conversely, when shares are trading at a discount shares may be bought back and cancelled or held in treasury when the board considers the discount to be significant and a buyback will be good relative value, taking gearing into account.

Business Model

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

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

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

Strategic Report *(continued)*

Key Performance Indicators

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

Performance against the Benchmark Index

This is a major KPI by which investment performance is judged and this is shown in graph form on page 11. The company's objective is to provide an above average level of income and income growth together with long term growth of capital through a policy of investing mainly in higher yielding large UK companies, and for this reason the FTSE All-Share is the benchmark index against which we measure our performance.

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

Year to 31 January 2018 Merchants Total Return

NAV Debt at market value +14.5%
NAV Debt at par +13.7%
Benchmark* +11.3%

Year to 31 January 2017 Merchants Total Return

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

Expenses of running the Company

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

Merchants	Peer Group
2018 0.59%	2018 0.79%
2017 0.63%	2017 1.0%

Performance against the Company's Peers

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

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

As at 31 January 2018, the company was ranked in the UK Equity Income sector as follows:

1 year - 6 out of 25
3 years - 9 out of 25
5 years - 16 out of 24

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

The company's yield, at 5.2% was second highest in the sector at 31 January 2018 (2017: 5.3% third highest). Source: J.P. Morgan Cazenove).

* Benchmark for the year under review is the FTSE All-Share Index, and in the prior year was the FTSE 100 Index.

Strategic Report *(continued)*

Dividends

The board has a policy of paying a progressive dividend each year, taking into account inflation and subject to general earnings growth and dividends received in the portfolio. Dividends paid in the past ten years are set out in the Historical Record table on page 40. Ordinary dividends have risen in every year since 1982.

2018 24.8p +2.5%
2017 24.2p +0.8%

The board also takes account of the company's dividend yields in relation to its peers. There is a graph showing the history on page 11.

Gearing

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

2018 Highest 21.4% Lowest 17.9% Average 19.7%
2017 Highest 27.4% Lowest 19.1% Average 22.7%

Risk Policy

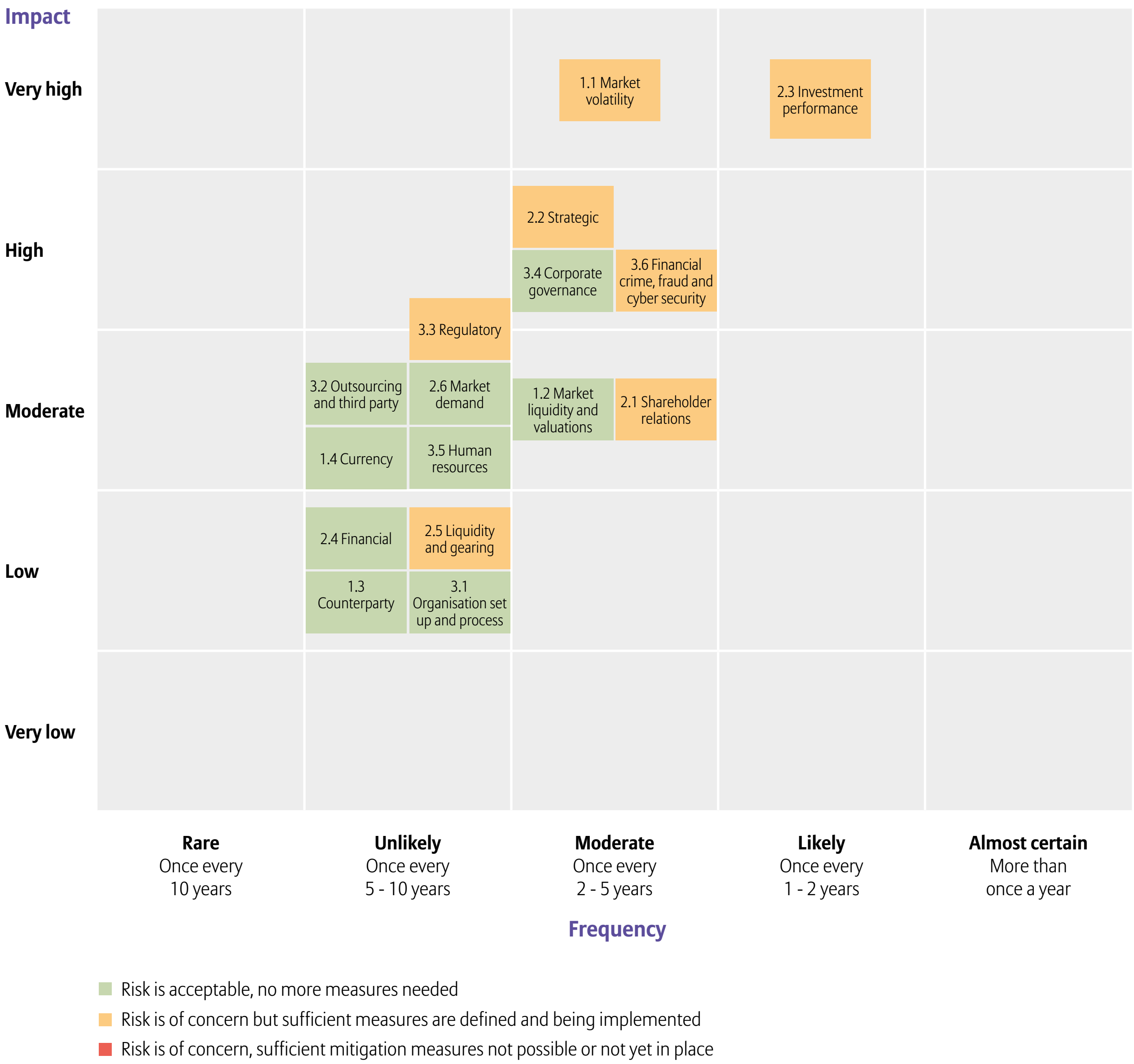
The board operates a risk management policy to ensure that the level of risk taken in pursuit of the board's objectives and in implementing its strategy are understood. The principal risks identified by the board are set out in the table on pages 49 and 50, together with the actions taken to mitigate these risks. The process by which the directors monitor risk is described in the Audit Committee Report on page 65.

Risk mapping

The chart overleaf shows the board's assessment of the principal risks facing the company. These have been grouped into three types: Investment and Portfolio Risks; Business and Strategy Risks; and Operational Risks. Risks are rated as 'red' or 'high' when the risk is of concern and sufficient mitigation measures are not possible or not yet in place; 'amber' or 'moderate' when the risk is of concern but sufficient measures are defined and have been or are being implemented; and 'green' or 'acceptable' when the risk is acceptable and no further measures are needed. The nature of the company's business means that a certain amount of risk must be taken for its objectives to be met therefore it is not surprising that portfolio risk types earn amber ratings.

Strategic Report *(continued)*

Risk Map



Principal risks

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

The principal risks are broadly unchanged from the previous year.

Risk appetite

The board identifies risks, considers controls and mitigation, the probability of the event, and assesses residual risk. It then evaluates whether its risk appetite is satisfied. The board confirms for the year ended 31 January 2018 that its assessment of risk is in line with its risk appetite for all key risks.

Strategic Report *(continued)*

	Investment and Portfolio Risks	Controls and mitigation examples
1.1	**Market volatility**	The board receives regular reporting from the manager on macro-economic intelligence received from its internal and external sources. The investment process is primarily bottom-up which manages the risk of impact if predictions are inaccurate. The portfolio is stress tested at least monthly.
1.2	**Market liquidity and valuations**	Board policies restrict the size of investments in individual companies and sectors. Liquidity reports including stock disposal times are evaluated by the manager at least monthly.
1.3	**Counterparty**	The manager operates on a delivery versus payment system, therefore reducing the risk of counterparty default.
1.4	**Currency**	The board monitors currency movement and determines hedging policy as appropriate.
	Business and Strategy Risks	**Controls and mitigation examples**
2.1	**Shareholder relations**	A review of shareholder lists takes place at each board meeting. Reports on shareholder sentiment are received from the manager and brokers and reviewed by the board. Significant movements in shareholder accounts are reported to the board. The AGM is the core interface between the company and shareholders in demonstrating accountable and transparent management of the company.
2.2	**Strategic**	Board policies restrict the size of investments in individual companies and sectors.
2.3	**Investment performance**	The investment manager attends all board meetings to discuss performance with the directors. The board manages these risks by giving investment guidelines which are monitored at each meeting. The board reviews the investment performance of the company against the benchmark and peer group. The board regularly discusses composition and succession planning to ensure that sufficient board members have the appropriate background and knowledge to evaluate performance.
2.4	**Financial**	The rolling income forecast (including special dividends), balance sheet and expenses are reviewed at every board meeting. Reporting from the custodian covering internal controls in place over custody of investments and over appointment and monitoring of sub-custodians is produced and reviewed at least annually. The board's investment restrictions are input in trading systems to impose a pre-trade check. The manager discusses derivative activity during a monthly risk call. Any overdue dividend debtors are monitored by the manager and variance analyses of income from meeting to meeting are provided to the board. The board annually reviews and approves the accounting policy for the income/capital split.
2.5	**Liquidity and gearing**	The board meets with the portfolio managers and considers asset allocation, stock selection and levels of gearing on a regular basis and has set investment restrictions and guidelines that are monitored and reported on by AllianzGI. Regular compliance information is prepared by the manager and submitted to lenders in accordance with the covenant requirements.
2.6	**Market demand**	The board regularly reviews the level of discount and shares can be bought back by the company at discounts greater than an agreed level when there is demand to do so.

Strategic Report *(continued)*

	Operational Risks	Controls and mitigation examples
3.1	**Organisation set up and process**	Business continuity plans are in place and are reviewed and tested on an annual basis by the manager. The manager engages an external party to audit its control environment, submitting the annual results to the board.
3.2	**Outsourcing and third party**	The board receives formal assurance reports from all of its direct service providers and the manager carries out regular monitoring of outsourced administration functions, this includes compliance visits and risk reviews where necessary. Results of these reviews are supplied to the board. Agreed Service Level Agreements (SLAs) and Key Performance Indicators (KPIs) are in place with each service provider and the board receives reports outlining performance against these. The company secretary reports to the board that the contracts with service providers are reasonable and competitive.
3.3	**Regulatory**	The board maintains close relations with its advisers and makes preparations for mitigation of these risks as and when they are known or can be anticipated.
3.4	**Corporate governance**	The board takes regular advice on best practice.
3.5	**Human resources**	Manager and board succession plans are in place. Cover is available for core members of the relevant teams of the manager, and work can be carried out by other team members should the need arise.
3.6	**Financial crime, fraud and cyber security**	AllianzGI has anti-fraud, anti-bribery policies and robust procedures in place. The board is alert to the risks of financial crime and threat of cyber attacks and reviews how third party service providers handle these threats. These reports confirm that all systems are secure and are updated in response to any new threats as they arise.

Strategic Report *(continued)*

Environmental, Social Governance & Stewardship (ESG)

Active stewardship is an integral component of our manager's active approach to investment. Investment stewardship can help unlock potential in companies, as well as protect companies from downside risks. ESG factors are important investment performance drivers from a risk mitigation and return perspective and AllianzGI has a dedicated ESG research team working with the portfolio managers to integrate ESG factors into investment decisions.

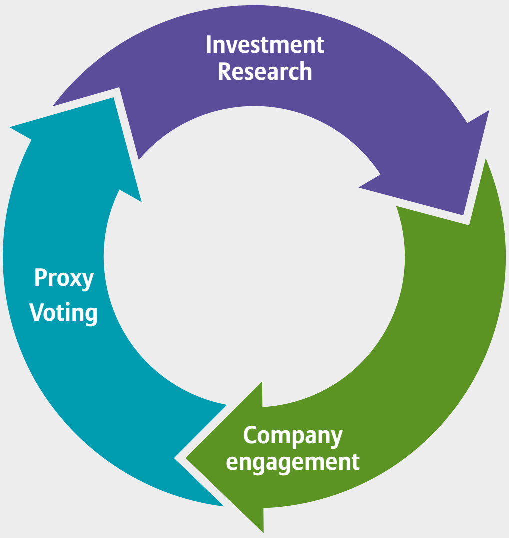
Active engagement by the manager with the direct involvement of investment professionals spans all aspects of company performance, improves practices and enhances company research. Engagement work is grounded in driving portfolio performance – AllianzGI does not undertake engagement for engagement's sake. AllianzGI are 'holders' not 'traders' of the assets held for us and we support their belief in the value of working with companies to help them build sustainable businesses, rather than reacting to day-to-day news flow. In the past year there have been twenty-three engagements with fourteen companies in the Merchants Trust portfolio. Further information on engagements is provided in the Investment Manager's Review.

Active proxy voting engagement for clients is seen as a core element of fiduciary responsibilities and the manager provides total voting coverage. Details of votes cast at investee company meetings are available on the AllianzGI website mentioned below. This active global approach to the exercise of voting rights is aimed at improving governance standards across all portfolios.

This shows how company engagement at AllianzGI enriches investment research and decision making:

Company Engagement

- Enriches investment analysis and decision making
- Helps assess company leadership and culture and build trust
- Active involvement from portfolio managers and sector analysts in company engagements
- Inclusive transparent process and multiple pressure points from within AllianzGI
- Focus on material issues: case-by-case approach
- Organic link to Proxy Voting decisions



Engagement success is part of delivering investment performance

More information can be found at: www.allianzgi.com/en/ourfirm/our-esg-approach

Strategic Report *(continued)*

Viability Statement

The Merchants Trust is an investment company and has operated as an investment vehicle since 1889 with the aim of offering a return to investors over the long term. The board has confidence in the future of the company. Over its 129 year history, the company has survived numerous external crises and economic events; it has a solid portfolio of blue chip stocks and has built up substantial revenue reserves. The directors have formally assessed the company's prospects for a period longer than the one year required by the Going Concern principle. The directors believe that five years is an appropriate outlook period for this review as this would give investors assurance that there is a realistic prospect that the company will continue to be viable and continue to seek to achieve its aim to provide an above average level of income and income growth together with long term capital growth, whilst acknowledging the difficulty of forecasting prospects for markets beyond a relatively short horizon.

The board has assessed the long-term viability of the company against the principal risks faced by the company, outlined in the reporting under Risk in the Strategic Report. The chief risks that could pose a threat to the future prospects of the company are around Investment Performance and Market Volatility, as described in the Risk reporting on pages 47 to 51.

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

- The company's investment strategy which, in the board's view, will continue to provide long term returns to shareholders as well as an attractive income as it has done in the past;
- The financial position of the company, including the impact of foreseeable market movements on cash flows - the board monitors the financial position in detail at each board meeting and at least twice each year it stress-tests the portfolio against significant market falls;
- The company's ability to meet interest payments and debt redemptions as they fall due. The next such planned payment is in 2023; and
- The liquidity of the portfolio, and the company's ability to pay dividends and to meet the budgeted expenses of running the company which is examined at each board meeting.

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

Social, Community and Human Rights Issues

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

Directors and employees and gender representation

Biographies of the directors of the company on 31 January 2018 are set out on page 54. As at the date of this report there are three male directors and two female directors. The company has no employees.

The Future

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

The Chairman gives his view on the outlook in his statement on page 9 and the investment manager discusses his view of the outlook for the company's portfolio in his review on pages 28 and 29.

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

On behalf of the board

Simon Fraser
Chairman
28 March 2018

The Merchants Trust PLC

Directors' Review

The oil production sector performed well over the year.

Directors, Investment Manager and Advisers

Directors

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

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

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

Mary Ann Sieghart
Joined the board in November 2014. She is Chair of the Social Market Foundation, and a non-executive director and Senior Independent Director of The Henderson Smaller Companies Investment Trust plc. Mary Ann is a trustee of the Kennedy Memorial Trust and holds other voluntary posts. Mary Ann is a political journalist and broadcaster and was formerly Assistant Editor of The Times, a Lex Columnist at the Financial Times and City Editor of Today. She has been appointed a Visiting Fellow of All Souls College, Oxford for the academic year 2018-19.

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

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

Committee memberships

All directors are members of the Management Engagement Committee. All directors, with the exception of the Chairman, Simon Fraser, are members of the Audit Committee. Further details are on page 58.

Directors, Investment Manager and Advisers

(continued)

The Manager or Alternative Investment Fund Manager (AIFM)

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

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

As at 31 December 2017, Allianz Global Investors had €498 billion of assets under management worldwide.

Through its predecessors, Allianz Global Investors has a heritage of investment trust management expertise in the UK reaching back to the nineteenth century and as at 31 December 2017 had £1.43 billion of assets under management in a range of investment trusts. Website: www.allianzgi.co.uk

Head of Investment Trusts

Melissa Gallagher Email: melissa.gallagher@allianzgi.com

Investment Manager

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

Company Secretary and Registered Office

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

Registered Number

28276

Independent Auditors

PricewaterhouseCoopers LLP

Bankers

HSBC Bank plc,
Barclays Bank plc

Registrars

Link Asset Services
(full details on page 107)

Solicitors

Herbert Smith Freehills LLP

Stockbrokers

J.P. Morgan Securities Limited

Depositary and Custodian

HSBC Bank plc

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

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

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

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

The Depositary must ensure that:

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

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

Report of the Depositary to the Shareholders of The Merchants Trust PLC (the company) for the year ended 31 January 2018.

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

HSBC Bank plc
2 March 2018

Further information about the relationship with the Depositary is on page 106.

Directors' Report

The directors present their report and the audited financial statements of the company for the year ended 31 January 2018.

Revenue

The revenue earnings attributable to ordinary shareholders for the year amounted to £27,732,007 or 25.5p per share (2017: £26,160,643, 24.1p per share).

The first quarterly dividend of £6,632,436, or 6.1p per share, and the second quarterly dividend of £6,741,165, or 6.2p per share, have been paid during the year. Since the year end the third quarterly dividend of £6,741,165, or 6.2p per share, was paid on 2 March. Subject to shareholder approval, a final dividend of 6.3p will be payable on 30 May 2018. In accordance with FRS 102 Section 32: 'Events after the end of the reporting period', the third interim dividend and final dividend are not recognised as liabilities within the financial statements on the basis that at the year end the third interim dividend had not been paid and the final dividend not approved by the shareholders.

Historical Record

The distribution of total assets is shown on pages 38 and 39, and the historical record of the company's revenue and capital over the past ten years is shown on page 40. Graphs appear on page 11 showing the performance on a total return basis over the past ten years of the net asset value of the company's ordinary shares against the FTSE All-Share Index, the growth in net ordinary distributions made by the company against the Retail Price Index, the company's discount/premium to net asset value and the dividend yield compared to the FTSE All-Share Index, UK gilt yield and cash, over the same period.

Invested Funds

Sales of investments during the year resulted in net gains based on historical costs of £23,575,112 (2017: £11,472,893). Provisions contained in the Finance Act 2010 exempt approved investment trusts from corporation tax on their chargeable gains.

Share issuance and buy back

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

Future Development

The future development of the company is dependent on the success of the company's investment strategy against the economic environment and market developments. The Chairman's Statement on page 9 sets out the outlook for the company and the investment manager also discusses his view of the outlook for the company's portfolio in his report beginning on page 12. The future is also discussed in the Strategic Report on page 52.

Going Concern

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

Section 992 of the Companies Act 2006

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

Capital Structure

The company's capital structure is summarised in Note 12 on page 95. The details of the 4% perpetual debenture stock and the 3.65% cumulative preference stock are provided in Notes 11(iii) and 11(iv) respectively on page 94.

Directors' Report *(continued)*

Voting Rights in the Company's Shares

The voting rights at 28 March 2018 were:

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

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

Interests in the Company's Share Capital

As at 28 March 2018 the company has received no declarations of notifiable interests in the company's issued share capital.

Common Reporting Standards (CRS)

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

Directors

Biographical details of the current directors at the date of the signing of this report are shown on page 54.

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

Details of the directors' attendance at board and committee meetings is set out in the table on page 58.

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

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

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

Related Party Transactions

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

Management Contract and Management Fee

The management contract with Allianz Global Investors GmbH, UK Branch (AllianzGI) provides for a fee of 0.35% per annum (2017: 0.35%) of the value of the assets, calculated quarterly, after deduction of current liabilities, short term loans under one year and any funds within the portfolio managed by AllianzGI. The management contract is terminable at one year's notice (2017: one year). Under the contract, other than a year's fees which may be paid in lieu of notice, there are no compensation payments due on termination.

Directors' Report *(continued)*

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

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

Corporate Governance Statement

The board has considered the principles and recommendations of the AIC Code of Corporate Governance 2016 (AIC Code) and been guided by the AIC Corporate Governance Guide for Investment Companies (AIC Guide). Both documents can be found on the AIC website www.theaic.co.uk. As confirmed by the Financial Reporting Council, following the AIC Guide enables investment company boards to meet their obligations under the UK Corporate Governance Code. The company has complied with the current recommendations of the AIC Code and the relevant provisions of UK Corporate Governance Code, except in relation to the UK Corporate Governance Code provisions relating to: the role of the chief executive; executive directors' remuneration; the remuneration committee; and the need for an internal audit function. For the reasons set out in the AIC Guide, and in the preamble to the UK Corporate Governance Code, the board considers these provisions are not relevant to the company as it is an externally managed investment company. The UK Corporate Governance Code published in April 2016 and the associated AIC Code of Governance published in July 2016 applied in the year ended 31 January 2018.

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

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

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

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

Special Rights Disclosure

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

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

Directors' Report *(continued)*

Conflicts of Interest

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

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

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

Board Composition and Succession Planning

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

Gender Diversity

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

Board Committees

Audit Committee

The Audit Committee Report is on pages 64 to 67.

Nomination Committee

The Nomination Committee meets at least once each year and makes recommendations on the appointment of new directors and the re-election of existing directors by shareholders. The committee also determines the process for the annual evaluation of the board. The committee is chaired by Simon Fraser, the Chairman of the board. All directors serve on the committee and consider nominations made in accordance with an agreed procedure. The recruitment process for new directors is for the board to appoint external consultants to nominate candidates for the committee to consider.

Management Engagement Committee

The Management Engagement Committee meets at least once each year to review the management agreement and the manager's performance. It has defined terms of reference and consists of the non-executive directors and would exclude any directors employed by the manager in the previous five years. It is chaired by Simon Fraser, the Chairman of the board.

Terms of Reference

The terms of reference for each of the committees may be viewed by shareholders on request and are published on the website www.merchantstrust.co.uk.

The board has not constituted a remuneration committee; all directors are non-executive and remuneration matters are dealt with by the whole board.

Financial Reporting

The Statement of Directors' Responsibilities in respect of the financial statements is on page 63. The Independent Auditors' Report can be found on pages 72 to 78.

Auditors' Information

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

(a) in so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and

(b) the director has taken all the steps he or she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Directors' Report *(continued)*

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

Internal Control

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

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

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

- The board, assisted by the manager, undertook a full review of the company's business risks and these are analysed and recorded (see pages 47 to 50). Every six months the board receives from the manager a formal report which details any known internal controls failures, including those that are not directly the responsibility of the manager. The board continues to check that good systems of internal control and risk management are embedded in the operations and culture of the company and its key suppliers.
- AllianzGI, as the manager, provides investment management, accounting and company secretarial services to the company. The manager therefore maintains the internal controls associated with the day to day operation of the company. These responsibilities are included in the management agreement between the company and the manager. The manager's system of internal control includes organisational arrangements with clearly defined lines of responsibility and delegated authority as well as control procedures and systems which are regularly evaluated by management and monitored by its internal audit department. The company receives full reports at least annually from the manager on its internal controls. The company, in common with other investment trusts, has no internal audit department, but the effectiveness of the manager's internal controls is monitored by AllianzGI's internal audit function.
- There is a regular review by the board of asset allocation and any risk implications. There is also regular and comprehensive review by the board of management accounting information including revenue and expenditure projections, actual revenue against projections and performance comparisons.
- Authorisation and exposure limits are set and maintained by the board.
- The audit committee assesses the systems of controls of third party service providers by reviewing internal control reports of those parties including the manager, the company's registrars, Link Asset Services and the custodian, HSBC Bank plc.

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

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

Relations with Shareholders

The board strongly believes that the annual general meeting should be an event which private shareholders are encouraged to attend. The annual general meeting is attended by the Chairman of the board, the Chairmen of the board's committees and the directors, and the investment manager makes a presentation at the meeting. The number of proxy votes cast in respect of each resolution will be made available at the annual general meeting.

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

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

Directors' Report *(continued)*

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

The UK Stewardship Code and Exercise of Voting Powers

The company's investments are held in a nominee name. The board has delegated discretion to discharge its responsibilities in respect of investments, including the exercise of voting powers on its behalf to the manager, AllianzGI. AllianzGI is a signatory to the UK Stewardship Code, which sets out good practice on engagement with investee companies. AllianzGI monitors our portfolio holdings and proactively engages with investee companies in line with the principles set out in the UK Stewardship Code and consistent with our investment objectives. AllianzGI subscribes to the ISS Proxy Voting Services. ISS manages the voting process and recommends actions based upon AllianzGI's Global Proxy Voting Policy Guidelines.

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

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

Criminal Finances Act 2017

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

Modern Slavery Act 2015

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

Bribery Act 2010

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

Greenhouse Gas Emissions

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

Annual General Meeting

1. Allotment of New Shares

Approval is sought in Resolution 11 for the renewal of the directors' authority to allot relevant securities, in accordance with section 551 of the Companies Act 2006, up to a maximum number of 36,242,821 ordinary shares, representing approximately one third of the existing ordinary share capital. This authority is renewable annually and will expire at the conclusion of the annual general meeting in 2019.

2. Disapplication of Pre-emption Rights

A resolution was passed at the annual general meeting held on 16 May 2017 in accordance with section 570 of the Companies Act 2006, to authorise the directors to allot ordinary shares for cash other than pro rata to existing shareholders. The authority is renewable annually and expires at the conclusion of the annual general meeting in 2018. Special resolution 12 is therefore proposed under special business at the forthcoming annual general meeting to renew this authority until the conclusion of the annual general meeting in 2019 or 16 August 2019 if earlier. This power is limited to a maximum number of 10,872,846 ordinary shares, being approximately 10% of the issued ordinary share capital of the company as at the date of this report, provided that there is no change in the issued share capital between the date of this report and the annual general meeting to be held on 16 May 2018.

Authority will also be sought in Resolution 12, which will be proposed as a Special Resolution, to disapply pre-emption rights in respect of the allotment of shares by the sale and reissue of shares held by the company as treasury shares.

The directors may allot shares under these authorities to take advantage of opportunities in the market as they arise but only if they believe it would be advantageous to the company's existing shareholders to do so. The directors confirm that no allotment of new shares will be made unless the lowest market offer price of the ordinary shares is at least at a premium to net asset value, valuing debt at market value.

Directors' Report *(continued)*

3. Purchase of Own Shares

The board is proposing that the company should be given renewed authority to purchase ordinary shares in the market to hold in treasury or for cancellation. The board believes that such purchases in the market at appropriate times and prices are a suitable method of enhancing shareholder value. The company would make either a single purchase or a series of purchases, when market conditions are suitable, with the aim of maximising the benefits to shareholders and within guidelines set from time to time by the board.

Under the Companies Act 2006, the company is allowed to hold its own shares in treasury following a buy back, instead of having to cancel them. This gives the company the ability to reissue treasury shares quickly and cost-effectively (including pursuant to the authority under resolution 12, see above) and provides the company with additional flexibility in the management of its capital base. Such shares may be resold for cash but all rights attaching to them, including voting rights and any right to receive dividends are suspended whilst they are in the treasury. If the board exercises the authority conferred by resolution 13, which will be proposed as a Special Resolution, the company will have the option of either holding in treasury or of cancelling any of its shares purchased pursuant to this authority and will decide at the time of purchase which option to pursue.

Where purchases are made at prices below the prevailing net asset value of the ordinary shares, this will enhance net asset value for the remaining shareholders. It is therefore intended that purchases would only be made at prices below net asset value, with the purchases to be funded from the capital reserves of the company (which are currently in excess of £500 million). The rules of the UK Listing Authority (Listing Rules) limit the price which may be paid by the company to 105% of the average middle-market quotation for an ordinary share on the five business days immediately preceding the date of the relevant purchase. The minimum price to be paid will be 25p per ordinary share (being the nominal value). Overall, this proposed share buy back authority, if used, could help to reduce the discount to net asset value when the company's shares trade at a discount.

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

Under the Listing Rules, the maximum number of its own shares which a listed company may purchase through the market pursuant to a general authority such as this is equivalent to 14.99% of its issued share capital. For this reason, the company is limiting its renewed authority to make such purchases to 16,298,396 ordinary shares, representing 14.99% of the issued share capital, provided that there is no change in the issued share capital between the date of this report and the annual general meeting to be held on 16 May 2018.

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

The authority in accordance with section 701 of the Companies Act 2006, will last until the annual general meeting of the company to be held in 2019 or the expiry of 15 months from the date of the passing of this resolution, whichever is the earlier. The authority will be subject to renewal by shareholders at subsequent annual general meetings.

4. Independent Auditors

The directors will place a resolution before the annual general meeting to appoint BDO LLP as statutory auditors for the ensuing year. Further information on the proposed appointment is in the Audit Committee Report on page 65. A resolution to authorise the directors to determine the auditors' remuneration will also be proposed at the annual general meeting.

The board and the Annual Report

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

By order of the board

Kirsten Salt
Company Secretary
28 March 2018

Statement of Directors' Responsibilities in respect of the Financial Statements

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

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

- select suitable accounting policies and then apply them consistently;
- state whether applicable UK Accounting Standards have been followed, comprising FRS 102, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors each have a duty to make themselves aware of any "relevant audit information" and ensure that the auditors have been made aware of that information. A disclosure stating that each director has complied with that duty is given in the Directors' Report on pages 59 and 60.

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

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

Statement under Disclosure and Transparency Rule 4.1.12
The directors at the date of approval of this report, each confirm to the best of their knowledge that:

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

For and on behalf of the board

Simon Fraser
Chairman
28 March 2018

Audit Committee Report

I am pleased to present the report of the audit committee for the year ended 31 January 2018.

Composition

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

Role

The principal role of the Audit Committee is to assist the board in relation to the reporting of financial information, the review of financial controls and the management of risk. The committee has defined terms of reference and duties and the terms of reference are published on the company's website. These include:

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

Activities

During the year the committee had two regular meetings during which the Annual Report and the Half-yearly Report respectively were reviewed in detail. The regular meetings were attended by representatives of the manager, including its compliance and risk departments. At each regular meeting the committee received reports on the operation of financial controls relating to the company and the proper conduct of its business in accordance with the regulatory environment in which both the company and the manager operate. The committee also considered the auditors' report on the annual report, the planning and the process of the audit and the auditor's independence and objectivity. The audit committee reviews the company's accounting policies with the manager and considers their appropriateness. The committee also reviews the terms of appointment of the auditors together with their remuneration, and, as signalled last year, conducted an audit tender.

Audit committee focus in 2017 / 2018

Annual Report

The audit committee oversaw a project to make the content and design of the Annual Report more accessible and engaging. We worked with designers and the companies in which we are invested to include relevant imagery and investment cases. The investment manager has also included a new section on investment philosophy and the stock selection process, together with more information on stewardship and engagement.

Alternative Performance Measures

We have added a Glossary of Alternative Performance Measures on page 41 and indicated where these appear on the various pages of the report.

Audit tender

As flagged in last year's Audit Committee Report, this year we held an audit tender to appoint a new auditor for the next financial year. We approached a number of firms, both large and mid-sized and the audit committee and management team received presentations from the two firms able to tender. We used a number of detailed criteria to evaluate the presentations and made a recommendation to the board that the appointment of BDO LLP is proposed to shareholders for approval at this year's AGM.

Review of the switch of the manager's outsourced back office service provider

During the year we asked our auditor to include in the audit process the move of the manager's back office to a new service provider, State Street Bank and Trust Company. The fee for this additional element of the audit was reimbursed by the manager. We received a report that no issues arose on the transition at the Audit Committee meeting in March 2018.

Review of new regulations, including MiFID II, PRIIPs and GDPR

During the year we noted preparations being made by the manager to ensure compliance for Merchants with a raft of new legislation coming into force in 2017 and 2018, including MiFID II, PRIIPS and GDPR.

Audit Committee Report *(continued)*

Change of Auditors

PricewaterhouseCoopers LLP have acted as auditors to the company for over twenty years. Recent EU audit legislation required the rotation of long-serving auditors, in Merchants' case, this is required to take place by 2020. As noted last year, the current partner, Jeremy Jensen, will have completed five years on the company's audit in 2018, and so it was agreed to tender the audit for the new financial year. Following the audit tender process it is proposed that BDO LLP be appointed as Auditor commencing with the financial year ending 31 January 2019, and a resolution to approve the appointment is being put to the AGM.

On behalf of the company, I would like to thank Jeremy Jensen and his team at PricewaterhouseCoopers LLP for their diligent and professional conduct of the audit process in this and previous years.

Risk

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

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

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

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

Resulting from the work of the audit committee, certain key risks are identified for disclosure and discussion in our annual report. We have also assessed residual risks after controls and mitigating actions have been applied and have evaluated if our risk appetite has been satisfactorily addressed. The principal risks are in relation to Portfolio, Business and Operational Matters. The risks identified together with mitigating actions are set out in the Strategic Report on pages 49 and 50.

Viability Statement

Based on this review of risk, including the chief risks around Investment Performance and Market Volatility and the arrangements in place to manage and mitigate these risks, the committee reviewed a paper that supported the board's conclusion, set out on page 52 in the strategic report, of their reasonable expectation that the company is viable in the longer term.

Internal audit

The audit committee continues to believe that the company does not require an internal audit function of its own as it delegates its day to day operations to third parties from whom it receives internal controls reports.

Assessment of Fair, Balanced and Understandable

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

Review of Disclosure and Communication

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

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

Whistleblowing

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

Audit Committee Report *(continued)*

Financial Report and Significant Issues

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

Significant issues considered by the audit committee in the year

Area of focus	Activity
Risks around the valuation of and the existence of investments	The company's assets are principally invested in large UK listed equities traded on major exchanges. The committee notes that investments are valued using stock exchange prices provided by third party financial data vendors. During the year the committee reviewed internal controls reports from the manager concerning the systems and controls around the pricing and valuation of securities. The committee also reviews the valuation of unlisted investments. Unlisted investments are recognised on a fair value basis as set out in the Statement of Accounting Policies on pages 84 and 85 and are reviewed by the manager's valuation committee before being approved by the company and being made available to the auditor.
Area of focus	**Activity**
The risk that income from the portfolio of investments was not correctly recognised and accounted for	The committee noted that the board receives income forecasts throughout the year and is able to compare these against actual income received. The committee has also received assurances from the manager that the company's stated accounting policies, which are set out on pages 84 to 86, were noted and adhered to, for example, each special dividend received is considered by the board at its meetings and is treated as a capital or revenue item depending on the facts or circumstances of each dividend. The board also receives reports at the board meetings of the impact of currency movements, e.g., the devaluation of sterling, on the portfolio revenue.

These and other matters, identified as posing lesser risk, were considered and discussed with the manager and the auditors as part of the year end process.

We also agreed the degree of materiality that the auditors would apply in their work, which is £5.9 million, or about 1% of Net Assets, although the auditors would bring to the audit committee's attention any significant misstatements below that level.

The audit and its effectiveness

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

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

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

The committee considered the representations made by the auditor and sought comments from representatives of the manager on the provision of services by the auditors and the effectiveness of the external audit. The audit committee believes that the performance of the auditors was satisfactory.

Non-audit services

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

Fees for non-audit services were £12,900 in the year (2017: £4,600). These fees are considered by the audit committee to be proportionate to the fees for audit services of £31,585 (2017: £27,400). This non-audit work was found not to have a significant impact on the financial statements.

Timon Drakesmith
Audit Committee Chairman
28 March 2018

Directors' Remuneration Report

The Remuneration Report

This is the Directors' Remuneration Report for the year. The report is submitted in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 for the year ended 31 January 2018. An ordinary resolution for the approval of the Directors' Remuneration Policy Report was first put to a binding shareholder vote at the annual general meeting in 2014 and was placed before shareholders for approval at the AGM in 2017. It will next be put to shareholders in 2020. The results of the vote at the 2017 AGM for this resolution were as follows: In favour 94.9%, against 5.1% and 693,409 shares were withheld (in aggregate, 31,770,124 votes). The results of the advisory vote at the 2017 AGM for the resolution to approve the Implementation Report were as follows: In favour 94.9%, against 5.1% and 726,829 shares were withheld (in aggregate 31,736,704 votes). The Directors' Remuneration Implementation Report will be put to an advisory shareholder vote at this year's AGM.

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

The Board

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

Directors' Shareholdings and Share Interests (Audited)

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

	2018	2017
Simon Fraser	20,000	20,000
Timon Drakesmith	15,000	15,000
Mary Ann Sieghart	1,000	1,000
Sybella Stanley	3,114	3,114
Paul Yates	20,000	10,000

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

Directors' Remuneration Policy

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

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

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

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

This Directors' Remuneration Policy is the same in all material respects as that currently followed by the board and summarised in the last Directors' Remuneration Report and approved by the shareholders at the annual general meeting held on 16 May 2017.

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

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

Directors' Remuneration Report *(continued)*

Annual Statement and Directors' Remuneration Implementation Report

Directors' Emoluments (Audited)

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

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

The fees were reviewed in January 2018 and it was determined that there would be no increase to directors' fees at that time.

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

	Directors' fees	
	2018 £	2017 £
Simon Fraser	37,500	36,500
Timon Drakesmith*	30,500	7,250
Mike McKeon**	-	27,750
Mary Ann Sieghart	25,000	24,000
Sybella Stanley	25,000	24,000
Paul Yates	25,000	24,000
Totals	**143,000**	**143,500**

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

There are no other benefits requiring reporting.

Analysis of Pay against Distributions

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

Expenditure by the company on remuneration and distributions to shareholders

	2018 £	2017 £
Remuneration paid to all directors	143,000	143,500
Distributions to shareholders	26,638,473	26,094,832

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

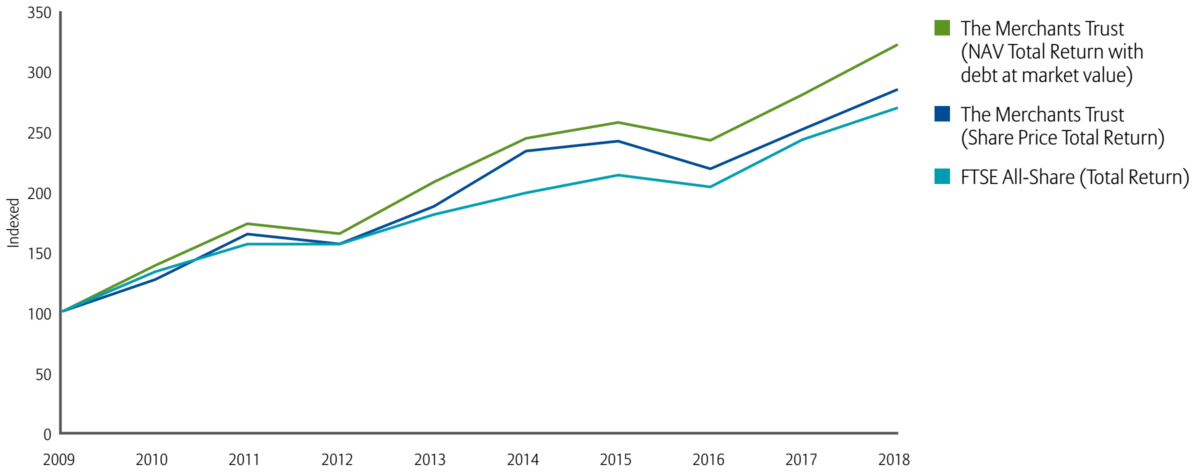
Directors' Remuneration Report *(continued)*

Performance Graph

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

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

Total shareholder return for the nine years to 31 January 2018



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

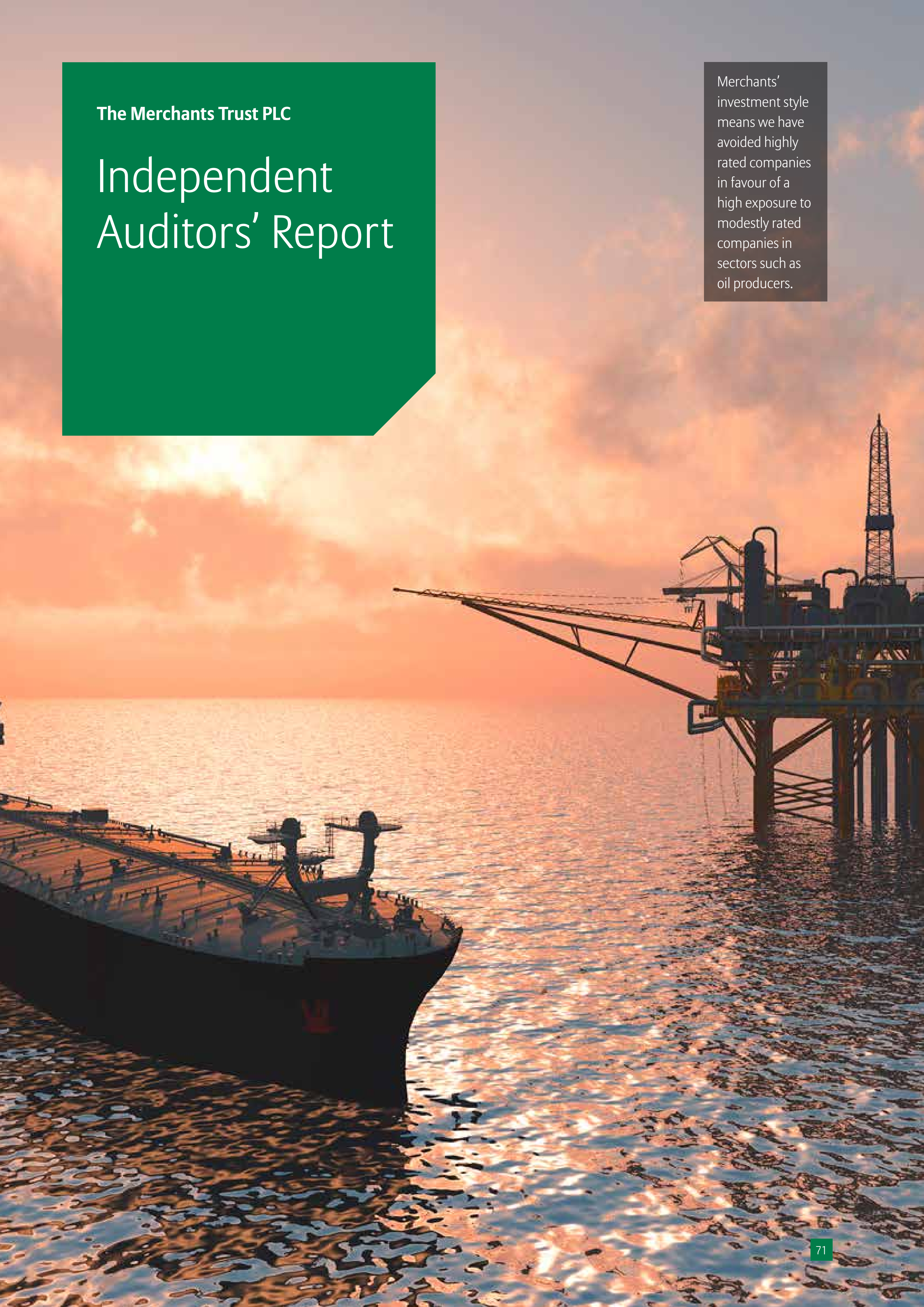
Signed on behalf of the board

Simon Fraser
Chairman
28 March 2018

The Merchants Trust PLC

Independent Auditors' Report

Merchants' investment style means we have avoided highly rated companies in favour of a high exposure to modestly rated companies in sectors such as oil producers.



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

Report on the audit of the financial statements

Opinion

In our opinion, The Merchants Trust PLC's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 January 2018 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report, which comprise: the Balance Sheet as at 31 January 2018; the Income Statement, the Cash Flow Statement, the Statement of Changes in Equity for the year then ended; the accounting policies; and the notes to the financial statements.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

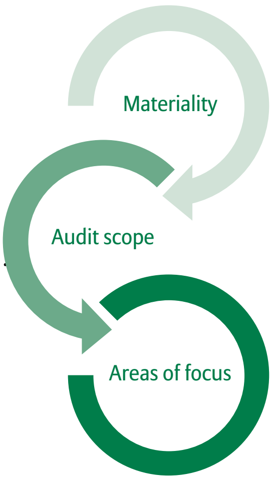
To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

Other than those disclosed in Note 3 to the financial statements, we have provided no non-audit services to the company in the period from 1 February 2017 to 31 January 2018.

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

Our audit approach

Overview



- Overall materiality: £5.9 million (2017: £5.5 million), based on 1% of net assets.

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

- Valuation and existence of investments.
- Dividend Income.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the company and the industry in which it operates, and considered the risk of acts by the company which were contrary to applicable laws and regulations, including fraud. We designed audit procedures to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the company's financial statements, including, but not limited to, Companies Act 2006 and section 1158 of the Corporation Tax Act 2010. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, enquiries of those charged with governance, review of minutes of meetings of those charged with governance and testing the compliance with section 1158 in the current year. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

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

Key audit matters

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

Key audit matter	How our audit addressed the key audit matter
Valuation and existence of investments Refer to page 66 (Audit Committee Report), pages 84 and 85 (Accounting Policies) and page 91 (notes). The investment portfolio at the year-end principally comprised listed equity investments. We focused on the valuation and existence of investments because investments represent the principal element of the net asset value as disclosed on the Balance Sheet in the financial statements.	We tested the valuation of the listed equity investments by agreeing the prices used in the valuation to independent third party sources. No misstatements were identified by our testing which required reporting to those charged with governance. We tested the existence of the investments by agreeing the holdings for investments to an independent custodian confirmation. No differences were identified by our testing which required reporting to those charged with governance.
Dividend Income Refer to page 66 (Audit Committee Report), pages 85 and 86 (Accounting Policies) and pages 87 and 91 (notes). We focused on the accuracy, occurrence and completeness of dividend income recognition and its presentation in the Income Statement as set out in the requirements of The Association of Investment Companies Statement of Recommended Practice (the "AIC SORP"). This is because incomplete or inaccurate dividend income could have a material impact on the Company's net asset value and dividend cover.	We assessed the accounting policy for income recognition for compliance with accounting standards and the AIC SORP and performed testing to check that income had been accounted for in accordance with this stated accounting policy. We found that the accounting policies implemented were in accordance with accounting standards and the AIC SORP, and that income has been accounted for in accordance with the stated accounting policy. In addition, we tested dividend receipts by agreeing the dividend rates from investments to independent third party sources. To test for completeness, we tested that the appropriate dividends had been received in the year by reference to independent data of dividends declared by investment holdings in the portfolio. We tested occurrence by tracing a sample of dividend received to bank statements. We tested the allocation and presentation of dividend income between the revenue and capital return columns of the Income Statement in line with the requirements set out in the AIC SORP. We then tested the validity of revenue and capital special dividends to independent third party sources. No misstatements were identified by our testing which required reporting to those charged with governance.

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

How we tailored the audit scope

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

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)').

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. We also addressed the risk of management override of controls, including evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

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

Materiality

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

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

Overall materiality	£5.9 million (2017: £5.5 million).
How we determined it	1% of net assets.
Rationale for benchmark applied	We have applied this benchmark, which is a generally accepted auditing practice for investment trust audits.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £297,000 (2017: £272,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

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

Reporting obligation	Outcome
We are required to report if the directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.	We have nothing to report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006, (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 January 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report. (CA06)

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

We have nothing material to add or draw attention to regarding:

- The directors' confirmation on page 63 of the Annual Report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The directors' explanation on page 52 of the Annual Report as to how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

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

We have nothing to report having performed a review of the directors' statement that they have carried out a robust assessment of the principal risks facing the company and statement in relation to the longer-term viability of the company. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the "Code"); and considering whether the statements are consistent with the knowledge and understanding of the company and its environment obtained in the course of the audit. *(Listing Rules)*.

Other Code Provisions

We have nothing to report in respect of our responsibility to report when:

- The statement given by the directors, on page 63, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the company's position and performance, business model and strategy is materially inconsistent with our knowledge of the company obtained in the course of performing our audit.
- The section of the Annual Report on pages 64 to 67 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.
- The directors' statement relating to the company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' Remuneration

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006. (CA06)

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 63, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the audit of the financial statements

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

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

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

Use of this report

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

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

Based on the records available, we were appointed by the directors to audit the financial statements for the year ended 31 January 1975, and have been annually reappointed by the members at the Annual General Meeting for subsequent financial periods. The period of total uninterrupted engagement is 44 years, covering the years ended 31 January 1975 to 31 January 2018.

Jeremy Jensen (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
28 March 2018

The Merchants Trust PLC

Financial Statements

HSBC has been an extremely strong performer over the last two years.

Income Statement

for the year ended 31 January 2018

	Notes	2018 Revenue £	2018 Capital £	2018 Total Return £	2017 Revenue £	2017 Capital £	2017 Total Return £
Gains on investments at fair value through profit or loss	8	-	54,592,570	54,592,570	-	54,569,087	54,569,087
(Losses) gains on foreign currencies		-	(17,161)	(17,161)	-	10,785	10,785
Income	1	32,633,321	-	32,633,321	31,123,179	-	31,123,179
Investment management fee	2	(844,297)	(1,567,980)	(2,412,277)	(773,904)	(1,437,251)	(2,211,155)
Administration expenses	3	(814,610)	(1,403)	(816,013)	(868,194)	(1,410)	(869,604)
Profit before finance costs and taxation		**30,974,414**	**53,006,026**	**83,980,440**	**29,481,081**	**53,141,211**	**82,622,292**
Finance costs: interest payable and similar charges	4	(3,242,407)	(5,939,250)	(9,181,657)	(3,320,438)	(6,085,717)	(9,406,155)
Profit on ordinary activities before taxation		**27,732,007**	**47,066,776**	**74,798,783**	**26,160,643**	**47,055,494**	**73,216,137**
Taxation	5	-	-	-	-	-	-
Profit after taxation attributable to ordinary shareholders		**27,732,007**	**47,066,776**	**74,798,783**	**26,160,643**	**47,055,494**	**73,216,137**
Earnings per ordinary share (basic and diluted)	7	**25.50p**	**43.29p**	**68.79p**	**24.06p**	**43.28p**	**67.34p**

Dividends in respect of the financial year ended 31 January 2018 total 24.80p (2017: 24.20p), amounting to £26,964,659 (2017: £26,312,288). Details are set out in Note 6 on page 90.

The total return column of this statement is the profit and loss account of the company. The supplementary revenue return and capital return columns are both prepared under the guidance published by the Association of Investment Companies.

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

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

The Statement of Accounting Policies and Notes on pages 84 to 104 form an integral part of these Financial Statements.

Statement of Changes in Equity

for the year ended 31 January 2018

	Notes	Called up Share Capital £	Share Premium Account £	Capital Redemption Reserve £	Capital Reserve £	Revenue Reserve £	Total £
Net assets at 1 February 2017		27,182,116	33,717,572	292,853	459,359,570	24,765,439	545,317,550
Revenue profit		-	-	-	-	27,732,007	27,732,007
Dividends on ordinary shares	6	-	-	-	-	(26,638,473)	(26,638,473)
Capital profit		-	-	-	47,066,776	-	47,066,776
Net assets at 31st January 2018		**27,182,116**	**33,717,572**	**292,853**	**506,426,346**	**25,858,973**	**593,477,860**

	Notes	Called up Share Capital £	Share Premium Account £	Capital Redemption Reserve £	Capital Reserve £	Revenue Reserve £	Total £
Net assets at 1 February 2016		27,182,116	33,717,572	292,853	412,304,076	24,611,248	498,107,865
Revenue profit		-	-	-	-	26,160,643	26,160,643
Dividends on ordinary shares	6	-	-	-	-	(26,094,832)	(26,094,832)
Unclaimed dividends		-	-	-	-	88,380	88,380
Capital profit		-	-	-	47,055,494	-	47,055,494
Net assets at 31 January 2017		**27,182,116**	**33,717,572**	**292,853**	**459,359,570**	**24,765,439**	**545,317,550**

The Statement of Accounting Policies and Notes on pages 84 to 104 form an integral part of these Financial Statements.

Balance Sheet

at 31 January 2018

	Notes	2018 £	2018 £	2017 £
Fixed assets				
Investments held at fair value through profit or loss	8		685,349,523	643,432,401
Current assets				
Other receivables	10	724,372		504,132
Cash and cash equivalents		20,095,813		14,484,822
		20,820,185		**14,988,954**
Current liabilities				
Other payables	10	(2,197,081)		(36,996,999)
Derivative financial instruments	8	(51,450)		(85,100)
		(2,248,531)		**(37,082,099)**
Net current assets (liabilities)			18,571,654	(22,093,145)
Total assets less current liabilities			**703,921,177**	**621,339,256**
Creditors: amounts falling due after more than one year	11		(110,443,317)	(76,021,706)
Total net assets			**593,477,860**	**545,317,550**
Capital and reserves				
Called up share capital	12		27,182,116	27,182,116
Share premium account	13		33,717,572	33,717,572
Capital redemption reserve	13		292,853	292,853
Capital reserve	13		506,426,346	459,359,570
Revenue reserve	13		25,858,973	24,765,439
Equity shareholders' funds	14		**593,477,860**	**545,317,550**
Net asset value per ordinary share	14		**545.8p**	**501.5p**

The financial statements of the Merchants Trust PLC on pages 80 to 83 were approved and authorised for issue by the Board of Directors on 28 March 2018 and signed on its behalf by:

Simon Fraser
Chairman

The Statement of Accounting Policies and Notes on pages 84 to 104 form an integral part of these Financial Statements.

Cash Flow Statement

for the year ended 31 January 2018

	Notes	2018 £	2017 £
Operating activities			
Profit before finance costs and taxation		83,980,440	82,622,292
Less: Gains on investments at fair value		(54,592,570)	(54,569,087)
Less: Losses (gains) on foreign currency		17,161	(10,785)
Purchase of fixed asset investments held at fair value through profit or loss		(155,820,497)	(115,799,369)
Sales of fixed asset investments held at fair value through profit or loss		167,788,923	130,849,550
(Increase) decrease in other receivables		(220,240)	442,682
Increase in other payables		53,361	87,656
Net cash inflow from operating activities		**41,206,578**	**43,622,939**
Financing activities			
Repayment of Stepped Rate Interest Loan		(34,000,000)	-
Net proceeds from 2.96% Fixed Loan Notes 2052		34,655,594	-
Interest paid		(9,552,550)	(9,557,445)
Dividend paid on cumulative preference stock	4	(42,997)	(42,997)
Dividends paid on ordinary shares	6	(26,638,473)	(26,094,832)
Unclaimed dividends over 12 years		-	88,380
Net cash outflow from financing activities		**(35,578,426)**	**(35,606,894)**
Increase in cash and cash equivalents		**5,628,152**	**8,016,045**
Cash and cash equivalents at the start of the year		14,484,822	6,457,992
Effect of foreign exchange rates		(17,161)	10,785
Cash and cash equivalents at the end of the year		20,095,813	14,484,822
Comprised of:			
Cash and cash equivalents		20,095,813	14,484,822

Cash inflow from dividends was £31,649,577 (2017: £30,624,230) and cash inflow from interest was £26 (2017: £6,433).

The Statement of Accounting Policies and Notes on pages 84 to 104 form an integral part of these Financial Statements.

Statement of Accounting Policies

for the year ended 31 January 2018

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

The company is a public company limited by shares and is registered in England and Wales. The address of the company's registered office is shown on page 55.

The principal activity of the company and the nature of its operations are set out in the strategic report on pages 42 to 52. The company conducts its business so as to qualify as an investment trust company within the meaning of sub-section 1158 of the Corporation Tax Act 2010.

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

1 **Basis of preparation** – The financial statements have been prepared under the historical cost convention, except for the revaluation of financial instruments held at fair value through profit or loss and in accordance with applicable United Kingdom law and UK Accounting Standards (UK GAAP), including Financial Reporting Standard 102 – the Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland (FRS 102) and in line with the Statement of Recommended Practice "Financial Statements of Investment Trust Companies and Venture Capital Trusts" issued by the Association of Investment Companies (AIC SORP) in November 2014 and updated in January 2017.

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

In order to better reflect the activities of an investment trust company, and in accordance with guidance issued by the AIC, supplementary information which analyses the Income Statement between items of revenue and capital nature has been presented alongside the Income Statement. In accordance with the company's Articles of Association, net capital returns may be distributed by way of dividend.

The directors believe that it is appropriate to continue to adopt the going concern basis in preparing the financial statements as the assets of the company consist mainly of securities, which are readily realisable and significantly exceed liabilities. Accordingly, the directors believe that the company has adequate financial resources, to continue in operational existence for the foreseeable future. The company's business, the principal risks and uncertainties it faces, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report on pages 42 to 52.

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

Special dividends are recognised on an ex-dividend basis and treated as a capital or revenue item depending on the facts and circumstances of each dividend. The board reviews special dividends and their treatment at each meeting.

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

Deposit interest receivable is accounted for on an accruals basis.

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

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

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

Statement of Accounting Policies *(continued)*

for the year ended 31 January 2018

of these investments on a fair value basis in accordance with its investment strategy, and information about the investments is provided on this basis to the board.

Investments held at fair value through profit or loss are initially recognised at fair value. After initial recognition, these continue to be measured at fair value, which for quoted investments is either the bid price or the last traded price depending on the convention of the exchange on which the investment is listed. Gains or losses on investments are recognised in the capital column of the Income Statement. Purchases and sales of the financial assets are recognised on the trade date, being the date which the company commits to purchase or sell the assets.

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

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

5 **Derivatives** – Options may be purchased or written over securities held in the portfolio for generating or protecting capital returns, or for generating or maintaining revenue returns. Where the purpose of the option is the maintenance of capital the premium is treated as a capital item. In accordance with FRS 102 Section 12: 'Other Financial Instruments', options are valued at fair value and are included in current assets or current liabilities in the balance sheet. When an option is closed out or exercised the gain or loss is accounted for as capital.

Where the purpose of the option is the generation of income, the premium is treated as a revenue item. Premiums received on written options are amortised to revenue over the period to expiry. If an option is exercised early unamortised premiums are taken to capital.

6 **Finance costs** – In accordance with the FRS 102 Section 11: 'Basic Financial Instruments' and Section 12 'Other Financial Instruments', long term borrowings are stated at the amortised cost being the amount of net proceeds on issue plus accrued finance costs to date. Finance costs are calculated over the term of the debt on the effective interest rate basis.

Where debt is issued at a premium, the premium is amortised over the term of the debt on the effective interest rate basis.

Finance costs net of amortised premiums are charged to capital and revenue in the ratio 65:35 to reflect the board's investment policy and prospective split of capital and revenue returns.

Dividends payable on the 3.65% cumulative preference stock are classified as an interest expense and are charged in full to revenue.

7 **Taxation** – Where expenses are allocated between capital and revenue, any tax relief obtained in respect of those expenses is allocated between capital and revenue on the marginal basis using the company's effective rate of corporation tax for the accounting period.

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax or a right to pay less tax in the future have occurred. Timing differences are differences between the company's taxable profits and its results as stated in the financial statements.

A deferred tax asset is recognised when it is more likely than not that the asset will be recoverable. Deferred tax is measured on a non-discounted basis at the rate of corporation tax that is expected to apply when the timing differences are expected to reverse.

8 **Foreign currency** – In accordance with FRS 102 Section 30: 'Foreign Currency Translation', the company is required to nominate a functional currency, being the currency in which the company predominately operates and in which its expenses are generally paid. The functional and reporting currency is pounds sterling. Transactions in foreign currencies are translated into pounds sterling at the rates of exchange ruling on the date of the transaction. Foreign currency monetary assets and liabilities are translated into sterling at the rates of exchange ruling at the balance sheet date. Profits and losses thereon are recognised in the capital column of the income statement and taken to the capital reserve.

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

Statement of Accounting Policies *(continued)*

for the year ended 31 January 2018

10 **Shares repurchased for cancellation and for holding in treasury** – Share capital is reduced by the nominal value of the shares repurchased, and the capital redemption reserve is correspondingly increased in accordance with section 733 Companies Act 2006. The full cost of the repurchase is charged to the capital reserve within Gains (Losses) on Sales of Investments.

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

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

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

13 **Significant judgements, estimates and assumptions** – In the application of the company's accounting policies, which are described above, the directors are required to consider whether there are any judgements, estimates, and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. There are no significant judgements, estimates, and assumptions.

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

Notes to the Financial Statements

for the year ended 31 January 2018

1. Income

	2018 £	2017 £
Income from Investments*		
Equity dividends from UK investments#	30,884,484	29,040,234
Unfranked dividends from UK investments	542,666	525,920
Equity dividends from overseas investments	420,495	610,098
	31,847,645	30,176,252
Other Income		
Deposit interest	26	6,433
Premiums on derivative contracts	671,191	880,863
Underwriting commission	114,459	59,631
	785,676	946,927
Total income	32,633,321	31,123,179

* All equity income is derived from listed investments.

\# Includes special dividends of £358,173 (2017: £1,038,910).

During the year, the company received premiums totalling £683,229 (2017: £851,571) for writing covered call options for the purpose of revenue generation. Premium income of £671,191 was amortised to income (2017: £880,863). All derivatives transactions were based on FTSE 100 stocks or the related index. At the year end there were five open positions with a net liability value of £51,450 (2017: £85,100).

2. Investment Management Fee

	2018 Revenue £	2018 Capital £	2018 Total £	2017 Revenue £	2017 Capital £	2017 Total £
Investment management fee	844,297	1,567,980	2,412,277	773,904	1,437,251	2,211,155

Under the terms of the Management and Administration Agreement the company's manager is Allianz Global Investors GmbH, UK branch (AllianzGI). The agreement was restated in July 2014, with the appointment of AllianzGI as the Alternative Investment Fund Manager. The terms of the agreement were unchanged in 2018: it provides for a management fee based on 0.35% (2017: 0.35%) per annum of the value of the assets after deduction of current liabilities, short-term loans with an initial duration of less than one year and other funds managed by AllianzGI. Under the contract, AllianzGI provides the company with investment management, accounting, company secretarial and administration services.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

3. Administration Expenses

	2018 £	2017 £
Auditors' remuneration		
For audit services*	31,585	27,400
Non-audit services - for certification of loan covenants~	12,900	4,600
VAT on auditor's remuneration	8,897	6,400
	53,382	**38,400**
Directors' fees	143,000	143,500
Marketing costs	254,290	303,064
Other administration expenses#	363,938	383,230
	814,610	**868,194**

(i) The above expenses include value added tax where applicable.
(ii) Directors' fees are set out in the Directors' Remuneration Report on page 69.
(iii) Custody handling charges of £1,403 were charged to capital (2017: £1,410).
(iv) 67% of marketing costs are payable to AllianzGI (2017: 78%).
* In 2018 an additional audit fee of £3,000 + VAT (2017: £ nil) was paid for the review of the transition of fund accounting services from Bank of New York Mellon to State Street. The fee will be reimbursed by AllianzGI .
# Includes accrual for reimbursement of additional audit fee.
~ Includes the additional certification for loan covenants in relation to the financing of the 2052 Loan Notes.

4. Finance Costs: Interest Payable and Similar Charges

	2018 Revenue £	2018 Capital £	2018 Total £	2017 Revenue £	2017 Capital £	2017 Total £
On Stepped Rate Interest Loan	1,227,324	2,279,317	3,506,641	1,343,604	2,495,264	3,838,868
On Fixed Rate Interest Loan repayable after more than five years	1,276,497	2,370,638	3,647,135	1,284,845	2,386,141	3,670,986
On 4% Perpetual Debenture Stock repayable after more than five years	19,355	35,946	55,301	19,184	35,628	54,812
On 5.875% Secured Bonds repayable after more than five years	629,627	1,169,308	1,798,935	629,292	1,168,684	1,797,976
On 3.65% Preference Stock repayable after more than five years	42,997	-	42,997	42,997	-	42,997
On 2.96% Fixed Rate Notes repayable after more than five years	45,253	84,041	129,294	-	-	-
On Sterling overdraft	1,354	-	1,354	516	-	516
	3,242,407	**5,939,250**	**9,181,657**	**3,320,438**	**6,085,717**	**9,406,155**

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

5. Taxation

	2018 Revenue £	2018 Capital £	2018 Total £	2017 Revenue £	2017 Capital £	2017 Total £
Overseas taxation	-	-	-	-	-	-
Total tax	-	-	-	-	-	-
Reconciliation of tax charge						
Profit before taxation	27,732,007	47,066,776	74,798,783	26,160,643	47,055,494	73,216,137
Tax on profit at 19.18% (2017: 20.00%)	5,317,707	9,025,214	14,342,921	5,232,129	9,411,099	14,643,228
Effects of:						
Non taxable income	(6,002,836)	-	(6,002,836)	(5,930,067)	-	(5,930,067)
Non taxable capital gains	-	(10,465,020)	(10,465,020)	-	(10,915,974)	(10,915,974)
Disallowable expenses	8,556	848	9,404	9,524	1,999	11,523
Excess of allowable expenses over taxable income	676,573	1,438,958	2,115,531	688,414	1,502,876	2,191,290
Total tax	-	-	-	-	-	-

The company's taxable income is exceeded by its tax allowable expenses, which include both the revenue and capital elements of the management fee and finance costs. As at 31 January 2018, the company had accumulated surplus expenses of £216.3 million (2017: £205.3 million).

The company has not recognised a deferred tax asset of £36.8 million (2017: £34.9 million) in respect of these expenses, based on a prospective corporation tax rate of 17% (2017: 17%) because there is no reasonable prospect of recovery . The reduction in the standard rate of corporation tax was substantively enacted on 6 September 2016 and is effective from 1 April 2020. Provided the company continues to maintain its current investment profile, it is unlikely that these expenses will be utilised and that the company will obtain any benefit from this asset.

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

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

6. Dividends on Ordinary Shares

	2018 £	2017 £
Dividends paid on ordinary shares		
Third interim dividend 6.1p paid 23 February 2017 (2016: 6.0p)	6,632,436	6,523,708
Final dividend 6.1p paid 18 May 2017 (2016: 6.0p)	6,632,436	6,523,708
First interim dividend 6.1p paid 11 August 2017 (2016: 6.0p)	6,632,436	6,523,708
Second interim dividend 6.2p paid 16 November 2017 (2016: 6.0p)	6,741,165	6,523,708
	26,638,473	26,094,832

Dividends payable at the year end are not recognised as a liability under FRS 102 Section 32 'Events After the End of the Reporting Period' (see page 85 - Statement of Accounting Policies). Details of these dividends are set out below.

	2018 £	2017 £
Third interim dividend 6.2p paid 02 March 2018 (2017: 6.1p)	6,741,165	6,632,436
Final proposed dividend 6.3p payable 30 May 2018 (2017: 6.1p)	6,849,893	6,632,436
	13,591,058	13,264,872

The proposed final dividend accrued is based on the number of shares in issue at the year end. However, the dividend payable will be based on the numbers of shares in issue on the record date and will reflect any changes in the share capital between the year end and the record date.

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

7. Earnings per Ordinary Share

	2018 Revenue £	2018 Capital £	2018 Total £	2017 Revenue £	2017 Capital £	2017 Total £
Profit after taxation attributable to ordinary shareholders	27,732,007	47,066,776	74,798,783	26,160,643	47,055,494	73,216,137
Earnings per ordinary share (basic and diluted)	25.50p	43.29p	68.79p	24.06p	43.28p	67.34p

The earnings per ordinary share is based on a weighted number of shares 108,728,464 (2017: 108,728,464) ordinary shares in issue.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

8. Fixed Asset Investments

	2018 £	2017 £
Listed on the London Stock Exchange at market valuation	685,321,554	643,404,432
Unlisted at fair value (see Note 9)	27,969	27,969
Fixed asset investments	**685,349,523**	**643,432,401**
Derivative financial instruments - written call options	(51,450)	(85,100)
Total investments	**685,298,073**	**643,347,301**
Market value of investments brought forward	643,347,301	603,155,023
Investment holding (gains) losses brought forward	(26,192,327)	14,074,117
Derivative holding (gains) losses brought forward	(31,414)	70,268
Cost of investments held brought forward	**617,123,560**	**617,299,408**
Additions at cost	155,147,125	116,472,741
Disposals at cost	(143,199,705)	(116,648,589)
Cost of investments held at 31 January	**629,070,980**	**617,123,560**
Investment holding gains at 31 January	56,185,202	26,192,327
Derivative holding gains at 31 January	41,891	31,414
Market value of investments held at 31 January	**685,298,073**	**643,347,301**
Gains on investments		
Gains on sales of investments based on historical costs	23,575,112	11,472,893
Adjustment for net investment holding (gains) losses recognised in previous years	(25,371,214)	8,221,708
(Losses) gains on sales of fixed asset investments based on carrying value at previous balance sheet date	**(1,796,102)**	**19,694,601**
Gains (losses) on derivative financial instruments	6,668	(886)
(Losses) gains on sales of investments based on carrying value at previous balance sheet date	**(1,789,434)**	**19,693,715**
Investment holding gains arising in the year	55,364,089	32,044,736
Special dividends credited to capital	1,007,438	2,728,954
Derivative holding gains arising in the year	10,477	101,682
Gains on investments	**54,592,570**	**54,569,087**

The board considers that the company's unlisted investment is not material to the financial statements. No material disposals of unlisted investments took place during the year (2017: none).

Transaction costs and stamp duty on purchases amounted to £780,986 (2017: £651,785) and transaction costs on sales amounted to £103,363 (2017: £93,688).

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

9. Investments in Other Companies

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

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

In the opinion of the directors, the company is not in a position to exert significant influence over the financial operating policies of FDF or Fintrust, either through voting rights or through agreement with those companies' other shareholders, due to provisions in FDF's and Fintrust's Articles of Association and in certain contracts between the company and each of FDF and Fintrust. Accordingly, FDF and Fintrust are not considered to be Associate Undertakings as per FRS 102 Section 14 and are therefore included in the Balance Sheet at the director's valuation. FDF and Fintrust are the lenders of the company's Stepped Rate Interest Loan and Fixed Rate Interest Loan, as detailed in Notes 10(i) and 11(i), respectively. Apart from the finance costs, there were no other transactions between FDF, Fintrust and the company during the year.

Following the repayment of the debenture holders on 2 January 2018, FDF was put into voluntary liquidation on 24 January 2018.

10. Other Receivables and Other Payables

	Notes	2018 £	2017 £
Other receivables			
Prepayments		40,053	30,777
Accrued income		684,319	473,355
		724,372	**504,132**
Other payables: amounts falling due within one year			
Purchases for future settlement		-	673,372
Stepped Rate Interest Loan	10(i)	34,109	34,034,109
Other payables		1,029,243	975,882
Interest on borrowings		1,133,729	1,313,636
		2,197,081	**36,996,999**
Interest on outstanding borrowing consists of:			
Stepped Rate Interest Loan		-	313,728
Fixed Rate Interest Loan		783,545	779,240
5.875% Secured Bonds 2029		208,243	207,105
4% Perpetual Debenture Stock		13,864	13,563
2.96% Fixed Rate Notes 2052		128,077	-
		1,133,729	**1,313,636**

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

(i) The Stepped Rate Interest Loan of £34,109 (2017: £34,034,109) comprised adjustable Stepped Rate Interest Loan Notes of £5,133,520 and Stepped Rate Interest Bonds of £20,534,079. The Loan Notes and Bonds were issued in 1987 at 97.4% and were repaid on 2 January 2018, together with a premium of £8,366,510.

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

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

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

£34m was repaid to FDF on 2 January 2018. Subsequent to this FDF was put into voluntary liquidation. The outstanding amount of £34,109 relates to the share capital.

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

	Notes	2018 £	2017 £
Fixed Rate Interest Loan	11(i)	43,880,622	44,150,818
5.875% Secured Bonds 2029	11(ii)	29,352,885	29,317,888
4% Perpetual Debenture Stock	11(iii)	1,375,000	1,375,000
3.65% Cumulative Preference Stock	11(iv)	1,178,000	1,178,000
2.96% Fixed Rate Notes 2052	11(v)	34,656,810	-
		110,443,317	**76,021,706**

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

As security for this loan, the company has granted a floating charge over its assets in favour of the lender.

The loan of £30,000,000 taken out in 1993 is stated at £29,938,391 (2017: £29,933,747) being the net proceeds of £29,858,947 plus accrued finance cost of £79,444 (2017: £74,800). The effective interest rate of this portion of the loan is 9.51%.

On assuming the additional loan of £12,000,000 in 1998, the company also received a premium of £5,286,564 to ensure that the finance costs on this additional loan were comparable to existing market interest rates. This premium is being amortised over the remaining life of the loan. At 31 January 2018, the loan is stated at £13,942,231 (2017: £14,217,071), being the principal amount of £12,000,000 plus the unamortised premium of £1,942,231 (2017: £2,217,071). The effective interest rate of this portion of the loan is 6.00%.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

Fixed Rate Interest Loan

	2018 £	2018 £	2017 £	2017 £
Fixed Rate Interest Loan (Original Loan)	30,000,000		30,000,000	
Less: Finance costs	(141,053)		(141,053)	
Net proceeds	**29,858,947**		**29,858,947**	
Add: Accrued Finance costs	79,444		74,800	
		29,938,391		**29,933,747**
Fixed Rate Interest Loan (Additional Loan)		12,000,000		12,000,000
Premium	5,286,564		5,286,564	
Amortised premium	(3,344,333)		(3,069,493)	
Add: Unamortised premium		**1,942,231**		**2,217,071**
Total Fixed Rate Interest Loan		**43,880,622**		**44,150,818**

(ii) The £30,000,000 of 5.875% Secured Bonds is stated at £29,352,885 (2017: £29,317,888), being the net proceeds of £28,942,800 plus accrued finance costs of £410,085 (2017: £375,088). The Bonds are repayable on 20 December 2029 and carry interest at 5.875% per annum on the principal amount. Interest is payable in June and December each year. The effective interest rate of this loan is 6.23% per annum.

As security for this loan, the company has granted a floating charge over its assets ranking pari passu with the floating charges referred to in Note 11(i) above.

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

(iv) The 3.65% cumulative preference stock is recognised as a creditor due after more than one year under the provisions of FRS 102 Section 11: 'Basic Financial Instruments' and Section 12: 'Other Financial Instruments'. The right of the preference stock holders to receive payments is not calculated by reference to the company's net return and, in the event of a return of capital is limited to a specific amount, being £1,178,000. Dividends on the preference stock are payable on 1 February and 1 August each year. The preference stock is non-redeemable.

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

The Private Placement of £35m, 2.96% Fixed Rate Note 2052 was funded on 18 December 2017. It was used to repay The Stepped Rate Interest Loan of £34m on 2 January 2018.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

12. Called up Share Capital

	2018 £	2017 £
Allotted and fully paid		
108,728,464 ordinary shares of 25p (2017: 108,728,464)	27,182,116	27,182,116

The directors are authorised by an ordinary resolution passed on 16 May 2017 to allot relevant securities, in accordance with section 551 on the Companies Act 2006, up to a maximum of 36,242,821 ordinary shares of 25p each. This authority expires on 16 May 2018 and accordingly a renewed authority will be sought at the annual general meeting on 16 May 2018.

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

13. Reserves

			Capital Reserve		
	Share Premium Account £	Capital Redemption Reserve £	Gains (losses) on sales of Investments £	Investment Holding Gains (losses) £	Revenue Reserve £
Balance at 1 February 2017	33,717,572	292,853	433,125,044	26,234,526	24,765,439
Losses on sales of fixed asset investments	-	-	(1,796,102)	-	-
Gains on derivative financial instruments	-	-	6,668	-	-
Net movement in fixed asset investment holding gains	-	-	-	55,364,089	-
Movement in derivative holding gains	-	-	-	10,477	-
Special dividends	-	-	1,007,438	-	-
Losses on foreign currencies	-	-	(9,621)	(7,540)	-
Transfer on sale of investments	-	-	25,371,214	(25,371,214)	-
Investment management fee	-	-	(1,567,980)	-	-
Finance costs of borrowings	-	-	(5,939,250)	-	-
Other capital expenses	-	-	(1,403)	-	-
Dividends appropriated in the year	-	-	-	-	(26,638,473)
Profit retained for the year	-	-	-	-	27,732,007
Balance at 31 January 2018	**33,717,572**	**292,853**	**450,196,008**	**56,230,338**	**25,858,973**

Distributions can be made from both the capital and revenue reserves. All paid or payable dividends for the year are payable from the revenue reserve (2017: same).

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

14. Net Asset Value per Share

	Net asset value per share attributable 2018 £	2017 £
Ordinary shares of 25p	545.8p	501.5p

	Net asset value attributable 2018 £	2017 £
Ordinary shares of 25p	£593,477,860	£545,317,550

The net asset value per ordinary share is based on 108,728,464 ordinary shares in issue at the year end (2017: 108,728,464).

15. Contingent Liabilities and Commitments

At 31 January 2018 there were no contingent liabilities (2017: £Nil).

Details of the guarantee provided by the company as part of the terms of the Loans are provided in Note 10(i), 11(i) and 11(ii) Creditors: Amounts falling due after one year on pages 93 and 94.

16. Financial Risk Management policies and procedures

The company invests in equities and other investments in accordance with its investment objective as stated in the strategic report on page 44. In pursuing its investment policy, the company is exposed to certain inherent risks that could result in either a reduction in the company's net assets or a reduction in the profits available for distribution by way of dividends.

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

(a) Market Risk

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

(i) Market Price Risk

Market price risk arises mainly from the uncertainty about future prices of financial instruments held. It represents the potential loss the company might suffer through holding market positions in the face of price movements. An analysis of the company's portfolio is shown on pages 36 and 37.

Changes in stock market valuations lead to changes in gearing ratios. The board's procedure for monitoring the gearing of the company is set out in Note 17 on page 104. This takes into account the investment manager's view on the market, covenant requirements and the future prospects of the company's performance.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

Market price risk sensitivity

The value of the company's listed investments (i.e. fixed asset investments, excluding unlisted equities) which were exposed to market price risk as at 31 January 2018 was as follows:

	2018 £	2017 £
Listed investments held at fair value through profit or loss	685,321,554	643,404,432
Derivative financial instruments - written call options	(51,450)	(85,100)
Total listed investments	685,270,104	643,319,332

The following illustrates the sensitivity of the return and the net assets to an increase or decrease of 20% (2017: 20%) in the fair values of the company's listed investments. This level of change is considered to be reasonably possible based on observation of market conditions in the recent years. The sensitivity analysis on the net return after tax is based on the impact of a 20% increase or decrease in the value of the company's listed equity investments at each balance sheet date and the consequent impact on the investment management fees for the year, with all other variables held constant.

	2018 20% Increase in fair value £	2018 20% Decrease in fair value £	2017 20% Increase in fair value £	2017 20% Decrease in fair value £
Revenue earnings				
Investment management fees	(167,904)	167,904	(157,634)	157,634
Capital earnings				
Gains (losses) on investments at fair value	137,054,021	(137,054,021)	128,663,866	(128,663,866)
Investment management fees	(311,821)	311,821	(292,749)	292,749
Change in net earnings and net assets	136,574,296	(136,574,296)	128,213,483	(128,213,483)

Management of market price risk

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

(ii) Market Yield Risk

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

Where call options are sold (written), in all cases a sufficient position is maintained in the underlying equity to cover any potential option exercise. Whilst the option value can be volatile, price movements should to some extent be offset by opposing movements in the value of the underlying equity. If options are retained until expiry they will either expire worthless or be exercised. The effect of any option exercise is to sell the underlying shares at the strike price of the option. A schedule of the company's listed holdings is shown on pages 36 and 37. Where put options are purchased, the market value of such options can be volatile but the maximum loss on any contract is limited to the original investment cost. No put options were purchased in the year (see Note 1 on page 87 for detail of income received).

Further explanation of the derivatives strategy is included in the Glossary on page 41.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

Management of market yield risk

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

(iii) Foreign Currency Risk

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

Management of foreign currency risk

The company invests predominantly in UK listed equities and although there is no direct impact there is implicit exposure as some of the companies in the portfolio generate income and cashflows in foreign currencies. (2017: same).

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

(iv) Interest Rate Risk

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

Interest Rate Exposure

The table below summarises in sterling terms the financial assets and financial liabilities whose values are directly affected by changes in interest rates.

	2018 Fixed rate interest £	2018 Floating rate interest £	2018 Nil Interest £	2018 Total £	2017 Fixed rate interest £	2017 Floating rate interest £	2017 Nil Interest £	2017 Total £
Financial assets	-	20,095,813	685,349,523	705,445,336	-	14,484,822	643,432,401	657,917,223
Financial liabilities	(110,443,317)	-	(51,450)	(110,494,767)	(76,021,706)	-	(85,100)	(76,106,806)
Net financial (liabilities) assets	**(110,443,317)**	**20,095,813**	**685,298,073**	**594,950,569**	**(76,021,706)**	**14,484,822**	**643,347,301**	**581,810,417**
Short term receivables and payables				(1,472,709)				(36,492,867)
Net assets per balance sheet				**593,477,860**				**545,317,550**

As at 31 January 2018, the interest rates received on cash balances or paid on bank overdrafts, was 0.14% and 0.35% per annum respectively (2017: nil and 1.10% per annum).

The fixed rate interest bearing liabilities bear the following coupon and effective rates as at 31 January 2018 and 31 January 2017.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

	Maturity date	Amount borrowed £	Coupon rate	Effective rate since inception*
Fixed Rate Interest Loan - Original Loan	20/05/2023	30,000,000	9.25125%	9.51%
Fixed Rate Interest Loan - Additional Loan	20/05/2023	12,000,000	9.25125%	6.00%
5.875% Secured Bonds 2029	20/12/2029	30,000,000	5.875%	6.23%
2.96% Fixed Rate Notes 2052	18/12/2052	35,000,000	2.96%	3.03%
4% Perpetual Debenture Stock	n/a	1,375,000	4.00%	4.00%
3.65% Cumulative Preference Stock	n/a	1,178,000	3.65%	3.65%
		109,553,000		

On 18 December 2017, £35m was funded by the 2.96% Fixed Rate Notes 2052. This was used to repay £34m to First Debenture Finance on 2 January 2018. The details in respect of the other loans above have remained unchanged since the previous accounting period.

* The effective rates are calculated in accordance with FRS 102 Section 12: 'Other Financial Instruments' as detailed in the Statement of Accounting Policies on page 85.

The weighted average effective rate of the company's fixed interest bearing liabilities (excluding the 3.65% Cumulative Preference Stock and the 4% Perpetual Debenture Stock) is 6.08% (2017: 8.54%) and the weighted average period to maturity of these liabilities is 16.8 years (2017: 7.2 years).

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

Management of interest rate risk

The company invests predominantly in equities, the values of which are not directly affected by changes in prevailing market interest rates. In the year to 31 January 2018, the company held no fixed interest securities. The company's policy is to remain substantially fully invested and thus does not expect to hold significant cash balances. The financial assets have minimal exposure to interest rate risk.

The company finances its operations through a mixture of share capital, retained earnings and long term borrowings which are subject to fixed rates. Movement in interest rates will not have a material effect on the finance costs and financial liabilities of the company as all the borrowings of the company are subject to fixed rates of interest.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

(b) Liquidity Risk

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

Maturity of financial liabilities

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

Cash flows in respect of the principal and interest on the Fixed Rate Notes 2052, Stepped Rate Interest Loan, Fixed Rate Interest Loan and 5.875% Secured Bonds 2029 reflect the maturity dates as set out in Notes 10 and 11 on pages 92 and 93. The loans are each governed by a trust deed. Only if the covenants are breached would early repayment be enforced. Therefore their repayment is not considered to be a likely short term liquidity issue. Cash flows in respect of the 4% Perpetual Debenture Stock and 3.65% Cumulative Preference Stock, which have no fixed repayment date, assumes maturity of 20 years from the balance sheet date. Cash flows have not been discounted.

2018	Three months or less £	Between three months and one year £	Between one and five years £	More than five years £	Total £
Other payables					
Finance costs of borrowing	-	6,760,824	-	-	6,760,824
Other payables	1,029,243	-	-	-	1,029,243
Derivative financial instruments	51,450	-	-	-	51,450
Creditors: amounts falling due after more than one year					
Amounts payable on maturity of borrowings	-	-	-	109,553,000	109,553,000
Finance cost of borrowings	-	-	27,129,288	46,867,566	73,996,854
	1,080,693	6,760,824	27,129,288	156,420,566	191,391,371

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

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

Management of liquidity risk

Liquidity risk is not significant as the company's assets mainly comprise realisable securities, which can be sold to meet funding requirements if necessary. Short term flexibility can be achieved through the use of overdraft facilities, where necessary. As at the 31 January 2018, the company had an undrawn committed borrowing facility of £10 million (2017: £10 million).

(c) Credit Risk

Credit risk is the risk of default by a counterparty in discharging its obligations under transactions that could result in the company suffering a loss. There were no impaired assets as of 31 January 2018 (31 January 2017: nil). The counterparties the company engages with are regulated entities and are of high credit quality.

Management of credit risk

Outstanding settlements are subject to credit risk. Credit risk is mitigated by the company through its decision to transact with counterparties of high credit quality. The company only buys and sells investments through brokers which are approved counterparties, thus minimising the risk of default during settlement. The credit ratings of brokers are reviewed quarterly by the manager.

The company is also exposed to credit risk through the use of banks for its cash position. Bankruptcy or insolvency of banks may cause the company's rights with respect to cash held by banks to be delayed or limited. The company's cash balances are held by HSBC Bank PLC, rated A2 by Moody's rating agency and UBS, rated A1 by Moody's rating agency. The directors believe the counterparties the company has chosen to transact with are of high credit quality, therefore the company has minimal exposure to credit risk.

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

	2018 £	2017 £
Other Receivables:		
Prepayments	40,053	30,777
Accrued income	684,319	473,355
	724,372	**504,132**
Cash and cash equivalents	20,095,813	14,484,822
Total	**20,820,185**	**14,988,954**

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

Fair Values of Financial Assets and Financial Liabilities

With the exception of those financial liabilities measured at amortised cost, the financial assets and financial liabilities are either carried at their fair value, or the balance sheet amount is a reasonable approximation of their fair value. The financial liabilities measured at amortised cost, including interest on outstanding borrowings due within one year, have the following fair values*:

	2018 Book Value £	2018 Fair Value £	2017 Book Value £	2017 Fair Value £
Stepped Rate Interest Loan	34,109	-	34,347,837	37,065,348
Fixed Rate Interest Loan	44,664,168	57,661,800	44,930,058	58,221,410
5.875% Secured Bonds 2029	29,561,128	39,360,000	29,524,993	37,913,338
4% Perpetual Debenture Stock	1,388,863	1,852,537	1,388,563	1,538,674
3.65% Cumulative Preference Stock	1,178,000	1,459,071	1,178,000	1,219,489
2.96% Fixed Rate Notes 2052	34,784,886	35,126,000	-	-
Total	**111,611,154**	**135,459,408**	**111,369,451**	**135,958,259**

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

	2018 £	2017 £
Net assets per balance sheet	593,477,860	545,317,550
Add: financial liabilities at book value#	111,611,154	111,369,451
Less: financial liabilities at fair value *	(135,459,408)	(135,958,259)
Net assets (debt at fair value)	569,629,606	520,728,742
Net asset value per ordinary share (debt at fair value)	**523.9p**	**478.9p**

* The fair value has been derived from the closing market value as at 31 January 2018 and 31 January 2017. Fair value and market value are used interchangeably throughout the Annual Report

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

The net asset value per ordinary share is based on 108,728,464 ordinary shares in issue at 31 January 2018 (2017: 108,728,464)

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

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

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

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

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

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

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

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

With the exception of those financial liabilities measured at amortised cost, all other financial assets and financial liabilities are either carried at their fair value or the balance sheet amount is a reasonable approximation of their fair value.

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

2018	Level 1 £	Level 2 £	Level 3 £	Total £
Financial assets at fair value through profit or loss				
Equity investments	685,321,554	-	-	685,321,554
Financial instruments	-	-	27,969	27,969
Derivatives financial instruments - written call options	(51,450)	-	-	(51,450)
	685,270,104	-	27,969	685,298,073

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

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

There were no transfers between levels for financial assets and financial liabilities during the year recorded at fair value as at 31 January 2018 and 31 January 2017.

Notes to the Financial Statements *(continued)*

for the year ended 31 January 2018

17. Capital Management Policies and Procedures

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

The company's capital at 31 January comprises:

	2018 £	2017 £
Debt		
Stepped Rate Interest Loan due within one year	34,109	34,034,109
Creditors: amounts falling due after more than one year	110,443,317	76,021,706
	110,477,426	110,055,815
Equity		
Called up share capital	27,182,116	27,182,116
Share premium account and other reserves	566,295,744	518,135,434
	593,477,860	545,317,550
Total capital	703,955,286	655,373,365
Debt as a percentage of total capital	15.7%	16.8%

The board, with the assistance of the investment manager, monitors and reviews the broad structure of the company's capital on an ongoing basis. The level of gearing is monitored, taking into account the investment manager's view on the market and the future prospects of the company's performance. Capital management also involves reviewing the difference between the net asset value per share and the share price (i.e. the level of share price discount or premium) to assess whether to issue shares or repurchase shares for cancellation or for holding in treasury.

The company is subject to several externally imposed capital requirements; the banks borrowings under the overdraft facility are not to exceed £10m, and as a public company the minimum share capital is £50,000. The company's objective, policies and processes for managing capital are unchanged from the preceding accounting period, and the company has complied with them. The terms of the debenture trust deeds have various covenants which prescribe that moneys borrowed should not exceed the adjusted total value of the capital and reserves. These are measured in accordance with the policies used in the annual report. The company has complied with these.

18. Transactions with the Investment Manager and related parties

The amounts paid to the investment manager together with details of the investment management contract are disclosed in Note 2 on page 87. The existence of an independent board of directors demonstrates that the company is free to pursue its own financial and operating policies and therefore, under FRS102 Section 33: Related Party Disclosures, the investment manager is not considered to be a related party.

The company's related parties are its directors. Fees paid to the company's board are disclosed in the Directors' Remuneration Report on page 69.

There are no other identifiable related parties at the year end, and as of 28 March 2018.

19. Post Balance Sheet events

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

The Merchants Trust PLC

Investor Information

Attractive pricing meant we added to our Greene King position during the year.

Investor Information (unaudited)

AIFM and Depositary

Allianz Global Investors GmbH (AllianzGI), is designated the AIFM. Allianz is authorised to act as an AIFM and to conduct its activities from its UK Branch by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), in accordance with AIFMD and Financial Conduct Authority requirements. The management fee and the notice period are unchanged in the restated Management and Administration Agreement (details in Note 2 on page 87).

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

Leverage and Risk Policies under AIFMD

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

Remuneration Disclosure of the AIFM

Employee remuneration of Allianz Global Investors GmbH for the financial year ending 31 December 2017 (all values in Euro).

Number of employees: 1,744

	all employees	thereof Risk Taker	thereof Board Member	thereof Employees with Control Function	thereof Other Risk Taker	thereof Employees with Comparable Compensation
Fixed remuneration	153,835,884	8,967,874	2,928,279	691,151	1,483,435	3,865,009
Variable remuneration	120,722,786	30,359,156	12,025,974	635,594	5,150,455	12,547,133
Total remuneration	**274,558,670**	**39,327,030**	**14,954,253**	**1,326,745**	**6,633,890**	**16,412,142**

Remuneration Policy of the AIFM

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

Key Investor Information Document (KIID)

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

Investor Information (unaudited) *(continued)*

Association of Investment Companies (AIC)

The company is a member of the AIC, the trade body of the investment trust industry, which provides a range of literature including fact sheets and a monthly statistical service. Copies of these publications can be obtained from the AIC, 9th Floor, 24 Chiswell Street, London EC1Y 4YY, or at www.theaic.co.uk.

AIC Category: UK Equity Income.

Financial Calendar

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

How to Invest

Alliance Trust Savings Limited (ATS) is one of a number of providers offering a range of products and services, including Share Plans, ISAs and pension products. ATS also maintains services including online and telephone-based dealing facilities and online valuations. More information is available from the ATS Customer Services Department on 01382 573737 or by e-mail: contact@alliancetrust.co.uk, or from Allianz Global Investors either via Investor Services on 0800 389 4696 or on the company's website: www.merchantstrust.co.uk.

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

Ordinary Dividends

It is anticipated that dividends will be paid as follows:

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

Preference Dividends

Payable half-yearly 1 February and 1 August.

Benchmark

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

Market and Portfolio Information

The company's ordinary shares are listed on the London Stock Exchange. The market price range, gross yield and net asset value are shown daily in the Financial Times and The Daily Telegraph under the headings 'Investment Companies' and 'Investment Trusts', respectively. The net asset value of the ordinary shares is calculated daily and published on the London Stock Exchange Regulatory News Service. The geographical spread of investments and ten largest holdings are published monthly on the London Stock Exchange Regulatory News Service. They are also available from the manager's Investors Helpline on 0800 389 4696 or via the company's website: www.merchantstrust.co.uk.

Website

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

Dividend

The board is recommending a final distribution of 6.3p to be payable on 30 May 2018 to shareholders on the Register of Members at the close of business on 20 April 2018, making a total distribution of 24.8p per share for the year ended 31 January 2018, an increase of 2.5% over last year's distribution. The ex dividend date is 19 April 2018.

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

Registrars

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

Shareholder Enquiries

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

Investor Information (unaudited) *(continued)*

Friday. Calls to the helpline number from outside the UK are charged at applicable international rates. Different charges may apply to calls made from mobile telephones and calls may be recorded and monitored randomly for security and training purposes.

Changes of name and address must be notified to the registrars in writing. Any general enquiries about the company should be directed to the Company Secretary, The Merchants Trust PLC, 199 Bishopsgate, London EC2M 3TY. Telephone: 020 3246 7513.

Dividend Reinvestment Plan for Ordinary Shareholders (DRIP)

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

Share Dealing Services

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

For further information on these services please contact: http://www.linksharedeal.com for online dealing or 0371 664 0445 for telephone dealing. Lines are open 8.00 am to 4.30 pm Monday to Friday (London time). Calls to the helpline number from outside the UK are charged at applicable international rates. Different charges may apply to calls made from mobile telephones and calls may be recorded and monitored randomly for security and training purposes.

Share Portal

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

CREST Proxy Voting

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

International Payment Services

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

The International Payment Service will generally cost less than the fees charged by your local bank to convert your sterling dividend into your local currency. A £5 administration fee per dividend payment applies. Your dividends are paid as cleared funds directly into your bank or sent to you as a draft.

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

To use this service you will need to register online at: http://ips.linkassetservices.com/services/share-dealing-services or by contacting Link as detailed below.

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

Warning to Shareholders

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

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

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

Notice of Meeting (unaudited)

Notice is hereby given that the annual general meeting of The Merchants Trust PLC will be held at Grocers' Hall, Princes Street, London, EC2R 8AD, on Wednesday 16 May 2018 at 12 noon to transact the following business.

Ordinary Business

1. To receive and adopt the Directors' Report and the Financial Statements for the year ended 31 January 2018 together with the Auditors' Report thereon.
2. To declare a final dividend of 6.3p per ordinary share.
3. To re-elect Simon Fraser as a director.
4. To re-elect Timon Drakesmith as a director.
5. To re-elect Mary Ann Sieghart as a director.
6. To re-elect Sybella Stanley as a director.
7. To re-elect Paul Yates as a director.
8. To approve the Directors' Remuneration Implementation Report.
9. To appoint BDO LLP as Auditors of the company, to hold office until the conclusion of the next general meeting at which financial statements are laid before the company.
10. To authorise the directors to determine the remuneration of the Auditors.

Special Business

To consider and, if thought fit, to pass the following resolutions. Resolution 11 will be proposed as an ordinary resolution and resolutions 12 and 13 as special resolutions:

11. That for the purposes of section 551 of the Companies Act 2006 the directors be generally and unconditionally authorised to exercise all the powers of the company to allot relevant securities (within the meaning of the said section) up to a maximum number of 36,242,821 ordinary shares provided that:

(i) the authority granted shall expire one year from the date upon which this resolution is passed but may be revoked or varied by the company in general meeting and may be renewed by the company in general meeting for a further period not exceeding one year; and

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

12. That the directors be empowered in accordance with section 570 of the Companies Act 2006 (the Act) to allot equity securities (within the meaning of section 560 of the Act) either for cash pursuant to the authority conferred by resolution 11 or by way of a sale of treasury shares as if sub-section (1) of section 561 of the Act did not apply to any such allotment provided that:

(i) the power granted shall be limited to the allotment of equity securities wholly for cash up to a maximum number of 10,872,846 ordinary shares;

(ii) the power granted shall (unless previously revoked or renewed) expire at the conclusion of the next annual general meeting of the company after this resolution is passed, or 16 August 2019 if earlier; and

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

13. That the company be and is hereby generally and unconditionally authorised in accordance with section 701 of the Companies Act 2006 (the Act) to make market purchases (within the meaning of section 693(4) of the Act) of ordinary shares of 25p each in the capital of the company (ordinary shares), either for retention as treasury shares or for cancellation provided that:

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

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

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

(iv) the authority hereby conferred shall expire at the conclusion of the annual general meeting of the company in 2019 or, if earlier, on the expiry of 15 months from the

Notice of Meeting (unaudited) *(continued)*

passing of this resolution, unless such authority is renewed prior to such time; and

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

By order of the board

Kirsten Salt
Company Secretary
199 Bishopsgate, London, EC2M 3TY
28 March 2018

Notes:

1. Members entitled to attend and vote at this meeting may appoint one or more proxies to attend, speak and vote in their stead by completion of a personalised form of proxy. Full details on how to complete the form of proxy are set out on the form of proxy. The proxy need not be a member of the company.
2. A proxy must vote in accordance with any instructions given by the member by whom the proxy is appointed. A proxy has one vote on a show of hands in all cases (including where one member has appointed multiple proxies), except where he/she is appointed by multiple members who instruct him/her to vote in different ways, in which case he/she only has one vote for and one vote against the resolution.
3. A personalised form of proxy is provided with the Annual Report. Any replacement forms must be requested direct from the registrar.
4. Completion of the form of proxy does not exclude a member from attending the meeting and voting in person.
5. Duly completed forms of proxy must reach the office of the registrars at least 48 hours (excluding non-business days) before the meeting.
6. Shares held in uncertificated form (i.e., in CREST) may be voted through the CREST Proxy Voting Service in accordance with the procedures set out in the CREST manual on the Euroclear website (www.euroclear.com/CREST).
7. To be entitled to attend and vote at the meeting (and for the purpose of determination by the company of the number of votes they may cast), members must be entered on the company's Register of Members by 6 p.m. on 14 May 2018 (the record date).
8. If the meeting is adjourned to a time not more than 48 hours after the record date applicable to the original meeting, that time will also apply for the purpose of determining the entitlement of members to attend and vote (and for the purpose of determining the number of votes they may cast) at the adjourned meeting. If, however, the meeting is adjourned for a longer period then, to be so entitled, members must be entered on the company's Register of Members at the time which is 48 hours before the time fixed for the adjourned meeting or, if the company gives new notice of the adjourned meeting, at the record date specified in that notice.

Notice of Meeting (unaudited) *(continued)*

9. The right to appoint a proxy does not apply to persons whose shares are held on their behalf by another person and who have been nominated to receive communications from the company in accordance with section 146 of the Companies Act 2006 (nominated persons). Nominated persons may have a right under an agreement with the registered shareholder who holds the shares on their behalf to be appointed (or to have someone else appointed) as a proxy. Alternatively, if nominated persons do not have such a right, or do not wish to exercise it, they may have a right under such an agreement to give instructions to the person holding the shares as to the exercise of voting rights. Nominated persons should contact the registered member by whom they were nominated in respect of these arrangements.

10. Corporate representatives are entitled to attend and vote on behalf of the corporate member in accordance with section 323 of the Companies Act 2006. Pursuant to the Companies (Shareholders' Rights) Regulations 2009 (SI 2009/1632), multiple corporate representatives appointed by the same corporate member can vote in different ways provided they are voting in respect of different shares.

11. Members have a right under section 319A of the Companies Act 2006 to require the company to answer any question raised by a member at the AGM, which relates to the business being dealt with at the meeting, although no answer need be given (a) if to do so would interfere unduly with the preparation of the meeting or involve disclosure of confidential information; (b) if the answer has already been given on the company's website; or (c) it is undesirable in the best interests of the company or the good order of the meeting.

12. Members satisfying the thresholds in section 527 of the Companies Act 2006 can require the company, at its expense, to publish a statement on the company website setting out any matter which relates to the audit of the company's accounts that are to be laid before the meeting. Any such statement must also be sent to the company's auditors no later than the time it is made available on the website and must be included in the business of the meeting.

13. As at 28 March 2018, the latest practicable date before this notice is given, the total number of ordinary shares and preference stock in the company in respect of which members are entitled to exercise voting rights was 108,728,464 ordinary shares of 25p each and 1,178,000 3.65% Cumulative Preference Stock of £1 each. Each carries the right to one vote and therefore, the total number of voting rights in the company is 109,906,464.

14. Further information regarding the meeting which the company is required by section 311A of the Companies Act 2006 to publish on a website in advance of the meeting (including this notice), can be accessed at www.merchantstrust.co.uk.

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

The Directors
The Merchants Trust PLC
199 Bishopsgate
London
EC2M 3TY

28 March 2018

Dear Sirs,

Statement of Reasons connected with ceasing to hold office as Auditors

In accordance with Section 519 of the Companies Act 2006 (the "Act"), we set out below the reasons connected with PricewaterhouseCoopers LLP, registered auditor number C001004062, ceasing to hold office as auditors of The Merchants Trust PLC, registered no: 00028276 (the "Company") effective from 16 May 2018.

The reason we are ceasing to hold office is that the Company undertook a competitive tender process for the position of statutory auditor and we mutually agreed with the Audit Committee not to participate due to the length of our tenure.

There are no reasons for and no other matters connected with our ceasing to hold office as auditors of the Company that we consider need to be brought to the attention of the Company's members or creditors.

Yours faithfully,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

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