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THE MERCHANTS TRUST PLC
Half-Yearly Financial Report
For the six months ended 31 July 2023

Interim management report

Economies, markets & Merchants' performance
Shareholders will recall that in the Full Year report to 31 January 2023 I was able to reflect on a period in 2022 where Merchants had thrived due to the prospect of rising inflation and interest rates and a corresponding decline in the share prices of highly rated 'growth' shares. Throughout that period, Merchants' portfolio of shares of good businesses bought at reasonable valuations had performed extremely well.

The first half of this year has been more difficult. As anticipated, central banks around the world employed aggressive interest rate hikes to cool rising inflation. In the UK, the Bank of England raised rates four times and by a total of 1.5% (from 3.5% to 5%) during the reporting period, with a further quarter-percent rise after the period end in August. Towards mid-year there were undoubtedly signs of some inflationary pressures subsiding but core inflation (which discounts volatile energy and food prices) had remained stubbornly high. The core inflation rate in the UK was 6.9% in July, up from 6.2% in February, whilst during the same period the headline inflation rate fell from 10.4% to 6.8%. These higher than expected levels of inflation have kept central bank rhetoric on the side of potential further rises, even if they are equally mindful of not driving the economy into recession.

The UK stock market is also affected by global equity market trends. After a fall from grace for technology and other high growth shares during 2022 due to the high inflation and rising rates backdrop, there has been a sharp reversal in the first half of 2023, with a rally in technology shares, particularly the largest 'mega-caps' that dominate the US market. This has supported higher growth stocks more broadly, rather than more value oriented companies. The early part of the year also saw a stark reminder of the risks in the banking sector when Silicon Valley Bank in the US found itself with a mismatch between bond assets it had invested heavily in and its obligations to provide liquidity to depositors. Investors were also unsettled shortly thereafter when Credit Suisse was forced by regulators into a rescue takeover by UBS. UK regulated banks have had stronger capitalisation requirements since 2008 and so this kind of scenario has been less of a concern domestically.

These conditions were not ideal for our investment manager and his value investing style. A relatively flat total return for the UK equity market masked the return of the dispersion between outperforming growth stocks and underperforming value stocks and Merchants' Net Asset Value (NAV) total return was -2.2%, compared to the benchmark's return of +0.8%. Our portfolio manager Simon Gergel describes the drivers of this underperformance in more detail within his Investment Manager's Review. Merchants' long-term record however remains strong and we believe that long term performance is the best continuing validation of Merchants' consistent strategy of providing a high and rising income, together with long-term growth in capital for our shareholders.

Despite an overall flat performance of the UK equity market the corporate sector has performed well and improving cash generation has continued to support the ongoing recovery in dividend income for the trust. This has given the board confidence to raise the dividend for shareholders and to do so at a higher rate than had been possible since the start of the pandemic. Last year the first half year dividends increased by 0.7% and this year the increase is 3.6%.

Image of the UK remains an issue
For a long time there have seemed to be reasons for investors to avoid the UK equity market. 'Old economy' stocks, Brexit, pandemic uncertainty, political turmoil and, latterly, concerns over the UK's domestic inflation and interest rate environment are a few of the reasons mentioned.

However, the UK equity market is not the same as the UK economy. Many of the larger market capitalisation stocks in the UK equity market are global multinationals which are much more tied to the global economy for their revenue generation than the UK economy. Many are largely unaffected by the tribulations of the UK economy.

Our investment manager feels strongly that the UK equity market often seems to be affected by negative investor sentiment over the UK economy and domestic outlook. As a result of this the UK equity market has become one of the cheapest markets in the world. Our investment manager continues to see considerable value opportunities within the market. Companies with robust business models and supportive long-term trends are now overlooked by investors who cannot see past a gloomy UK economic environment. The manager continues to actively manage the portfolio and take advantage of these new opportunities as they arise.

Market demand
Although this has been a challenging first half for the Trust, we have seen continuing demand for our shares illustrated by the share price continuing to trade around par with the Net Asset Value (NAV) for much of the period. Periodically the shares have traded at a premium to NAV, where we have consequentially issued new shares in the Company. Over the period 6,660,000 new shares were issued at an aggregate value of £37.9m, with a further 275,500 issued since 31 July up to the point of publishing these results. (As has been mentioned in previous reports shares are only ever issued at a premium to the prevailing Net Asset Value, to make the process accretive to existing shareholders. The board continues to believe that a growing trust benefits all shareholders as the company's fixed costs can be spread over a wider base.)

Our strong and consistent long-term performance and our income generation, illustrated by our 41-year Dividend Hero status as defined by the Association of Investment Companies (AIC), are in our view the key factors behind ongoing shareholder and investor demand for Merchants' shares.

Earnings
As noted above, we have continued to see an improvement in corporate earnings following the lows of the pandemic. Earnings per share (EPS) for the six months under review reached 17.4p (2022: 16.0p) which is now also comfortably above the pre-pandemic level of 16.1p for the equivalent period in 2019 (2020 financial year). Our investment manager necessarily remains somewhat cautious however on near-term earnings, given ongoing economic uncertainties and rising costs for businesses.

That said, the impact of the pandemic upon UK company dividend distributions was so profound, with some cuts and rebasing proving more permanent, it is very pleasing to be back well above pre-pandemic levels.

Dividends
There are two pleasing effects from the positive earnings noted above. Firstly, it has given the board confidence to propose an increased dividend and, secondly, it allows us to continue rebuilding revenue reserves that were partially utilised in order to continue our strategy of paying a high and rising dividend to shareholders through the pandemic. Not all trusts are able to provide such income support and smoothing during tough times, which is why Merchants is one of only 20 companies to be awarded the AIC's coveted Dividend Hero status from a universe of well over 400 listed companies.

The board has declared a second quarter dividend for the current financial year of 7.1p per ordinary share, payable on 10 November 2023 to shareholders on the register at close of business on 6 October 2023. A Dividend Reinvestment Plan ('DRIP') is available for this dividend for which the relevant Election Date is 20 October 2023 and the ex-dividend date is 5 October 2023. We are pleased to advise that for CREST-registered shareholders, dividend payments are enabled in CREST. This means that for the first half of the 2024 financial year, the aggregated dividend will be 14.2p compared with 13.7p for the same period last year, a 3.6% year-on-year rise.

Shareholder contact
In 2022 we marked our first opportunity to host an in-person Annual General Meeting for shareholders since the pandemic. It was therefore a pleasure for the board to be able to once again host shareholders in May 2023. The board was pleased to see the event so well supported by shareholders and there was a lively dialogue between many of those shareholders, the board and our investment manager. I would like to thank those shareholders who managed to attend, but for those who couldn't, a video of my introduction and portfolio manager, Simon Gergel's investment update is available on Merchants' website under the 'Videos, Podcasts & Reading' tab.

As you will hopefully be aware we spend considerable effort ensuring our reporting is informative and interesting for shareholders. It was a pleasure therefore to once again be nominated in the 'Best Report and Accounts, Generalist' award at the Association of Investment Companies' annual awards. Having been a winner for three consecutive years, we were naturally disappointed not to have lifted the accolade this year, however congratulations to the winner and we are sharpening our pencils again ready for next year.

We continued to have positive press coverage during the period, but of particular note was a national press profile piece. After having already received a "buy" recommendation from The Times' 'Tempus' column in January, The Daily Telegraph's 'Questor' column at the end of March highlighted: "A strong track record of capital growth enhances Merchants Trust's reputation for long-term performance". After taking a deeper look at Merchants, columnist Robert Stephens concluded "With Merchants having a stunning track record of dividend growth over recent decades, plus an excellent history of capital returns, it offers a long-term solution to a long-term problem. Buy."

Board
We reported in our latest Annual Report that the planned retirement dates of two directors had been noted and that the board would commence the process of conducting searches for suitable successors making use of external search consultants. That process has been initiated with the appointment of an external recruitment firm to assist with the process and we will keep shareholders informed as appropriate. In the Annual Report we confirmed the board's support of the FCA's encouragement of greater diversity on boards and we disclosed in line with the Listing Rules (LR 9.8.6R(9)). At present the board consists of three women and two men, and there are no directors with a minority ethnic background. We will be reporting on the outcome of the current recruitment exercise over the next few months.

Outlook
Central banks around the world continue to tread a tentative path around reducing inflation whilst trying to avoid recession. Recession may ultimately be unavoidable depending on how aggressive central banks decide to be. We note however that whilst that scenario can provide a challenge to the financial markets, assets such as the listed shares of companies often start to outperform well before the trough of an economic cycle. Our manager reminds us that any signals that inflation is moderating and that interest rates may fall could lead to investor sentiment improving very rapidly.

Uncertainty such as we have now is the enemy of calm and rational markets and so one might reasonably expect markets to continue to be very sensitive to news flow in the near term. For the dedicated stock picker this continues to provide opportunities where strong companies become caught up in general negativity and become, in the view of our manager, mispriced. He continues to see numerous opportunities to invest in good companies at attractive prices in the UK stock market which is one of the cheapest in the world and is currently trading near a 20-year low whilst its peer - the US equity market - is close to a 20-year high.

Whether the tech rally witnessed so far this year in the US is indicative of global markets having once again got ahead of themselves from AI-driven tech euphoria is still to be determined. Our manager continues to focus on the fundamentals of companies with strong business models and which are backed by clear long-term supportive themes. He continues to avoid distraction from short term news flow and stock market momentum. Merchants is positioned with a long-term focus and a clear emphasis on the value provided by the companies we invest in. We will maintain this focus in order to pursue continuing growth in income together with above-market total returns for Merchants' shareholders.

Colin Clark
Chairman

25 September 2023

Principal Risks and Uncertainties

As identified in the Annual Report, the principal risks are now considered to be emerging risks, followed by the risks of market decline.

The principal risks and uncertainties facing the company, together with the board's controls and mitigation, are those described in the Annual Report for the year ended 31 January 2023 published in April 2023 and are listed below:

- Emerging risks, such as significant geopolitical risks.
- Risk of market decline adversely affecting investments and returns.
- Investment strategy risk leading to a failure to meet the company's objectives, such as income generation and dividend growth.
- Risk of poor performance in difficult markets for the portfolio.

The board's approach to mitigating these risks and uncertainties is set out in the explanation with the Risk Map in the Annual Report. In the board's view these will remain the principal risks and uncertainties for the six months to 31 January 2024.

Going Concern

The directors have considered the company's investment objective and capital structure both in general terms and in the context of the current macro-economic background. Having noted that the portfolio is liquid as it consists mainly of securities which are readily realisable, and through continuous assessment of the company's financial covenants, the directors have concluded that the company has adequate resources to continue in operational existence for the foreseeable future. The directors have also considered the continuing risks and consequences of macroeconomic and unanticipated shocks on the operational aspects of the company and have concluded that the company has the ability to continue in operation and meet its objectives in the foreseeable future. For this reason, the directors continue to adopt the going concern basis in preparing the financial statements.

Responsibility Statements

The directors confirm to the best of their knowledge that:

- The condensed set of financial statements contained within the half-yearly financial report has been prepared in accordance with FRS102 and FRS104, as set out in Note 2, the Accounting Standards Board's Statement 'Half-Yearly Financial Reports'; and
- The interim management report includes a fair review of the information required by The Financial Conduct Authority's ('FCA') Disclosure and Transparency Rule 4.2.7 R of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
- The interim management report includes a fair review of the information concerning related parties transactions as required by the Disclosure and Transparency Rule 4.2.8 R.

Colin Clark
Chairman

25 September 2023

Enquiries:

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Investment Manager's Review

Major geopolitical events seem to have occurred at the start of recent financial years, with the Covid pandemic spreading to Europe in February 2020 and the Russian invasion of Ukraine in February 2022. The start of this year was not quite on the same scale, but there were important events, nevertheless. Financial markets were rocked by the collapse of Silicon Valley Bank (SVB) in California and the forced rescue of Credit Suisse by Union Bank of Switzerland. Throughout the early months of the year, there was also a boom in the valuation of the large US technology stocks driven by excitement over generative artificial intelligence (AI). There was a hope that AI could lift the technology sector out of a post-Covid slowdown. This hope was boosted when Nvidia announced a surge in orders of its graphics chips that fuel AI.

Perhaps the dominant theme to affect the UK stock market was the continued and stubborn rise in inflation. Western central banks had to raise interest rates aggressively to try to stem inflationary pressures. As interest rate expectations increased, bond yields rose and mortgage costs went up, raising concern about the prospects for consumer spending and the economy more broadly. Interest rate increases were also a contributory cause to the Silicon Valley collapse, as rising bond yields hit the value of SVB's bond portfolio and exposed specific vulnerabilities.

In the UK, 10 year government bond yields rose from 3.3% to 4.3% over the period, with 2 year yields rising even higher, as the Bank of England raised interest rates from 3.5% to 5%. Inflation statistics exceeded expectations for most of the period, even as inflationary pressures started to subside in the US and Europe, leading to a narrative that the UK had a worse inflationary problem than elsewhere. It was only in July, when reported inflation came in lower than expectations, that investors became a bit more optimistic about UK inflation and the prospects for interest rates. Sterling strengthened against the dollar in a move that generated little attention, especially compared to the weakness of sterling last year, when Liz Truss was prime minister. The pound rose from \$1.23 to \$1.28, well above the \$1.07 hit last September.

The combination of rising economic concerns, stress in parts of the banking system and a surge in excitement about AI, led to a sharp polarisation within stock markets. In the US, most of the stock market gains were made by a handful of large technology companies. In the UK, whilst the overall UK stock market return was modest, with the market trading in a fairly tight range, there was a large gap between the strong performance of higher growth companies, and the weak performance of more lowly valued companies. Large companies outperformed medium and smaller sized companies. The latter tend to be more cyclical and more exposed to the domestic economy. The UK stock market also suffered from continued investor outflows, on concerns about the UK's inflation and interest rate outlook.

Sector performances were mixed. In many cases, the overall sector move reflected the average of a wide range of different share price movements. For example, within banks, HSBC benefitted from a relative "safe haven" status and produced a 13% total return, whilst Barclays and NatWest gave negative returns of between -14% and -18%. Of the largest sectors, the most notable move was the 16% drop in the industrial metals & mining sector on concern about weak growth in the important Chinese economy. Pharmaceuticals and personal care outperformed, due to their defensive characteristics, whilst banks and energy performed close to the market average.

The dispersion in share prices was also driven by a number of competing forces that affected businesses. Some industries, like tourism and leisure benefitted from a continued recovery to more normal levels of activity. Other industries, like chemicals and packaging, had to deal with an excess of inventory built up during the Covid period, which had to be worked off, impacting sales. Rising interest rates affected businesses in different ways, especially in the financial sectors. House building in the UK slowed in response to rising mortgage costs. In addition, companies had to deal with volatility in commodity costs and exchange rates.

Performance

It was a difficult period for our value-oriented investment approach. The portfolio total return was -2.3%, compared to a benchmark return of +0.8%. The underperformance was due to stock selection within sectors. Sector strategy was net positive, as the portfolio benefitted from a high exposure to the construction & building materials sector, which performed well, and a low exposure to metals & mining, which was weak.

The top ten individual positive and negative stock contributions to the relative performance are shown in the table. These top ten contributors only account for about a third of the underperformance, with the rest accounted for by a tail of smaller impacts, reflecting broad underperformance of lowly valued companies this year.

Two of the largest three negative contributors were HSBC and AstraZeneca. Neither was owned in the portfolio, and both are very large companies that performed well, boosting the FTSE All-Share return. There were smaller but similar impacts from not owning Rolls Royce and Flutter.

Three financial companies were among the top ten negative contributors. Shares in the wealth manager St James's Place fell in July, as the company announced a fee reduction for certain longstanding clients who have been with the firm for a decade. Whilst this will impact profitability, St James's remains a very strong business with an attractive growth profile that we do not believe is reflected in the valuation. OSB (Onesavingsbank) also fell in July as the company announced that a certain group of mortgage customers were moving off variable rate mortgages, onto cheaper fixed rate deals, at a faster pace than previously. This meant that the bank had to change its expectations for the profitability of these customers. We believe the shares over-reacted to the news, and we took advantage of the depressed valuation to add to the holding. Financial trading company IG Group's shares fell in March, when it reported a relatively quiet quarter for trading activity by its client base, but overall profitability has been supported by higher interest rates. IG's trading is always subject to market volatility, but it is a highly profitable market leading business, and remains well positioned, with long term growth opportunities.

Elsewhere, the consumer goods company PZ Cussons, which owns Original Source, Imperial Leather and other brands, suffered from a post-Covid drop in sales of its Carex soap and sanitiser business, as well as economic volatility in its large African business. However, we believe the relatively new management team is making considerable progress in improving the quality of the company which has good potential. National Express, now called Mobico group, suffered from a shortage of drivers and high cost inflation in its school bus operations in the USA, and its UK bus business. Finally, the specialist recruitment company SThree de-rated sharply on economic concerns, although the business has been quite resilient and has an excellent long term growth record.

Looking at the positive individual stock contributors, the top three were all stocks that were not owned in the portfolio, but fell sharply, pulling back the FTSE All-Share return. These were the two mining companies Anglo American and Glencore, and the financial stock Prudential.

Three of the top ten contributors are involved in the building industry, with all three having a large exposure to the USA, where construction and housing trends have been stronger than the UK. Tyman, which has a large market share in components for doors and windows, saw its shares rally from a very low valuation on optimism about a recovery in the business, supported by strong profit margin improvement reported in North America. The building materials giant CRH reported robust trading and excited investors with a proposed shift of its primary stock market listing to the USA. Ground engineering company Keller also performed well, with its key US operation seeing a strong margin improvement.

Elsewhere, BMW responded well to resilient conditions and high levels of profitability in the car industry and reinsurer SCOR performed well on the back of strong industry pricing. Pets At Home outperformed on the back of trading results, where it reported 13% sales growth in its vet business and 6% growth in its retail stores last year, despite a difficult consumer environment. Finally, BAE Systems followed last year's strong gains with further outperformance on the back of increasing defence spending and good operational performance.

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

Positive Stocks	**Performance Impact %**	**Negative Stocks**	**Performance Impact %**
Overweight (holding larger than index weight)			
Tyman	0.3	St James's Place	-0.5
BMW	0.3	PZ Cussons	-0.3
SCOR	0.2	OSB	-0.3
Pets At Home	0.2	Mobico	-0.3
CRH	0.2	IG	-0.3
BAE Systems	0.2	SThree	-0.2
Keller	0.1		
Underweight (zero holding or weight lower than index weight			
Anglo American	0.5	HSBC	-0.6
Prudential	0.3	AstraZeneca	-0.4
Glencore	0.3	Rolls Royce	-0.3
		Flutter	-0.2

Portfolio Changes
The wide range of share price movement in the UK equity market, coupled with high dispersion between valuations, has created many new investment opportunities and also the potential for sales from the portfolio. In response, we have been quite active, adding four new companies and selling out of five, as well as making significant changes to other position sizes.

Three of the four new holdings were medium sized companies, whilst the other was a straight switch within the banks sector. We are generally finding the best value among medium sized companies, which may be off the radar of global investors. In our opinion, persistent outflows from UK equity funds have led to forced selling pressure on many sound companies, without enough new money to arbitrage out the value opportunities. Conversely, four of the five disposals were large companies.

We made a new investment in building materials company Marshalls. Well known for its paving products, Marshalls is diversified into commercial, infrastructure, new housing and repair & maintenance products. It has an attractive and growing presence in more sustainable areas, like concrete products with a low carbon footprint, and complete roofing solutions with integrated solar panels. Due to difficult trading conditions in the new housing and renovation markets, Marshalls traded on a modest valuation for the quality of the company and its strong market position.

We also bought Inchcape, the world's largest independent car distribution company, which has exclusive relationships representing over 50 brands in more than 40 countries. Some of these relationships date back decades. Inchcape is consolidating a fragmented market as car manufacturers need strong partners in the smaller markets, to provide the latest digital capabilities to consumers and to manage an increasingly complex industry structure. We had sold out of Inchcape shares on valuation grounds in 2021. Since then, the company has grown rapidly via acquisition, with almost half group profits now coming from Latin America. Some short-term concerns over a large recent transaction, had upset investors, providing an opportunity for us to re-invest at what we believed to be a compelling valuation, and below the price we had sold at in 2021. We did not believe the share price reflected the inherent strengths of the company, or the considerable strategic progress it has made in the last two years.

The other two new purchases were switches within financial sectors. We bought Lancashire Holdings, a medium sized reinsurance company with a strong presence in the Lloyd's of London market. Lancashire has a disciplined approach to insurance, only committing capital when it views pricing as favourable. In the last two years, it has built up its book of business rapidly as reinsurance pricing has improved, and it should be a beneficiary of this stronger market environment, as well as from higher interest rates, which boost investment returns. We funded Lancashire partly by selling Swiss Re. Although Swiss Re is also exposed to the same improving market conditions, its exposure is diluted by a more diversified business model, and its valuation was significantly higher than Lancashire where we saw more upside.

In the banks sector, we switched out of NatWest into Lloyds. Both banks are well capitalised and benefitting from better industry conditions than in recent years, with higher interest rates boosting margins and relatively low bad debt charges, despite economic uncertainty. Both banks were modestly valued, but we had a preference for Lloyds, given the scale advantage of its leading position in UK consumer banking and an improving cash generation profile.

Turning to the sales, we sold out of BAE Systems which has been in the portfolio for many years. BAE is Britain's largest defence manufacturer and also the country's largest manufacturing business. BAE has been trading well, with a large order book and sound prospects. Selling the shares brought mixed emotions. However, our job is not simply to own strong businesses on behalf of shareholders, we are looking for exceptional investment opportunities. BAE shares had been very strong performers, with the share price doubling over the preceding two years, even excluding dividends. Our assessment was that the shares had moved up to a fair valuation, and therefore we decided to exit the position to fund more attractive situations. We wrote up the BAE Systems investment as a case study in the 2023 annual report, reflecting its strong contribution to last year's results.

The other two complete disposals were Vodafone and Ashmore. In our investment process, there are three reasons for selling an investment. First, it may reach our target price. BAE systems was such a case. Second, the investment view may have changed. And third, there may be better opportunities elsewhere. Both of these sales were examples of the second reason: a change in investment view. Changes of opinion are often the most psychologically difficult decisions. They usually follow a period of poor stock performance. Either, we have to admit to being wrong about our initial investment decision, or we have to recognise that something has fundamentally changed to challenge our initial view. Both can be uncomfortable, but it is important to be as objective as we can.

Investing in Vodafone had been a poor investment decision. Having not owned the company for many years, due to concerns over the highly competitive industry structure and the need for persistently high capital expenditure, we bought a position during the pandemic as we liked its strong cash generation, a high dividend yield and limited economic sensitivity. We also saw some signs that the business was performing better. However, that business improvement proved short-lived. We sold part of the investment last year, close to the original cost price, as our level of conviction declined, but we held onto the rest, and only sold it in June after another trading disappointment. Whilst the share price was lower, we had to recognise that our initial investment case was wrong, and we did not have sufficient confidence to maintain a position.

Ashmore was a slightly different situation. It is a leading emerging market, predominantly fixed income, fund management business, with a strong culture and a differentiated market position. Merchants has owned Ashmore previously and made a good return. When we bought back into the shares in 2021, Ashmore's funds had been through a period of poor performance, and it had seen outflows. Our investment case was built around the potential for a cyclical recovery in the emerging markets asset class, improvement in the company's funds' performance and ultimately a strong pick up in profitability. However, performance and flows were worse than we expected, making it more challenging for the business to retain assets and to take advantage of an eventual recovery. Like Vodafone, we had already sold part of the holding earlier in the year as our level of conviction declined and we decided to sell the rest.

Apart from these new purchases and total disposals, we made a large number of changes to position sizes. The biggest additions included Drax, the UK's largest renewable power generator, Energean, which is ramping up production of gas in Israel, helping the country to reduce its dependence on highly polluting coal fired power generation, and the pharmaceutical and vaccines business GSK. All three are lowly priced companies where we have high conviction. The biggest partial sales included the building materials company CRH, which had performed very well as discussed above. We also reduced three consumer companies that had all rallied and re-rated closer to fair value. Unilever and Tesco have relatively defensive business models, manufacturing and selling every-day food and consumer products. The car company BMW is a more cyclical business, but trading in the industry has been robust, despite a nervous consumer environment, as limited car production during Covid had kept new and used car supply constrained and boosted prices.

As well as making portfolio changes, we continued to actively engage with companies in the portfolio as part of our ongoing stewardship process. Many of these engagements covered the risk of climate change and how companies plan to reduce their greenhouse gas emissions over time, particularly in the extractive and energy industries. In the case of banks, the issue is more about how they incorporate climate change risks into their business processes, both in terms of credit risk and in terms of the emissions of the companies they finance. We also had several engagements on more traditional governance areas, such as capital allocation policies and remuneration structures. A particular feature of the discussions this year, has been how companies think about returning surplus capital to shareholders, either via share buy-backs or special dividends. With many shares trading at low valuations, the case for buy-backs is stronger than it may have been historically.

Income

We have been pleased by the steady improvement in the income generation of the portfolio, with strong dividend growth continuing in industries like banking and oil & gas, which have seen a substantial recovery in profitability since the pandemic period. Higher inflation is also feeding through to higher dividend growth, either in industries where pricing is directly linked to inflation, like utilities, or more indirectly through higher nominal sales and profits. We have been encouraged by the operational progress that many of the portfolio companies have made, which also supports their dividend growth.

Of course, it has not all been plain sailing. The consumer environment is difficult, and sectors like housing are seeing a sharp slowdown. This means that there are likely to be some dividend cuts in the portfolio in the months ahead. But we do not envisage wholesale dividend cuts like we saw during the pandemic or the Great Financial Crisis, partly due to the considerably stronger balance sheets of many of the businesses in the portfolio.

Overall, higher income receipts have boosted Merchants revenue earnings per share to 17.4p, an increase of 8.7% compared to 16.0p last year.

Economic and Market Outlook

In our opinion, the UK stock market offers exceptional opportunities for investors. According to Goldman Sachs, the UK stock market is trading close to its lowest absolute valuation in the last 20 years, in terms of price to earnings ratio, at the same time that the USA is trading close to its highest level. That is unusual in itself. But, in addition, the dispersion of valuations across the UK stock market (the gap between growth and value stocks) is around the widest it has been in 50 years, according to Morgan Stanley. These are conditions, that I don't remember seeing before in my career. Many sound businesses are trading on depressed valuations, offering the potential to make very healthy capital and income returns. To understand why this is the case, and why conditions may change, it is worth discussing the circumstances that have led to this unusual situation.

Since the Brexit referendum in June 2016, the UK stock market has been out of favour with international investors, and it has gradually de-rated. Initially, this was driven by fears over the economic impact of Brexit itself, and this was exacerbated by the tortuous political wranglings with the EU during Theresa May's and Boris Johnson's premierships. Political uncertainty increased, when Jeremy Corbyn, a hard-left leaning politician looked like he could win the general election in 2019. Then, just as the Brexit and political uncertainty started to fade, following Johnson's emphatic election win in 2019, the Covid pandemic hit in early 2020, and the UK seemed to suffer especially hard, providing another reason for foreign investors to stay away. Next, as the pandemic was fading into the rear-view mirror, the Russian invasion of Ukraine caused a huge inflationary spike that particularly affected Europe, giving global investors reason to stay clear of the whole continent. Further political uncertainty ensued when Liz Truss became prime minister for a brief period in 2022 and unsettled the financial markets with what were perceived as unfunded tax cuts. Finally, more recently, as discussed above, the UK's inflation rate has been higher and more sticky than the rate in the US and the EU, creating a narrative that the UK has a more challenging outlook.

These concerns about the UK, have led to steady outflows from UK equity funds in recent years. This comes on the back of a structural, forty-year period, where domestic pension funds and institutions have gone from owning around half the UK stock market, to only 4%. The selling has largely been due to the increasing maturity of defined benefit pension funds, and accounting rules which encouraged funds to sell equities and buy bonds. This selling pressure has exacerbated the de-rating of the stock market, and widened the gulf between those companies that are popular with global investors – typically the large multi-nationals and the higher growth / higher return companies - and the rest. It has often felt like there were no buyers for some of the medium sized and smaller companies, and it not surprising that we have seen a step-up in the number of portfolio companies buying back their own shares, to take advantage of the bargain prices available.

Whilst some people may see this set of circumstances as a reason to shun UK equities, we see the glass as half-full. The selling pressure by domestic pension funds and institutions really cannot go much further, as they own very few UK equities. Furthermore, the government is keen to promote the UK stock market, and to get domestic savers and institutions to support investment and innovation. This may take time to have any effect, but the relentless selling should be nearly finished. The latest inflation numbers suggest that the UK is nearing the peak of the inflation cycle and any visibility on peak interest rates could lead to a significant change in depressed investor sentiment. UK politics seems to be becoming less polarised, with the policy gap between Rishi Sunak and Sir Keir Starmer quite narrow, removing one of the often-cited reasons for avoiding UK investments. Most importantly, the valuations of many UK companies are compelling, especially compared to their peers overseas, despite the majority of sales of UK listed companies actually coming from abroad. We would expect to see a resurgence in takeover activity, as companies and private equity funds look to take advantage of this situation. The cost of debt and volatility of interest rates may keep some of these investors on the sidelines for a while longer, but once the interest rate cycle looks more supportive, sentiment could change rapidly.

We are therefore excited about the prospects for Merchants' portfolio. It is diversified across industries and geographic exposure, as well as between defensive and more cyclical businesses. But it is a portfolio of strong businesses, trading on very modest valuations, and paying an income stream well in excess of the broader stock market.

Simon Gergel
Allianz Global Investors

THE MERCHANTS TRUST PLC

Twenty Largest Equity Holdings as at 31 July 2023

Name	Value £'000s	% of Holdings	Benchmark Weightings	Sector
GSK	41,318	4.7	2.4	Pharmaceuticals & Biotechnology
Shell	40,308	4.6	6.9	Oil, Gas & Coal
British American Tobacco	32,694	3.7	2.5	Tobacco
Rio Tinto	29,355	3.4	2.4	Industrial Metals & Mining
BP	28,724	3.3	3.6	Oil, Gas & Coal
DCC	27,511	3.1	0.2	Industrial Support Services
IG Group	26,753	3.1	0.1	Investment Banking & Brokerage
WPP	25,889	3.0	0.4	Media
Energean	25,071	2.9	0.1	Oil, Gas & Coal
Inchcape	24,555	2.8	0.1	Industrial Support Services
SSE	24,355	2.8	0.8	Electricity
Tate & Lyle	24,330	2.8	0.1	Food Producers
Imperial Brands	23,447	2.7	0.7	Tobacco
Redrow	20,706	2.4	0.1	Household Goods & Home Construction
Drax Group	20,321	2.3	0.1	Electricity
Barclays	19,912	2.3	1.0	Banks
Next	19,729	2.3	0.4	Retailers
St. James's Place	19,270	2.2	0.2	Investment Banking & Brokerage
Pets At Home Group	18,077	2.1	0.1	Retailers
Grafton Group	17,693	2.0	0.1	Industrial Support Services
	510,018	**58.5**		**% of Total Invested Funds**

Portfolio Analysis as at 31 July 2023

Sector	% Held	Benchmark weighting
Financials	22.6	22.2
Consumer Staples	14.0	15.0
Industrials	18.1	12.2
Consumer Discretionary	14.8	11.9
Energy	12.2	10.8
Utilities	7.0	3.5
Health Care	7.5	11.3
Basic Materials	3.9	7.4
Real Estate	2.0	2.4
Net current liabilities	-2.2	
	100.0	

May not add up due to roundings

** Total Assets include current liabilities

THE MERCHANTS TRUST PLC

Summary of Unaudited Results

INCOME STATEMENT
For the six months ended 31 July 2023

	Revenue £'000s	Capital £'000s	Total Return £'000s
			(Note 1)
Losses on investments held at fair value through profit or loss	-	(45,784)	(45,784)
Losses on foreign currencies	-	(15)	(15)
Income from investments	27,147	-	27,147
Other income	655	-	655
Investment management fee	(556)	(1,033)	(1,589)
Administrative expenses*	(603)	(2)	(605)
Profit (loss) before finance costs and taxation	**26,643**	**(46,834)**	**(20,191)**
Finance costs: interest payable and similar charges	(937)	(1,700)	(2,637)
Profit (loss) on ordinary activities before taxation	**25,706**	**(48,534)**	**(22,828)**
Taxation	(679)	-	(679)
Profit (loss) after taxation attributable to ordinary shareholders	**25,027**	**(48,534)**	**(23,507)**
Earnings (loss) per ordinary share (Note 4) (basic and diluted)	**17.36p**	**(33.67p)**	**(16.31p)**

BALANCE SHEET
As at 31 July 2023

	£'000s
Fixed Assets	
Investments held at fair value through profit or loss	893,161
Net current liabilities	(19,293)
Total assets less current liabilities	**873,868**
Creditors: amounts falling due after more than one year	(66,838)
Total net assets	**807,030**
Called up share capital	36,699
Share premium account	220,520
Capital redemption reserve	293
Capital reserve	521,378
Revenue reserve	28,140
Equity shareholders' funds	**807,030**
Net asset value per ordinary share	**549.8p**

The net asset value as at 31 July 2023 is based on 146,794,887 ordinary shares.

*Administrative expenses for 2022 included the London Stock Exchange block listing fee of £170,000.

THE MERCHANTS TRUST PLC

Summary of Unaudited Results

INCOME STATEMENT
For the six months ended 31 July 2022

	Revenue £'000s	Capital £'000s	Total Return £'000s
			(Note 1)
Losses on investments held at fair value through profit or loss	-	(18,646)	(18,646)
Gains on foreign currencies	-	29	29
Income from investments	22,997	-	22,997
Other income	439	-	439
Investment management fee	(515)	(957)	(1,472)
Administrative expenses*	(690)	(1)	(691)
Profit (loss) before finance costs and taxation	**22,231**	**(19,575)**	**2,656**
Finance costs: interest payable and similar charges	(634)	(1,137)	(1,771)
Profit (loss) on ordinary activities before taxation	**21,597**	**(20,712)**	**885**
Taxation	(490)	-	(490)
Profit (loss) after taxation attributable to ordinary shareholders	**21,107**	**(20,712)**	**395**
Earnings per ordinary share (Note 4) (basic and diluted)	**16.04p**	**(15.74)p**	**0.30p**

BALANCE SHEET
As at 31 July 2022

	£'000s
Fixed Assets	
Investments held at fair value through profit or loss	841,088
Net current liabilities	(11,753)
Total assets less current liabilities	**829,335**
Creditors: amounts falling due after more than one year	(66,782)
Total net assets	**762,553**
Called up share capital	33,731
Share premium account	157,058
Capital redemption reserve	293
Capital reserve	547,640
Revenue reserve	23,831
Equity shareholders' funds	**762,553**
Net asset value per ordinary share	**565.2p**

The net asset value as at 31 July 2022 is based on 134,924,887 ordinary shares.

*Administrative expenses for 2022 included the London Stock Exchange block listing fee of £170,000.

BALANCE SHEET
As at 31 January 2023

	£'000s
Fixed Assets	
Investments at fair value through profit or loss	909,638
Net current liabilities	(30,454)
Total assets less current liabilities	**879,184**
Creditors: amounts falling due after more than one year	(66,809)
Total net assets	**812,375**
Called up share capital	35,034
Share premium account	184,239
Capital redemption reserve	293
Capital reserve	569,912
Revenue reserve	22,897
Equity shareholders' funds	**812,375**
Net asset value per ordinary share	**579.7p**

The net asset value as at 31 January 2023 is based on 140,134,887 ordinary shares.

THE MERCHANTS TRUST PLC

STATEMENT OF CHANGES IN EQUITY

	Called Up Share Capital £'000s	Share Premium Account £'000s	Capital Redemption Reserve £'000s	Capital Reserve £'000s	Revenue Reserve £'000s	Total £'000s
Six months ended 31 July 2023						
Net assets at 1 February 2023	35,034	184,239	293	569,912	22,897	812,375
Revenue profit	-	-	-	-	25,027	25,027
Dividends on ordinary shares (Note 3)	-	-	-	-	(19,784)	(19,784)
Capital loss	-	-	-	(48,534)	-	(48,534)
Shares issued during the period	1,665	36,281	-	-	-	37,946
Net assets at 31 July 2023	**36,699**	**220,520**	**293**	**521,378**	**28,140**	**807,030**
Six months ended 31 July 2022						
Net assets at 1 February 2022	31,926	118,047	293	568,352	20,432	739,050
Revenue profit	-	-	-	-	21,107	21,107
Dividends on ordinary shares (Note 3)	-	-	-	-	(17,708)	(17,708)
Capital loss	-	-	-	(20,712)	-	(20,712)
Shares issued during the period	1,805	39,011	-	-	-	40,816
Net assets at 31 July 2022	**33,731**	**157,058**	**293**	**547,640**	**23,831**	**762,553**

THE MERCHANTS TRUST PLC

CASH FLOW STATEMENT

	Six Months ended 31 July 2023 £'000s	Six Months ended 31 July 2022 £'000s
Operating activities		
(Loss) profit before finance costs and taxation	(20,191)	2,656
Add: Losses on investments held at fair value	45,129	17,696
Add: Losses (gains) losses on foreign currency	15	(29)
Purchase of fixed asset investments held at fair value through profit or loss	(132,771)	(176,160)
Sales of fixed asset investments held at fair value through profit or loss	107,145	130,106
Transaction costs	(655)	(950)
Increase in other receivables	(2,473)	(1,569)
Decrease in other payables	(116)	(87)
Less: Overseas tax suffered	(679)	(490)
Net cash outflow from operating activities	**(4,596)**	**(28,827)**
Financing activities		
Interest paid	(2,475)	(1,725)
Dividends paid on cumulative preference stock	(21)	(21)
Dividends paid on ordinary shares	(19,784)	(17,708)
Share issue proceeds	37,946	41,109
Net cash inflow from financing activities	**15,666**	**21,655**
Increase (decrease) in cash and cash equivalents	**11,070**	**(7,172)**
Cash and cash equivalents at the start of the period	11,465	18,626
Effect of foreign exchange rates	(15)	29
Cash and cash equivalents at the end of the period	22,520	11,483
Composed of:		
Cash at bank	22,520	11,483

Notes to the Financial Statements

Note 1 – Financial Statements

The half-yearly financial report has been neither audited nor reviewed by the company's auditors. The financial information for the year ended 31 January 2023 has been extracted from the statutory financial statements for that year which have been delivered to the Registrar of Companies. The auditors' report on those financial statements was unqualified and did not contain a statement under section 498 of the Companies Act 2006.

The total return column of the Income Statement is the profit and loss account of the company.

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

Allianz Global Investors UK Ltd acts as Investment Manager to the company. Details of the services and fee arrangements are given in the latest annual report of the company, which is available on the company's website at www.merchantstrust.co.uk.

Note 2 – Accounting Policies

The Company presents its results and positions under 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' (FRS 102), which forms part of the Generally Accepted Accounting Practice ('UK GAAP') issued by the Financial Reporting Council.

The condensed set of financial statements has been prepared on a going concern basis in accordance with FRS 102 and FRS 104, 'Interim Financial Reporting' and the Statement of Recommended Practice – 'Financial Statements of Investment Trust Companies and Venture Capital Trusts' ('SORP'). The context of the current macro-economic background has been thoroughly considered and the directors have concluded that there are no material uncertainties related to going concern. They have also been prepared on the assumption that approval as an investment trust will continue to be granted.

The interim financial statements and the net asset value per share figures have been prepared in accordance with FRS 102 using the same accounting policies as the preceding annual accounts.

Note 3 – Dividends on Ordinary Shares

Dividends paid on ordinary shares in respect of earnings for each period are as follows:

	Six months ended 31 July 2023 £'000s	Six months ended 31 July 2022 £'000s
Third interim dividend 6.9p paid 15 March 2023 (2022 - 6.85p)	9,669	8,758
Final dividend 7.0p paid 26 May 2023 (2022 - 6.85p)	10,115	8,950
	19,784	17,708

In accordance with FRS 102 section 32 'Events After the End of the Reporting Period', dividends payable at the period end have not been recognised as a liability. Details of these dividends are set out below.

	Six months ended 31 July 2023 £'000s	Six months ended 31 July 2022 £'000s
First interim dividend 7.10p paid 24 August 2023 (2022 - 6.85p)	10,412	9,208
Second interim dividend 7.10p payable 10 November 2023 (2022 - 6.85p)	10,422	9,242
	20,834	18,450

The dividends above are based on the number of shares in issue at the period end. However, the dividend payable will be based upon the number of shares in issue on the record date and will reflect any purchase or cancellation of shares by the company settled subsequent to the period end.

Note 4 – Earnings per Ordinary Share

The earnings per ordinary share is based on a weighted number of ordinary shares 144,134,526 (31 July 2022 - 131,625,080) in issue.

Note 5 – Fair Value Hierarchy

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.

FRS 102 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 (i.e., developed using market data) for the asset or liability, either directly or indirectly.

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

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

As at 31 July 2023, the financial assets at fair value through profit and loss of £893,086,000 (31 July 2022: £841,080,000; 31 January 2023: £909,618,000) are categorised as follows:

	Level 1 £'000s	Level 2 £'000s	Level 3 £'000s	Total £'000s
Financial assets at fair value through profit or loss at 31 July 2023				
Equity investments	893,161	-	-	893,161
Financial instruments	-	-	-	-
Derivative financial instruments - written call options	-	(75)	-	(75)
	893,161	(75)	-	893,086
Financial assets at fair value through profit or loss at 31 July 2022				
Equity investments	841,088	-	-	841,088
Financial instruments	-	-	-	-
Derivative financial instruments - written call options	-	(8)	-	(8)
	841,088	(8)	-	841,080
Financial assets at fair value through profit or loss at 31 January 2023				
Equity investments	909,638	-	-	909,638
Financial instruments	-	-	-	-
Derivative financial instruments - written call options	-	(20)	-	(20)
	909,638	(20)	-	909,618

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.

Note 6 – Status of the Company

The company applied for and was accepted as an approved investment trust for accounting periods commencing on or after 1 February 2013, subject to it continuing to meet eligibility conditions at section 1158 Corporation Taxes Act 2010 and the on-going requirements for approved companies in Chapter 3 Part 2 Investment Trust (Approved Company) (Tax) Regulations 2011 (Statutory Instrument 2011/2999).

Note 7 – Transactions with the Investment Manager and related parties

As disclosed in the annual report, the existence of an independent board of directors demonstrates that the company is free to pursue its own financial and operating policies and therefore, under FRS 8: Related Party Disclosures, the investment manager is not considered to be a related party. The company's related parties are its directors.

There are no other identifiable related parties as at 31 July 2023, 31 July 2022 and 31 January 2023.

The half-yearly financial report will be sent to shareholders at the end of September 2023 and will be available to members of the public from the company's registered office at 199 Bishopsgate, London EC2M 3TY or by calling the Investor Services Helpline on 0800 389 4696.